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Features of bankruptcy in the Romanian economy: Comparative perspective and analysis

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European Institute of Romania

Study no. 8

FEATURES OF BANKRUPTCY IN THE ROMANIAN ECONOMY¹

-comparative perspective and analysis-

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Introduction

In the process of EU integration, the key criterion² Romania has to meet is the economic one, which presupposes a functioning market economy. Even though the concept of functioning market economy is rather ambiguous and judgmental, there is a wide consensus that market exit constitutes one of the main characteristics of a market economy, in the sense that there should not be any legal, administrative, and political or other type of barriers to market exit for the loss-making companies. The market exit process is mainly defined by the institution of bankruptcy, which plays an important role in the reallocation of resources and the improving of the business environment.

Starting from the perspective of Romania becoming an EU member, and from the need to develop a healthy domestic economy, this study makes an attempt to evaluate bankruptcy procedures. It tries to explain the current situation and to suggest possible developments that may contribute to upgrading the competitiveness and the functionality of the Romanian economy.

The methodology is tailored to cover an analysis of the bankruptcy legislation, at both the national and the international level. In addition to the interpretation of legal texts, this study also provides an economic perspective on bankruptcy and insolvency, based on a comparative analysis of the bankruptcy procedures at regional and international levels.

This study must be considered together with other studies from the Pre-Accession Impact Studies programme – PAIS II – coordinated by the European Institute of Romania. For example, study 10, „*The control policy of state aids in specific sectors*”, deepens the prospects for state involvement in supporting specific industrial sectors. As our study remarks, the state aid policy has a direct effect on the market exit process, through its rescue-restructuring component, as well as through the support directed to sectors that may develop dynamic comparative advantages³.

The structure has three sections. The first section analyses the economic implications of bankruptcy, explaining the economic rationale for this procedure, describing how to increase its effectiveness, and evaluating the potential impact of bankruptcy.

² According to the accession criteria set in Copenhagen, in 1993;

³ Another relevant component is the active policy of supporting specific centres of excellence – e.g. the Nokia case in Finland;

The second section draws upon a comparative analysis on the international harmonization of the bankruptcy procedure. A particular attention is being paid to the EU harmonized provisions and to the situation in the EU new member states.

The third section is focused on the case of Romania. Apart from discussing the legal aspects, which give the juridical and procedural framework, the emphasis is placed on the state's role and involvement in the bankruptcy procedure, and on the consequences this state policy has on the market exit process.

1. The institution of bankruptcy

1.1. Principles, goals, effectiveness

The rationale for bankruptcy

The concept of bankruptcy has been studied by commercial law specialists and by economists with increasing interest for the last two decades. This analytical effort resulted in a considerable amount of works, theoretical and empirical, devoted to the efficacy of bankruptcy procedures and to the reform process in the area of insolvency. Despite a vast number of works and approaches in the relevant literature, there are premises for reaching a consensus regarding the goals of bankruptcy and the most important characteristics of an effective bankruptcy procedure. Yet, there is no single, harmonized system, to be recommended as „best practice” for any country.

It has to be emphasized, from the very beginning, that the reform of the bankruptcy procedure should not be regarded separately, but in the larger context of other juridical and institutional reforms, such as educating the judges, improving the corporate governance, consolidating the banking and financial sector, observing laws in general.

Regarding bankruptcy, the first question that needs to be asked is why we need to institutionalise such a complex procedure. The economic agents end up indebted for various reasons. Maybe the most important reason is the capacity to obtain financial resources in the present by anticipating their future revenues. If the anticipation process is misjudged, or from whatever other causes, one may reach the situation of incapacity of payment – in other words, insolvency. The latter must be distinguished from the liquidity crisis, which regards only the temporary shortage of the means of payment. The bankruptcy legislation is mainly built to address the problems generated by insolvency.

In the absence of a bankruptcy procedure, the creditor has two alternatives (Hart, 2003). He can forcefully execute the assets used as collateral, in the case of a guaranteed loan; and he can ask in court to sell the debtor's assets, in the case of a loan without guarantees. The second option to collect debts is nevertheless ineffective when there are more creditors and when the debtor's assets do not cover his liabilities. Under such circumstances, the creditors would compete one against another to have the debts repaid. Such a race between creditors may however lead to the partition of the debtor's assets,

which at its turn may result in a drastic decrease of the aggregated, functional value of assets, having a negative effect on other creditors' chances to get their money back.

Therefore, it is in the collective interest of creditors that the debtor's assets are executed in a regulated and effective way, through a bankruptcy procedure.

In theory, the economic agents can establish themselves, by a binding contract, the bankruptcy procedure they prefer. This is to say that the debtor could have stipulated in a loan contract what would have happened in the case of his insolvency. Yet, such contracts are difficult to draw, because the debtor might acquire new assets, and he might get new creditors in the meantime. The empirical analysis, indicating that most states have a formal bankruptcy procedure (more or less advanced), defined as a public institution, suggests that the solutions for a private resolution of bankruptcy are not very effective (Hart, 2003). In other words, governments must get involved in this area, at least by providing a standard bankruptcy procedure, which should be applied when the respective parties do not stipulate otherwise by private contracts.

Shall the necessity of a bankruptcy procedure do not need to be further demonstrated, it is still not easy to establish the fundamentals of such a regulation.

The principles and goals of bankruptcy

As we already mentioned, there is no universal bankruptcy code, no single law applicable at the international level. In many countries, the bankruptcy legislation has witnessed an evolution in the balance of power between different interests, in parallel with the structural transformation of the economy and with the historical development of the society as a whole. The provisions of the national bankruptcy laws must be adapted to the specificity of each country, although the implementation of some internationally accepted standards might have its benefits. The problem is that such standards are hard to define; at the international level, there are a large number of changes in the bankruptcy legislation and a set of directions in which these changes take place (see section 2 of this study). Stiglitz holds that there is no national legislation of bankruptcy that would be clearly the best solution for all interested parties in a society, which means there is no

Pareto-optimal⁴ bankruptcy legislation. Still, it can be agreed that there is always legislation better than the other existing alternatives, under the given circumstances, from viewpoint of a national economy. Different bankruptcy legislations impose different informational costs and risks' allocations, part of which might prove ineffective.

Although the bankruptcy regime is not universal, and neither is the respective legislation, the goals of bankruptcy are nevertheless generally accepted worldwide. The World Bank, within its initiatives to develop an international cooperation in the area of insolvency, and to set a series of general principles and recommendations, suggests three fundamental goals attributed to bankruptcy (World Bank, 2004).

The first goal is the maximization of the total value distributed to creditors, shareholders, employees, and to the other interested parties. The respective firms can be reorganized, sold or liquidated – whatever maximizes the total value.

The second goal is the rehabilitation of the viable businesses and the closure of the non-viable ones. The bankruptcy legislation should be neither too harsh on companies that may have a future, nor too gentle with companies that only have a past.

The third goal is the prioritisation of creditors' claims in a simple, predictable way: secured creditors must be paid first. In this manner, the institution of credit is consolidated and the costs of crediting are significantly diminished.

Based on the assumption that a functional bankruptcy regime is determinant for the efficiency of a market economy, Stiglitz (2003) also summarizes three principles of bankruptcy.

First, the central role of bankruptcy in modern capitalist economies is to encourage firms' reorganization. In many countries, the US included, one cannot any more put the equality sign between bankruptcy and liquidation or the simple ownership transfer from a debtor to a creditor.

Second, bankruptcy not only affects debtors and creditors, but other interested parties, too – primarily, the employees of the indebted company. Consumers may also be interested parties, especially in the case of monopolies or public utilities. Hence, an important externality appears: solving the conflict between debtors and creditors affects third parties.

⁴ A Pareto optimum describes the situation in which the resource allocation at the level of the entire society is undertaken in such a manner that no other alternative resource allocation could give someone a welfare gain without producing a welfare loss to someone else;

Third, a bankruptcy procedure should secure a more efficient allocation of resources after the bankruptcy. A number of factors may intervene here, sometimes with opposite influences: a slow procedure holds debtor's assets captive, hence denying potential chances to redress; the fastest procedure implies keeping existing management in place – but then the ones who must address the problem are the ones who created it; the existing management is most inclined to understand third parties problems (non-creditors).

The effects of bankruptcy

Any legislation regarding bankruptcy tries to reach a balance between the protection of claims from creditors and other interested parties, on the one hand, and avoiding the early liquidation of viable businesses, on the other hand (Claessens and Klapper, 2002).

The policy options that are implicit in the national bankruptcy legislations are a function of the normative perspectives regarding the expected results, although on many occasions these policy options are taken in the absence of a clear idea about the best methods to reach those expected results (Westbrook, 2003).

From a macroeconomic viewpoint, the expected result is the re-capitalization of assets that are unproductively frozen by a surrounding mass of illiquid liabilities. Some systems re-capitalize by selling the assets or the going-concern business to a buyer with the necessary capital to re-deploy them, while others emphasize re-capitalizing the existing business by debt reduction and refinancing. The key point is that assets-tangible, intangible, and organizational-are separated from liabilities and thus become productive (Westbrook, 2003).

Another controversial policy choice, apart from assets re-capitalization, refers to the initiation of the bankruptcy procedure: who should have the initiative and, most important, when? In theory, the early initiation of the bankruptcy procedure is beneficial. The problem arises from the debtors' reluctance to start the procedure, because shareholders are usually the last ones who get something from the remaining assets. Moreover, there is an information asymmetry between debtors and creditors: the debtors are better informed about their financial situation than creditors are. The national bankruptcy legislations that do not solve these two issues representing incentives against

the initiation of the bankruptcy procedure, end up in raising active interest rates in the respective economy. If bankruptcy is not initiated at due time, then the debtor's financial situation may worsen and the claims, even those pertaining to the secured creditors, are more difficult to be recovered. Given the difficulties of post-bankruptcy claims recovery, the lenders raise the interest rates ex-ante, as an additional risk premium. This problem is less important in the economies where firms' financing is based, on a large scale, on venture capital, which implies a direct attitude towards risk-sharing, from the position of a shareholder.

Premises for the effectiveness of an insolvency regime

The bankruptcy legislation does not function in an isolated environment. A corrupt or inefficient juridical system may fail to implement the laws. Moreover, Westbrook (2003) mentions a few related aspects, which are extremely relevant for the effectiveness of bankruptcy.

First, strong and functional institutions must exist. The fact that the bankruptcy legislations in many advanced economies has not been oriented towards institutional reform and administrative capacity building - which is explained through the adequate functioning of institutions in those economies – might have misled many of the developing and emerging economies which inspired themselves from those legislations. The implementation of the bankruptcy legislation requires strong, independent institutions. Bankruptcy, especially when large enterprises are at stake, may determine political ramifications and may imply political interventions in specific cases. While the political decisions can properly design and administer the directions of macroeconomic development, experience shows the political interventions in solving individual cases at the micro-economic level help spurring inefficiency and corruption (Lam and Kan, 1999).

The administrators, as well as the syndic judges, must stay independent to political pressures, for the bankruptcy procedure they are in charge with to be successful. Moreover, the administrators must be competent, in the sense of having an economic education that would allow them, for example, to separate an efficient reorganization plan from an inefficient one. If they lack such a competence, the procedure is more difficult,

lasts longer and there runs the risk of side-taking, because other competent persons, or even the creditors, are asked to make the needed financial and economic judgments.

Second, the legislation on debt collection, banking prudential rules and tax laws must go well together with the bankruptcy legislation. In particular, an effective debt-collection system maximizes bankruptcy's effectiveness. If such a system succeeds linking overdue debts by a stay on assets, then debtors will be more stimulated to look for debt repayment solutions (than to prolong the situation), and in case such solution are not found, they will have an incentive to initiate the bankruptcy procedure themselves. Otherwise, no legislation on bankruptcy will manage, acting independently, to solve out the problems in an economy where the culture of non-payment prevails. Should we refer to Romania, in a brief anticipation of the next sections of this study, an economy where arrears reached 40% of GDP may be considered as having such a culture. Therefore, the bankruptcy legislation is merely a part of the transition to a functional market economy, and it cannot act effectively without strong institutions and a harmonized legislative framework.

In the economies plagued by a certain institutional fragility, a demonstration effect appears: one case of bankruptcy brings more; one delay in bankruptcy, through various means, may slow down the functioning of the market economy; and an efficient reorganization could be a model for other efficient reorganizations (Stiglitz, 2003).

Bankruptcy implementation does not depend on strong institutions and related legislation alone. A determinant factor is the economic philosophy chosen by governments. The Asian countries implemented an active industrial policy, which meant significant state aid and resistance to closing down large enterprises. This policy was supported by import substitution and a more permissive competition policy that sheltered domestic firms. Even at the heart of Europe there are countries with a history of massive state aids. France is an example, among the well-known cases of state aid being Renault (automotive industry), Thomson (defence), Bull (IT), and more recently Alstom. Italy is another example; Parmalat is just a case from a more extensive list including corporations like FIAT, which were supported in times of financial distress.

1.2. Systemic bankruptcy

The bankruptcy legislation, aiming at regulating individual cases, cannot act efficiently when a large part of the economy faces major financial distress. Hence, a distinction has to be made (Stiglitz, 2003) between the individual bankruptcy and the systemic bankruptcy.

When a single company goes bankrupt, that company has probably made a mistake that other companies have not (e.g. bad management, too large debts). When many companies fail to pay their debts, the wrongdoing is not individual anymore, but it pertains to the system. Many well managed companies in the advanced economies would probably go bankrupt the next day after the interest rate reaches the levels at which it has been in many emergent economies for the last decade (and it still is in some cases, Romania included).

When a single firm goes bankrupt, there is typically a large supply of alternative managerial teams. When a large part of the firms in the economy go bankrupt, it becomes impossible to replace all the managers.

Furthermore, when there is systemic financial distress, ascertaining the net worth of a firm, or indeed valuing many of the financial claims, becomes difficult. This is because many of the assets of a corporation may be claims on other firms that are themselves bankrupt.

Maybe the most important aspect of the systemic bankruptcy refers to its macroeconomic consequences: mass unemployment, shortage of financial flows in the banking system, an entire vicious circle including production cuts and, in the end, slowing down the economic growth or, if it is the case, deepening the economic recession. The efficiency of the judicial system, and hence that of the designated administrators for bankrupt firms, is also low when a systemic bankruptcy occurs. Stiglitz also considers that only a legislation dealing specifically with systemic legislation can solve such cases; a legislation that would provide a framework outside the juridical system, and would therefore avoid the waste of public money that happens through various state aid mechanisms for individual firms. A holistic, systemic solution is needed for a holistic, systemic problem.

Within systemic bankruptcy, and the environments encouraging systemic bankruptcy, loss-making state enterprises play a major role, in particular in those

economies where the state still holds a large share of total assets. The bankruptcy of state enterprises in transition economies has a series of macroeconomic implications more serious than a simple case of insolvency; Johnson (1999) details some of them.

If the state is the owner, the debtor, and the creditor at the same time, then the normal incentives and trade-off solutions are distorted. When the state uses debt forgiveness to avoid the liquidation of his assets, the financial system runs an additional risk, and the banks and other credit institutions implement additional prudential measures leading to higher credit costs. A second macroeconomic implication is the potential moral hazard. A debt forgiveness policy may stimulate other debtors, state and private alike, not to pay their commercial or fiscal debts. However, without debt forgiveness, the enterprises facing financial distress usually continue to make losses.

Another macroeconomic implication is the unemployment – we mentioned earlier that bankruptcy affects third parties. When state enterprises are at stake, the employees often have a better negotiation position and they can slow down the needed restructuring. On the other hand, even if the restructuring goes along with job cuts, the problem of labour market absorption appears. In many transition and emerging economies the absorption capacity is reduced, especially because working for years in loss making firms and in downsizing sectors, the new unemployed are less qualified for the booming sectors. These redundancies put further budgetary pressures.

In theory, bankruptcy, as a market exit mechanism, frees resources that are then transferred to more productive uses. In the reality of economies facing systemic bankruptcy, markets may not be capable to absorb new resources. The net effect is that either the assets lose value in the liquidation process or while waiting for a potential buyer to pay their nominal value, or the assets are sold for only a fraction of their nominal value. One of the bankruptcy's goals, that of maximizing the total distributed value, can no longer be attained in the case of systemic bankruptcy.

The systemic bankruptcy concept has been developed around the big financial crises, and particular attention has been paid to it after the 1997-1998 Asian crisis. Nevertheless, that Asian crisis was rather a liquidity crisis, than a systemic one. An argument in this direction is that most of the countries affected recovered very fast. The systemic bankruptcy concept is better fit to describe the situation of the Central and Eastern European transition economies that started economic transformations with an

inherited “structural strain” (Daianu, 1996) which was a determinant and negative factor influencing systemic bankruptcy.

In Romania, the systemic crisis was combined with a liquidity crisis (the latter had a number of episodes, among which 1991 and 1999). This situation has not yet been fully reversed. Almost half of the total assets in the economy are still state owned, and they continue to accumulate debts. Moreover, one can find in the Romanian economy most of the set of specific elements (Johnson, 1999), which undermine the efficient redressing of the state enterprises’ financial difficulties in transition economies, namely:

- political involvement and conflict of interests;
- weak financial systems; after the banking sector crisis in 1998-1999, the National Bank introduced proper prudentially measures, but their effectiveness is yet to be proven;
- the domestic capital market is underdeveloped; the level of financial intermediation is very low (non-governmental credits represented about 14% of GDP in 2003), the Stock Exchange capitalization is very low (about 7% of GDP in 2003), the spread between the active and the passive interest rates is still too large (more than 10 percentage points);
- corporate governance is thin; a non-compulsory regulation introduced by the Stock Exchange and a Government ordinance mentioning some corporate governance principles for state enterprises and *regies autonomes* are still too little and rather too late;
- the business environment does not provide for enough competition and some entrepreneurs may find it hostile. State aids are widespread, and in some sectors the first comers (by privatisation deals) got market power inducements that allowed them to behave detrimental to the final consumers. Moreover, the quasi-fiscal arrears, another widespread practice, are in fact a way to take rents from the state.
- the legislative framework has witnessed frequent changes and it has not been yet fully implemented.

2. Comparative international analysis

2.1. Legislative types: their characteristics and efficiency

The British bankruptcy law from 1732 was the first law of its type in the modern age. The US introduced the first bankruptcy law in 1800, France, Spain and Germany did the same of the beginning of the 19th century. Bankruptcy was punished with imprisoning, and it was seen as a mean for financial liquidation of troubled firms and for asset distribution among creditors. The first, rudimentary, reorganization procedure was foreseen in Austrian legislation in 1914. The first modern reorganization procedure appeared not earlier than 1978, when the “chapter 11” of the American bankruptcy legislation was adopted. IN the following 25 years, the wave of reforms regarding the bankruptcy legislation reached Italy in 1979, France in 1985, UK in 1986, New Zealand in 1989, Australia and Canada in 1992, Germany in 1994 and 1999, Sweden in 1996, Japan and Mexico in 2000. China, Russia and most post-communist regimes also introduced or changed their bankruptcy laws after 1990.

According to the World Bank (2004), the average age of the bankruptcy legislation in the first ten “best practice” countries – Belgium, Canada, Finland, Ireland, Japan, Korea, Latvia, Netherlands, Norway, Singapore – is only six years.

In this context, Romania’s legislative efforts on bankruptcy regulations, especially by means of updating the Law 64/1995 under the recent Law 149/2004, are in line with the international dynamics. The provisions of national legislations differ however from case to case, and the same is true for their efficiency.

The international literature admits some large categories of bankruptcy legislation: British (including Australia, South Africa, Canada, US), French (including half of the EU-15 members), German (including Japan) and Nordic (including the Scandinavian countries). As table 1 indicates, the bankruptcy legislation in the EU has roots and representatives in all these large categories; a single law does not exist, nor does a standard European regime regarding bankruptcy.

Table 1: Main international categories of bankruptcy legislation

	No automatic stay on assets	Secured creditors are paid first	Restrictions on managers' possibility to look for Courts' protection in face of creditors	Managers replaced during the reorganization process
	<i>(0 for no, 1 for yes)</i>			
Ireland	0	1	0	0
United Kingdom	1	1	1	1
British-origin legislations – average	0.72	0.89	0.72	0.78
Belgium	1	1	0	0
France	0	0	0	0
Greece	0	0	0	1
Italy	0	1	1	0
Netherlands	0	1	1	0
Portugal	0	1	0	0
Spain	1	1	0	0
French-origin legislations – average	0.26	0.65	0.42	0.26
Austria	1	1	1	0
Germany	1	1	1	0
German-origin legislations – average	0.67	1.00	0.33	0.33
Denmark	1	1	1	0
Finland	0	1	0	0
Norway	0	1	1	0
Sweden	0	1	1	0
Nordic-origin legislations – average	0.25	1.00	0.75	0.00

Note: 49 economies were analysed. The average reflects all the analysed economies, yet we emphasized only the EU-15 member states.

Source: La Porta and others (1997, 1998), adapted from Westbrook (2003)

Analysing these legislative categories, or classes, rather than country by country, a number of distinctive features can be remarked.

The British-origin legislation offers the best protection from creditors. 72% of the countries implementing British-type of legislation do not automatically freeze debtor's assets when bankruptcy is initiated. With few exceptions (but not among European countries), secured creditors are the first paid; usually there are restrictions on managers' possibility to seek Court protection from creditors and to remain in place during the reorganization procedures. The US is an exception, having a rather anti-creditors legislation, allowing for the stay on assets, debtors' Court protection and managers retaining their places during the reorganization procedure. On the contrary, in the UK, debtors can initiate the bankruptcy procedure only upon their creditors' agreement.

The French-origin legislation is the opposite of the British one, providing the weakest creditors' protection. Only 26% of the countries implementing it, and only 2 out of the 7 EU-15 members that belong to this legislative category (Spain and Belgium) do not put an automatic stay on assets. Among EU members, France and Greece do not guarantee that secured creditors are paid first. Only 42% of these countries limit debtor's unilateral access to legal protection; among EU members having French-type of legislations, only Italy and Netherlands impose restrictions in this regard. Only 26% of the countries in this category impose managers to be replaced during the reorganization process (Greece is the only such example among the EU members with French-type of legislation).

The German-origin legislation favours creditors. Germany and Austria do not permit an automatic stay on assets and priority is given to secured creditors, allowing them to get the collaterals. Since the liquidation procedure is made easier and the focus is not on reorganization, the German-type of legislation is more permissive to managers, precisely because their role is limited.

The Nordic-origin legislation is also rather in favour of creditors, as all countries in these legislative family prioritise secured creditors and, except Finland, they all restrict debtors' rights to unilaterally seek Court protection. Yet, a certain balance is kept: only Denmark does not accept the automatic stay on assets and all Scandinavian countries allow managers to keep their places during reorganization.

As EU as a whole⁵ is regarded, the majority of countries fall in the following categories:

⁵ This analysis refers only to the EU-15 members, before the 1st of May 2004 enlargement of the Union.

- 13 out of 15 countries prioritise secured creditors;
- 8 out of 15 countries freeze assets when the bankruptcy procedure is initiated;
- 8 out of 15 countries impose restrictions on the managers' possibility to unilaterally seek Court protection against creditors;
- 13 out of 15 countries allow the existing managers to keep their places during the reorganization procedure.

We noticed that bankruptcy legislations differ, in some important respects, internationally and, in particular, within the EU. But how efficient are they?

A recent World Bank (2004) study, including transition economies as well (while it mixes the legislative German and Nordic typologies in one group) finds out that the Nordic countries are most efficient bankruptcy-wise, because the procedure lasts only two years and it costs the equivalent of only 4.5% of the assets. British-origin legislation follows, with a 2.7 years average. French-origin legislation take a longer time to finalize bankruptcy (3.7 years), and the costs mount to 15% of the assets. The transition economies are not under-performers, as the bankruptcy procedure lasts on average 3 years and it costs 7% of the assets. One remark should be made: in the transition economies, these figures are valid for those firms that are allowed to go bankrupt. Regarding Romania, the World Bank evaluation is that the bankruptcy procedure lasts 3.2 years and it costs 8% of the assets.

While Canada, Ireland, Japan, Norway and Singapore complete a bankruptcy procedure in less than one year, Brazil and India need more than one decade. In Norway and Singapore the procedure costs less than 1% of the assets, while in the Czech Republic, Thailand and Venezuela the procedure may cost up to half of the assets.

Table 2 presents some other interesting indicators. As the order of claims' priorities is regarded, Romania appears to be close to the French-origin legislation, priority being given to the employees (like in France, Italy, Greece) and even to the tax authorities (like in Spain and Portugal).

The low efficiency of both the procedure and the outcome, similar to that in some French-origin legislations (France, Greece) and in some transition economies (Bulgaria, Hungary, Czech Republic), confirms not only the need for legislative changes, but also the fact that other aspects connected to the bankruptcy legislation – such as strong institutions, competent administrators and syndic judges – are not properly functioning.

Table 2: Bankruptcy efficiency, international comparison

	Time (years)	Cost (% assets)	Claims priority	Efficient outcome	Efficient procedure
Bulgaria	3.8	18	1	0	48
Chile	5.8	18	4	0	19
China	2.6	18	1	0	51
Croatia	3.1	18	1	0	50
Czech Rep.	9.2	38	2	0	42
Denmark	4.2	8	1	1	79
Finland	0.9	1	1	1	99
France	2.4	18	2	0	43
Germany	1.2	8	1	0	61
Greece	2.2	8	3	0	42
Japan	0.6	4	1	1	93
Hungary	2	38	2	0	38
Ireland	0.4	8	1	1	88
Italy	1.3	18	2	0	46
Latvia	1.2	4	1	1	92
Poland	1.5	18	2	1	70
Portugal	2.6	8	3	1	66
Romania	3.2	8	3	0	39
Russia	1.5	4	2	0	58
Slovakia	4.8	18	1	1	71
Spain	1.5	8	3	1	68
Turkey	1.8	8	2	0	51
United Kingdom	1	8	1	1	86
United States	3	4	1	1	88

Note: a.) claims priority for creditors: 1-creditors are paid first, 2-creditors are paid after employees, 3-creditors are paid after employees and tax authorities, 4-creditors are paid after employees, tax authorities and shareholders

b.) efficient outcome: 1-the result is either foreclosure or liquidation with a going concern sale, or successful rehabilitation

c.) efficient procedure: the average of the other four indicators, from 0-minimum efficiency to 100-maximum efficiency

Source: Doing Business in 2004, based on a survey among a representative number of law and consulting in each country

An indirect measure of the efficiency of a bankruptcy regime is also the number of firms that declare bankruptcy in a formal manner. Table 3 presents a comparative perspective, focused on the EU countries. By comparison, according to an European Commission estimation, between 1997-2002, 40000 bankruptcies were formally filed in Romania, which means an annual average of 6700 firms, representing less than 1% of

total firms. These data bring Romania again next to some French-origin legislation countries (Italy, Spain, Portugal, Greece) and to the only post-communist country, which is comparable with Romania in terms of the large share of loss making state companies (Poland). Of course, such statistics does not include the firms that failed to legally re-register by increasing the volume of their equity capital.

Table 3: Bankruptcy cases, international comparison

	Time period	Annual number of bankruptcy cases, average	Share of bankrupt firms in total firms, %
Austria	1990-1999	2065	1.33
Belgium	1990-1999	4850	2.59
Czech Rep.	1992-1996	1729	1.49
Denmark	1990-1999	2375	1.53
Finland	1990-1998	5106	4.14
France	1990-1999	51671	2.62
Germany	1992-1998	21152	1.03
Greece	1990-1994	857	0.29
Hungary	1992-1996	8425	1.99
Ireland	1990-1999	788	2.64
Italy	1990-1996	8663	0.54
Netherlands	1990-1999	4154	1.30
Norway	1990-1998	3546	1.83
Poland	1990-1996	3319	0.23
Portugal	1991-1999	516	0.08
Spain	1990-1999	518	0.02
Sweden	1990-1999	13916	7.61
United Kingdom	1923-1998	46583	1.85
United States	1990-1999	55752	3.65

Source: Claessens and Klapper, 2002

Claessens and Klapper (2002) made a number of econometric tests for bankruptcy determinants. Their main findings were:

- The more developed countries (in terms of GDP/capita) have a higher incidence of bankruptcy cases. The explanation could be that a higher level of development implies a higher efficiency of the judicial system.

- The frequency of bankruptcy cases is higher in those economies where the financial instruments market is more developed, and therefore the respective economies are less dependent on banking intermediation. The explanation could be that a lower level of creditors reduces the need for Courts' involvement.

- There is a positive and significant correlation between the time needed to start a business and the frequency of bankruptcy cases; the countries with more restrictions and difficulties, be them formal or informal, to starting a business also have a lower rate of formal closing of a business. This is to say that market entry barriers lead to lower market exist rates. A number of explanations might be submitted; among them, the existence of a natural selection process, or the fact that the market entry barriers keep artificially alive under-performing, but more experienced firms (usually, state owned firms). For transition economies in particular, another explanation could be also valid: both procedures, market entry and market exit, need an efficient public sector – but many transition economies, Romania included, still have to improve on this issue.

- The countries with a higher share of small and medium enterprises in total firms have a lower number of bankruptcy cases filed to Courts. The explanation could be linked to the sometimes-prohibitive costs of the formal bankruptcy procedures.

When considering the low frequency of bankruptcy cases filed to Courts in Romania, the findings above appear to be applicable to Romania as well: the GDP/capita is not big, the financial instruments are not yet sophisticated, market entry barriers still persist, and most registered firms are small and medium size companies.

2.2. Directions of action at the international level

At the international level, Westbrook (2003) identifies a number of major elements that can be met in most legislative reforms regarding bankruptcy:

- focusing on reorganization rather than on liquidation;
- limiting the priority claims to employees and secured creditors;
- involving the secured creditors in the reorganization plans;
- increasing international cooperation in bankruptcy cases involving transnational corporations.

At its turn, a recent European Commission report (2003) recommends that an increased emphasis should be placed on: the implementation of early warning systems to prevent financial distress; the professional upgrading of the judicial system towards increased competence dealing with bankruptcy cases; the elimination of the social stigma put on the bankrupt entrepreneurs and the support for giving them a second chance.

The recent corporate scandals have raised the pressure towards the reform of the bankruptcy legislation, as well as the reform of some related legislative acts. In the United States, the Enron bankruptcy (investors' losses were above 60 billion dollars when the bankruptcy procedure was initiated), the Worldcom bankruptcy (investors' losses were above 150 billion dollars when the bankruptcy procedure was initiated), or the moral bankruptcy at Arthur Andersen (which ended up being acquired by Ernst&Young) – to mention only a few of the spectacular bankruptcy cases in recent years – all of them have questioned the corporate ethics and the so-called creative accounting. More than anything, they questioned the investors' and creditors' possibility to protect themselves against the potentially fraudulent behaviour of the top managers and of the auditors. At the European level, the recent Parmalat bankruptcy goes in the same direction.

In response to these corporate scandals, an important change in the bankruptcy legislation was initiated in the US. The respective legislative proposal passed in the House of the Representatives (in March 2003) and it will be debated in the Senate. One of the main changes it contains, supported by some economists (Krugman, 2004), refers to the obligation to record top managers' stock options as a cost in the company's accounting. These options stimulated the managers to hide the financial realities of the

corporations they were running, in order to raise the stocks' value. Such a provision was already adopted as a standard in Canada, by the professional association of accountants.

The American administration⁶ envisages a larger corporate reform, aimed, among others, at dealing with the creative accounting, based on the principle that the firms should attract investors by demonstrating their strengths, not by hiding their weaknesses. It is worth mentioning the creation of an independent organism which has the role to supervise the way in which the accounting firms fulfil their ethical standards. Another goal of the corporate reform is the protection of the small investors, including pension funds investors, in particular by raising their access to the financial information of the companies they invested in.

At the European level, the European Commission is about to adopt a directive that would force EU registered companies to change their auditing firms once each seven years. The UK and Sweden already apply such a rule.

Moreover, as a direct reaction to the Parmalat scandal (Delaney, 2004), the Italian ministry of finance intends to propose the creation of an authority – under the Parliament supervision – that would oversee the activity of three institutions regarded as being responsible for the failure to properly prevent and solve some market failures, namely the central bank, the securities commission (Consob) and the anti-trust authority. Other reform proposals look into the creation of a fund to cover part of investors' losses, and increasing the degree of responsibility – by raising sanctions – at all levels: managers, auditors, investment banking, and regulating agencies.

⁶ Of course, it might be mentioned that the Bush administration has been associated, in the American media, with the Enron scandal: 34 White House employees, including the vice-president, has business connections with Enron, and Enron had sponsored three Republican campaigns, the last one as well.

2.3. Experience of Member States in the field of insolvency and bankruptcy (France, Germany, Spain, Italy, United Kingdom)

France

In France, the proceedings of insolvency are regulated by the Sixth Book of the Commercial Code – “About enterprises difficulties” („*Des difficultes des entreprises*”). Three proceedings are thus regulated: the first one regards the amicable settlement of companies in financial difficulties without being in default of payment; a judicial procedure for insolvent companies that can be reorganized and the third procedure, the judicial liquidation and the sale of the assets.

The judicial liquidation as well as the reorganization is decided by the Commercial Court (if the debtor is a merchant, a commercial society or a craftsman) and the Civil Court (if the debtor is a farmer or an NGO). Liquidation procedure can be open by a creditor, by the directors of insolvent company, by the Republic prosecutor or by the president of the Court. Liquidation is conditioned by the default of payments but also by the impossibility of reorganising the society or by fully ceasing the activity.

The liquidation is pronounced at the opening of the procedure or at the end of an observation period (*periode d’observation*), if the judicial administrator wasn’t able to establish a reorganisation plan or if a plan approved by the court was not fulfilled by the debtor. The debtor is stripped of the management powers and he is replaced by a liquidator appointed by the Court.

The creditors must notify their credits to the liquidator in the next two months following the official notification of opening the procedure. The creditors from outside the metropolitan France have two more months for notifying their claims.

The amiable liquidation is decided by the shareholders or by the associates of the company. The assembly of associates or of shareholders appoints a liquidator – which can be even the former manager – in charge with the sale of assets and with payment of social debts.

In the case of reorganisation (*redressement*), the plan must be approved by the court after an observation period, fixed by the law at six months to one year maximum. During this period, the judicial administrator, appointed by the Court, assists the debtor at managing the company, at urgent let-offs, but only with the approval of a judge-

commissioner (*juge commissaire*), he submits a report describing the causes of default of payments and presents solutions of reorganisation.

The creditors must notify their credits to a creditors' representative (*representant des creanciers*) appointed by the Court. He verifies the credits and accepts or rejects them. Also, he has to check with each creditor the reorganisation plan proposed by the debtor, regarding the payment delays and he informs the receiver about their answers.

The reorganisation plan must have a solution for company to continue its activity or a solution for assets' cession. The modality of reorganisation is decided by the Court, the period cannot exceed 10 years, the dividends being paid in successive instalments. The adoption of a reorganisation plan put an end at the debtor's rights. He can manage the activity of the society if he pays the price for the reorganisation plan (the dividends, in the case of continuation of activity or the price of the given-up assets in the case of cession). If the debtor does not execute the plan, any creditor must complain and a new proceeding of insolvency is being opened.

Unfortunately, the French law does not advantage the creditors, the accent being put on salvation of the enterprise. The French law does not recognise the real security on a floating asset, but only on a well-specified good. A real security gives the right to creditor to sell the good, to keep the right of security in case of reselling or to ask in instance the property right on the good, as a payment for the credit.

These rights do not apply in the case of reorganisation or judicial liquidation proceedings. There is only one exception – the right of property, provided on a contractual basis and the creditor can benefit of it in the following three months after the publication of the procedure's opening.

In the case of reorganisation, the goods are kept by the insolvent company. In the case of liquidation, only the liquidator has the right to sell the assets during a period of three months after the opening of the procedure. After this period, the creditors can proceed to individual claims, only if their credits are declared in the liabilities. The payment of creditors detaining real securities can be postponed after the payment of other creditors (such as the fiscal credits or salaries).

The unsecured creditors are paid after the credits appeared during the insolvency procedure, after secured creditors and after privileged creditors. Therefore, they have the smallest chance to be paid in the case of judicial liquidation.

Germany

All insolvency proceedings opened after 1st of January 1999 are ruled by the Insolvency Law of 1994 (*Insolvenzordnung* - InO). The insolvency procedure may occur only on request of a creditor or of the debtor. If the District Court considers that it exists indeed an insolvency situation will open the insolvency procedure and will appoint an administrator. The administrator must act in the collective interest of debtor and creditor and administrate the debtor's goods during the procedure.

After declaring the insolvency status, there are several alternatives to continue the activity. The first one is an out-of-court settlement, between the debtor and its creditors to give survival of the business. Such settlement can be more favourable for the creditors than the initiation of judicial insolvency proceedings. The main advantage of the out-of-court settlement is the faster execution, as no legal base must be established. At the same time, due the fact that there is no legal regulation, the reorganisation contract must be approved by all creditors. In the case of out-of-court settlement, the equal treatment of creditors applies, so that the preference for individual creditors does not apply.

The second procedure is based on an insolvency plan (*Insolvenzplan*). Before starting the insolvency proceeding, reorganisation can be carried out informally. Very often restructuring will be based on a voluntary settlement between the debtor and its creditors following the negotiations between them.

The reorganisation plan must first be approved by the Court. The German Law provides few restrictions regarding the reorganisation plan. Nevertheless, the reorganisation plan has to make the distinction between secured and unsecured creditors and to list the classes of creditors. The plan must be approved by each class of creditors and afterwards the Court decides to confirm or not the plan.

The third modality to continue the activity is represented by the asset-deal. This measure consists in selling all or part of the assets to a purchaser willing to continue the business.

The parties to an asset-deal have to decide on assets to be transferred to the purchaser. The creditors are paid either from sale revenue or from a future surplus achieved by the company. According to German legislation, the assembly of creditors decides if the debtor's activity would continue or if it will be fully or partially shut down.

Therefore, the creditors have the power to decide on an agreement regarding the assets of the company.

Spain

The legal framework regarding insolvency was very much criticised because it is based on rules established in the 19th century and at the beginning of years 1990s. Therefore, in July 2003, Spain has adopted a law which radically modifies the bankruptcy proceedings and which will enter into force on 1st of September 2004. The new law, inspired by the UNCITRAL Law Model regarding the cross border insolvency proceedings, tries to simplify and unify all aspects related to insolvency.

Since now, the distinction between bankruptcy (*quibera*) and suspensions of payments (*suspension de pagos*) was made, while the new law defines only the insolvency statute (*concurso*) being that situation in which a debtor cannot regularly meet, on a day-by-day basis, its commercial obligations.

The insolvency proceedings can be requested by the debtor (voluntary insolvency) or by the creditors (necessary insolvency). According to the new law, the debtor has to declare the insolvency before getting to this situation if he anticipates he will become insolvent in the future. If the debtor fails to request the insolvency, there is a presumption that the debtor acted with gross negligence or even in bad faith. As a consequence, company managers may be prevented from doing business for up to 15 years.

Any creditor may request the Court to declare the debtor insolvent. To avoid to be declared insolvent, the debtor has to prove that he paid the creditor in order to be allowed to continue the activity. On the other hand, if the creditor's request proved not to be justified, the creditor must bear the costs of the proceedings and pay damages to the debtor.

If the debtor does not pay its debts and the insolvency proceedings are initiated, the creditor who started the procedure is entitled to receive 25% of his credit before the other unsecured creditors.

After the beginning of the insolvency proceedings, unsecured credits must be brought to the Commercial Judge where the insolvency proceedings are being heard. The law prevents the unsecured creditors from starting enforcement proceedings against the

debtor and any such proceedings which are ongoing at the time of declaring the insolvency are automatically suspended.

Concerning the secured creditors, the new Spanish law suspends, during one year, the rights of creditors over the assets of the debtor. During the same period, the creditors must suspend any action already started against the debtor and must refrain from starting new such actions. From the point of view of legislator, this measure provides a fair balance between the interests of all parties involved in the insolvency procedure.

If the creditors fail to notify their credits in a fixed period of time, they will be classified as subordinated credits of insolvency, being among the last to be paid and their holders are denied the right to vote at the creditors' meetings.

The subordinate creditors are also those having a "special relationship" with the debtor, such as the partners with unlimited liability for the company's debt, the shareholders holding a stake of more than 5% in the case of listed companies etc.

The insolvency law has special provision for the case in which the appointed administrator, the debtor or even the employees request the Court the suspension, amendment or termination of employment contracts. Taking into account that the main goal of the proceedings is to protect employees' rights, but, at the same time to favour the continuation of business, it is worth mentioning that such protection is not awarded to high executives. The administrator is entitle to request the cancellation or suspension of the employment contracts with high executives and asks to reduce any contractual indemnities which are considered excessive.

Italy

The insolvency proceedings are ruled by the Bankruptcy Law from 1942. The bankruptcy is declared by the Court having jurisdiction over the debtor's principal place of business. Small entrepreneurs (is the activity is carried out by the entrepreneur and his family) and farmers are not subjected to insolvency proceedings. They will be included in the provisions of a new law on insolvency proceedings, officially debated since autumn 2003. The new law will bring substantial improvements having modern characteristics based on efficiency. Since it was not adopted yet, we will focus on current legislation features.

According to the legal framework, the debtor loses the right to dispose of his goods and the Court appoints a statutory auditor to take possession of goods, to sell them, under the supervision of a delegated judge. The sale revenue is distributed by the judge, with respect to priority credits.

In the Italian practice, there is a series of extra-judicial execution proceedings, outside the legal framework, through which the debtor tries to avoid the insolvency. The problem is that the payment made this way may be declared void at the opening of the insolvency proceedings.

The law gives the right to request the insolvency proceedings to debtor, to creditors, to Public Prosecutor, to Ministry of Industry and to Bankruptcy Court. The opening of the procedure is mostly asked by the unsecured creditors which are the most numerous. The Italian Law shows that the main goal of various proceedings is to protect creditors' interests.

The enterprise reorganisation is possible only in the controlled administration procedure – *amministrazione controllata*, the preventive creditors' settlement – *concordato preventivo* (can be initiated only by the debtor) and the extraordinary administration – *amministrazione straordinaria* (applied only to large enterprises, with more than 200 employees and only for a certain level of debts).

The controlled administration procedure consists in the possibility for the entrepreneur to postpone the payment of debts for a period of maximum two years. Such benefit is awarded by the Court, upon debtor's request who, being in a situation of temporary financial crisis, demonstrates the possibility to reorganise the enterprise. The Court appoints a Judicial Commissioner (*Commissario giudiziale*) who shall supervise the debtor's activity and shall assist him, if necessary, in the administration of the business.

Preventive creditors' settlement procedure is admitted only if the debtor offers guarantees of his capability to pay at least 40% of the credits. The settlement proposal must be approved by the majority of creditors and by the Court. If the plan is not approved by the creditors or if the debtor fails to fulfil the settlement, the enterprise is subjected to the liquidation bankruptcy procedure.

The extraordinary administration has two stages. The first stage is compulsory and it starts with the recognition of the Court of the existence of insolvency status. In the following two months, the Court supervises the enterprise in order to decide whether to

start an extraordinary administration procedure – which will lead to reorganisation – or to open a bankruptcy procedure.

The second stage takes place only if the Court agrees with the reorganisation. The procedure is carried out under the supervision of the Industry Ministry. The Ministry appoints an Extraordinary Commissioner entrusted with the preparation of the reorganisation plan, submitted to the approval of the Ministry. Once the plan approved, the Extraordinary Commissioner will carried out all necessary action for its completion.

In this case, the creditors are not called to vote the plan in order to recognise the plan. They only have the right to request the opening of the procedure and to ask the Court to recognise their credits.

United Kingdom

The Insolvency Act of 1986 applies to voluntary liquidation and also to compulsory liquidation and it is completed by secondary legislation provided by Insolvency Rules. The last modification of Insolvency Act took place in 2000.

The High Court of England and Wales has the power to liquidate any company incorporated in England and Wales. For certain cases, the County Court has concurrent jurisdiction with the High Court. For voluntary liquidation, the Court's assistance may be required. The voluntary liquidation has two forms:

- Members' voluntary liquidation – MLV, which is under the effective control of the shareholders
- Creditors' voluntary Liquidation – CVL, which is under the control of the creditors.

Voluntary liquidation begins at the time when the insolvency resolution is voted by the shareholders. The directors' power cease at that date. In addition, the activity of the company ceased except to the extent necessary for the liquidation procedure.

Compulsory liquidation begins at the request of a creditor, the directors of the default company. On grounds of public interest, the liquidation procedure may be requested by the Secretary of State for Trade and Industry or by the official receiver.

Unsecured and non-preferential creditors are entitled to share a company's available asset in strict proportion to the amount of their claims. All creditors submit their claims to liquidator by way of a "proof of debt". The liquidator can reject a proof, in

whole or in part, but he must provide reasons to the creditor. Creditors who hold security are entitled to be paid in full out of the proceeds of sale of the assets, which are subject to their security.

Creditors are classified in distinct categories (secured creditors, preferential creditors, unsecured creditors etc.), and each creditor will be paid in full under one category before any lower category is paid. As the unsecured credits are on the last place, it means that secured creditors are almost always paid in full and the unsecured creditors receive nothing.

The enterprise reorganisation is possible and it can be done either without the involvement of the Court – informal restructuring, or with its involvement. Informal restructuring can take the form of a consensual arrangement between the company and its major creditors. Under this procedure, the bankers or the major creditors of the company jointly ensure that it has sufficient liquidity to continue the activity.

A second modality of informal restructuring is the arrangement between the company and its creditors and its stakeholders, which supposes a reorganisation plan proposed by the directors, involving delay or reduced payments or a capital restructuring.

The third modality of informal restructuring is given by a compromise or arrangement between its creditors (or its shareholders). The company may choose the creditors to which its scheme will apply.

Restructuring with Court involvement applies to administration procedure, which has as objectives to rescue of the company, to achieve a better result for the company creditors than would be likely if the company were liquidated.

The administrator, appointed by the Court must have as his prime objective the rescuing the company. He has the power to make distributions to preferential and secured creditors. The administrator may also make distributions to other creditors either with the Court permission or without if he believes the payment is assisting him in achieving the administration's aim. The law does not provide any assistance as to how an administrator might come to such conclusions, which gives an idea of the power of the administrator.

2.4. Transition countries' experience in the field of insolvency and bankruptcy

It is widely accepted that one of the causes of the slow transition process in the former socialist countries is the low level of development of some basic institutions in a market economy. One of the major changes in these countries was the introduction of a new legal framework, based on private property and the related institutions. This legal framework is meant to encourage, facilitate, protect and regulate the functioning of the new system. The change was nevertheless very slow in many areas and the respective institutions underdeveloped, becoming themselves important barriers against the evolution of the market economy. The bankruptcy law, a basic, *sine qua non* element of the private law system, is one of these underdeveloped sectors, with major implications on the transformation process.

An important feature of the market system is the dynamic selection mechanism by which new products and process are replacing the old ones. Some entrepreneurs and some firms cannot face the competitive pressure and they leave the market, allowing for a more efficient resource reallocation. The Schumpeterian concept of “creative destruction” integrates this dynamism. The establishment of new systems in the transition economies has enhanced the selection process, which got a higher importance than in the more mature economies. The inherited economic structure was improper for a market system and it had to be dramatically changed, many enterprises being closed or restructured. The extensive development of the private sector at the beginning of transition, as well as the high market entry and market exit rates, emphasized this selection mechanism.

The main goal of the bankruptcy law (or of the insolvency procedures) is to regulate the selection process. The law establishes the market exit procedures for the bankrupt companies and the re-use of their assets and other resources in new firms and activities. Moreover, the insolvency procedures create the legal assurance for the potential creditors and investors, to secure them that even in case of financial distress or bankruptcy, there will be legal processes to prevent an open race for assets and to regulate the assets distribution between the firm's creditors.

The systemic transformation in Central and Eastern Europe is closely linked to the changes in managers and firms behaviour and to the creation of a proper environment for new investments (foreign or local investors). This is why the insolvency procedures play a more important role in transition economies than in established market economies. The

bigger the uncertainty, the lack of experience and the informational asymmetry, the more the disadvantages shareholders, financial institutions and creditors have against the managers of the financially distressed companies. Moreover, the possibility to act fraudulently – which is higher in the transition economies, as compared to the developed market economies – does not encourage individuals and companies to develop relationships with the newly established firms.

In the transition economies, the insolvency process is linked to other two fundamental processes: restructuring and privatisation. Restructuring requires the change of the former state owned enterprises to market-oriented firms, by changing the passive administrative unit behaviour into independent economic agents, capable to make their own decisions with the aim of profit maximizing. Also, radical changes were needed in the governmental approach on state companies, to orient them to the market mechanisms, and not to shelter them any longer at the expense of taxpayers. The restructuring process led in many occasions to financial problems and potential or even actual insolvency, as well as to the recovery of production factors (production cuts and consequent resources' savings, lay-outs or firms' liquidation).

On the other hand, the privatisation process (which is also of paramount importance for the systemic transformation) emphasized the dilemma of indebted companies that could not be privatised. The bankruptcy law provided a solution for the problems of arrears and insolvency; it also fastened the privatisation of bankrupt companies (e.g., the special liquidation procedure used in Poland). This radical option was not used in all the transition economies.

Apart from those already said, the bankruptcy law plays an important role for the process of transformation itself: it gives credibility to changes, telling companies that they must face the competition alone, in order to survive on the market. Only in such a case, the firms' managers may change their expectations and play under the bankruptcy imposed constraints.

If the bankruptcy law has flaws, or the administrative capacity is under-developed, the managers and the other shareholders will have a fraudulent activity and they will use the insolvency procedure for the wrong reasons.

Although the governments in most transition economies have adopted modern bankruptcy laws, they were not coherent in the implementation of the basic insolvency procedure. After more than a decade of experience, many of these countries have not yet

came to terms with the fact that not all former state companies can survive in a market economy, either because the demand suffered dramatic changes, or because their inner inefficiency. Instead of allowing these large enterprises to go bankrupt, and hence to provide for the transfer of assets to more efficient owners, the governments in some transition economies excluded these companies from the normal bankruptcy procedure and wasted financial resources (which were insufficient anyway) for inefficient subsidies. In many cases, the real motifs of such a policy were rather of a political, than of an economic nature.

The recurrent debt forgiveness and the non-implementation of the bankruptcy law during privatisation are examples of such behaviour. In some countries, the so-called “strategic enterprises” were moved under the authority of a restructuring agency supporting their financial recovery. They were ruled out from insolvency procedures and were not included in the privatisation program. The results were often negative: the state subsidies were used for prolonging their inescapable bankruptcy.

The lesson of the more advanced transition economies and the experience of the laggards, is that the insolvency process must be the same for all firms, in order to: (a) signal government’s commitment to systemic transformation; (b) determine companies’ managers to change their attitude and to engage in massive restructuring; (c) fasten the reallocation of resources from the insolvable firms from old sectors to the new firms in the new sectors.

The table below presents the range of the insolvency procedures in some selected transition economies (Germany is included for its Eastern lands). They indicate that, while none of these countries has solved the problem of customers’ insolvency, in some countries the state has reassumed additional powers and it has imposed a variety of exceptions and extra-procedural measures. Such measures are often counter-productive – as the experience of Romania and other countries, which tried to protect certain firms or sectors from bankruptcy, proves it. Addressing insolvency is a private law issue and all firms should be treated equally, at least in principle.

Table 4: The enforcement of the insolvency procedures in selected transition economies

Country	Individuals	Legal persons: exemptions and special rules
Bulgaria	Commercial agents only	Some sectors have preferential rules (non-commercial juridical persons)
Croatia	Commercial agents only	Juridical persons in the military and defence sector are exempted only on approval from the Defence Ministry; farmers and private pension funds are exempted
Czech Republic	Commercial agents only	Political parties are exempted during the electoral campaigns; farmers are exempted between April and September
Germany	Consumers' insolvency/ minor procedures	None
Hungary		Private pension funds are exempted
Poland	Commercial agents only; other entrepreneurs, non-registered, especially farmers, are excluded	Following are exempted: sickness funds; institutions and organizations created by Parliament laws; a number of six state enterprises
Romania	Commercial agents only	Numerous exceptions (enterprises undergoing privatisation; the <i>regies autonomes</i>)
Slovakia	Commercial agents only	Farmers are exempted from April to September; "strategic" suppliers are also exempted

Source: Balcerowicz et al., 2003

One of the most common arguments in support of state intervention, heard especially in the first part of the last decade, is the risk of mass bankruptcy and mass unemployment, the so-called "domino effect", which may appear unless a "potential brake" intervenes against the automatic triggering of procedures. In the literature, opinions remain divided over the positive or negative effect of mass bankruptcy on the restructuring process and the structural reform. In Hungary, for example, despite de large wave of bankruptcy fillings that followed the 1992 bankruptcy law, the recession was not drastic or very different from other transition economies. At the same time, there are other authors suggesting that the respective policy was wrong, because a more moderate approach would have benefited the economy more (Westbrook, 2003).

Next, we will present a comparative analysis of the legal and administrative framework regarding the insolvency in the transition countries, starting with several essential benchmarks of the market exit process.

The commencement of insolvency proceedings

The first essential benchmarks of insolvency proceedings are given by the definitions of trigger mechanisms through which the insolvency is opened, as well as by ascertaining the responsibilities for declaring the insolvency status.

The criteria for opening the insolvency proceedings must be clear, objective and easily to be verified. In transition countries, three such criteria are used: the lack of liquidities criterion, the over-debt criterion and the imminent insolvency criterion.

The first criterion, the incapacity of paying the real, liquid and due debts is the most frequent. Normally, a combination of several criteria is used as trigger mechanisms.

Table 5. Criteria for opening the insolvency proceedings

Country	Lack of liquidity	Over-debt	Imminent insolvency
Bulgaria	✓	✓	-
Czech Republic	✓	✓	✓
Hungary	✓	-	-
Poland	✓	✓	-
Slovakia	✓	✓	-
Romania	✓	-	✓

Source: Balcerowicz et al., 2003

The over-debt criterion is based on analysing the balance sheet, the document reflecting the financial situation of a company. Theoretically, the balance sheet analysis should offer a better perspective over the existence of an insolvency situation than the default, maybe accidentally, of payments. This mechanism is successfully used in Germany for opening the proceedings. However, in the transition countries, and not only in their case, a major problem remains the evaluation of the assets. The evaluation process is difficult because of the differences between the accounting value and the market value of the assets. For this reasons, countries such as the Czech Republic, adopted the Western-European practice of commencement criterion based on the “Two-Tier Method”. The mechanism implies the arithmetic evaluation of the assets based on the balance sheet and a correction taking into account the enterprise’s “survival” chances and on its assets’ value if the company remains on the market. In the transition countries, the use of this two-fold evaluation is controversial, due to the difficulties of evaluating the reorganisation scenarios and of precise estimation of liquidation value.

The imminent insolvency criterion appeared recently in legislation dealing with insolvency. This criterion encourages the debtor, more exactly the manager of the debtor,

to take measures before reaching the default of payments. Therefore, the chances of saving the enterprise and of re-enter the market are considerably are bigger compared to a company which already has the insolvency status. Furthermore, some legislation encourages this kind of behaviour by wipe out the residual debts and by permitting the managers to remain in charge of business. This criterion is successfully used in Germany and it was copied⁷, at some extent, by two of the transition countries – Croatia and Romania. But, there are also potential negative effects, especially if this commencement method is abusively used, in order to escape the payment of certain debts.

In Romania, the imminent insolvency criterion was introduced in 2002⁸ and it is found in the Art 25, Paragraph 2⁹, stipulating that a debtor threatened by insolvency may open the procedure, in conformity with the law. The formulation is vague and it does not objectively define the notion of “threaten”. Although, the amendments adopted in 2004¹⁰ bring some light through the Paragraph 4 of the same article, stipulating that the “premature introduction and in bad-will by the debtor of a request to open the proceeding brings along the debtor’s patrimonial responsibility [...] for the caused prejudices”. This way the potential abuses are limited.

Another important aspect of the opening the insolvency proceedings is the compulsory duty for the manager of the debtor enterprise to declare the insolvency status before getting in default of payment. As the managers knows the best the situation, they have to be transparent and not to engage even more credits, only for their wish to run a little bit longer, affecting this way the creditors’ rights. In conclusion, besides the debtor’s right to anticipate and to declare the insolvency in order to save the firm, there is the obligation for the manager of the debtor firm to declare, in due time, the difficulties related to insolvency.

Table 6. Right and obligation to open the insolvency proceedings

Country	The right to open the proceedings	Managers’ obligation to open the proceedings	Legal punishments
Bulgaria	debtor, creditor, liquidator	15 days before	Patrimonial responsibility

⁷ The two countries’ legislation does not explicitly encourage the application of this criterion, as it is the case in Germany;

⁸ GO 38/2002;

⁹ Law 64/1995 amended and republished after adopting the Law 149/2004;

¹⁰ Law 149/2004;

Czech Republic	debtor, creditor	Unspecified, but compulsory, without delay	Patrimonial responsibility
Hungary	debtor, creditor, Registrar of Commerce	No obligation	Patrimonial responsibility
Poland	debtor, creditor	14 days before	Civil and penal responsibility
Slovakia	debtor, creditor, liquidator	60 days before	Patrimonial responsibility
Romania	debtor, creditor	30 days before	Unspecified

Source: Balcerowicz et al., 2003

As one can observe in the above table, there are a series of differences between legislations of various transition countries. Many differences are based on the past experience of each country. For example, in Hungary, in 1991 it was adopted a bankruptcy law providing the managers' obligation to declare the insolvency if they had arrears of over 90 days. This so-called "automatic trigger" led to a wave of almost 22.000 declarations of insolvency in less than 2 years of applying the law. In 1993, the automatic trigger method was suspended. The effects of the method were ver debated in the literature. On one hand, the entire economic system risked to collapse, through a systemic bankruptcy. On the other hand, the accumulation of arrears was stopped and the financial discipline was strengthened.

In the Czech Republic, until 1996, the managers were not obligated to declare the insolvency. As a consequence, the number of declared insolvencies diminished. Even after the compulsory declaration was introduced, it was not clearly specified an ex-ante limit to declare the insolvency, therefore the pressure on managers was not too important.

In Poland, the legal rules are the strongest regarding the obligation to anticipate the insolvency. Moreover, the Polish legislation introduced, in 1997 the penal responsibility beside the civil one, copying the model of German legal provisions.

It is worth noticing that in some transition countries more actors have the right to initiate the insolvency proceedings. The liquidators play an important role in Bulgaria and Slovakia; they can take initiative and request for opening the proceedings.

In Romania, until 2004, the Chambers of Commerce had also the right to ask the opening of the insolvency procedure. The new regulations cancelled the prerogatives of the Chambers of Commerce. The main reason was the fact that the Registrar of Commerce, important source of data regarding the companies' activity, was moved in 2002 from the Chambers of Commerce to Ministry of Justice. Presently, the Registrar of

Commerce does not have any competence for investigating the insolvency status of the registered companies, as it is the similar institution in Hungary.

Last, but not least, it is worth mentioning that until 2004, Romanian legislation stipulated the patrimonial responsibilities of managers in the case of declaring “too late”¹¹ the insolvency status. It is bizarre that by amending the law in 2004, this provision disappears, although the obligation of declaring the insolvency status, with 30 days before, still exists. Obviously, it is a lack of the present legislation, reducing the incentive of applying the law.

Liquidation vs. reorganisation

Following the opening of the insolvency proceedings, accepted by the Court, the debtor has two main options – liquidation or judicial reorganisation. In general, both the debtor and the creditors state their option, but the final decision is given by the Court. Either liquidation or reorganisation, the debtor’s credits are suspended for ensuring a fair treatment for all creditors, classified by the priority of their credits (in the case of liquidation) or for preparing a successful reorganisation plan (in the case of reorganisation).

If the reorganisation applies, the suspension or even the cancellation of credits can lead to perverted incentives: the debtors might be encouraged to request the reorganisation only for escaping the creditors, even if saving the company is unlikely.

The credits treatment for the case of reorganisation varies over the transition countries. In Hungary, the former legislation offered a period of 90 days after the reorganisation was approved, during which the debts were suspended. After the modification of legal framework in 1993, the suspension of credits cannot be done without the approval of creditors, in order to avoid abuses on the managers’ side. It has to be mentioned that the managers of debtor firm are the one to prepare the reorganisation plans.

In the Czech Republic, during a period of 90 days the debtor can propose a “settlement” plan, which has to be approved afterwards by the Court. During the period, the debts are suspended, excepting the salaries claims or the state’s claims appeared from

¹¹ according to Art. 25, paragraph 4;

the current operations. Under special conditions, an addition period of 90 days can be granted. These provisions were used especially in post-privatisation situations, when the new owners tried to negotiate with the creditors a solution for saving the privatised companies, having outstanding debts. After 1996, when the privatisation was almost finished, the protection period was granted only for firms with more than 50 employees.

In Poland, the debtor how opts for reorganisation requests the Court to approve a plan, already agreed on with the creditors. If the judge accepts the request, the reorganisation will take place only if the assembly of creditors accepts the reorganisation. Only then, the debts can be suspended and only if the reorganisation plan includes clear provisions regarding the payment of secured credits.

In general, as also presented in chapter 3, at international level, continues the debate on choosing between liquidation and reorganisation, as the two options to finish the insolvency proceedings.

The developed countries and the international institutions¹² suggest that the reorganisation should be preferable, as the revitalisation of debtor firms would lead to achieving better results for the creditors and for the economy. Even if the liquidations is a faster process, it can be sometimes premature. Therefore, legislation of development countries encourages the reorganisation¹³.

For transition countries, reorganisation can be a better solution as the financial difficulties of the debtors are due to the external business environment and not to the internal management of the company. The important volume of inter-enterprises systemic arrears¹⁴ makes the viable enterprises to be in default of payments because of the clients who, at their turn, did not paid the their debts.

Also, in transition countries one can observe the distort effects of the emphasis put on the reorganisation. As we showed in Chapter 3.2, the reorganisation can be an excuse for prolonging an incompetent management or the life of inefficient enterprise (especially in the case of own-state enterprises).

The experience of transition countries is different. In Hungary, despite a massive wave of insolvency declarations at the beginning of the transition, the accent was put on the reorganisation, showing that the risk of a systemic bankruptcy, leading to shutting

¹² e.g. IMF, the World Bank or the European Commission;

¹³ see Chapter 11 from US Bankruptcy legislation;

¹⁴ mostly public, but also private;

down a great number of enterprises, was unfounded. Even in 1992, at the peak of generalised insolvency, 67% of enterprises managed to save themselves with a reorganisation plan.

In the Czech Republic, the legislation was and still is less favourable to reorganisation. The legal conditions for opening the reorganisation are clear and extremely severe. Therefore, from a statistic point of view, only one out of one thousand cases finalised the reorganisation process.

In Poland, the situation is similar. The process for obtaining the Court approval for opening the reorganisation proceedings is pretty much inflexible. The number of the approvals was particularly low in the period 1990 – 2003. It has to be mentioned that the state-owned enterprises benefited from a different legal system, permitting their survival, in order to be ready for privatisation.¹⁵

Table 7. Reorganisation proceedings in several transition countries

Country	Period for realising the reorganisation plan	Reorganisation period	Conditions to be accepted by the creditors
Bulgaria	30 days	30 days	Simple majority and half of the total requests
Czech Republic	90 days (possible addition – 90 days)	30 days for valuing the assets	Simple majority and $\frac{3}{4}$ of the total requests
Hungary	90 days (possible addition – 60 days)	n/a	Simple majority and $\frac{2}{3}$ of the total requests
Poland	30 days from Court decision	n/a	Simple majority of $\frac{2}{3}$ of the debts
Slovakia	The plan must be elaborate and presented 15 days before the debtors' assembly	n/a	Majority of $\frac{2}{3}$
Romania	The plan must be elaborated within 30 days after the Court approval and verification	Maximum 3 years	Majority of $\frac{2}{3}$ of creditors' vote

Source: Balcerowicz et al., 2003

From the above table, one can observe that, even the acceptance conditions vary from a country to another; in most cases the majority of votes is needed, for avoiding to disfavour the creditors. Romania chose to limit the maximum reorganisation procedure, an example to be followed.

¹⁵ the situation was similar in Romania – see Ch. 3.2;

Another essential element of the reorganisation proceedings is the decision to change or not the management of the debtor enterprise. On the one hand, if kept in charge, the managers have the advantage of knowing the enterprise, from inside, better than an out-comer. Moreover, maintaining the management encourages the managers' preventive behaviour, co-interested in the success of the reorganisation process. Poland and Hungary chose such a modality, inspired by the USA model.

On the other hand, the experience demonstrates that the managers of debtor enterprises have the tendency to opt for desperate measures, often affecting the debtors. This is the reason for which in the Czech Republic or Romania, but also in Germany and other developed European countries, accepting the insolvency status automatically leads to replacing the managers with outside experts – liquidators or administrators.

Allocation of assets as a result of the insolvency status

If the reorganisation is not possible – the plan proposed is rejected by the creditors or the solutions for saving the enterprise are unrealistically – the insolvency process leads to liquidation. An efficient liquidation process has to accelerate the allocation of the assets, but also to find the best way to value the existing assets. One of the most important aspects of liquidation is the payment of debts, on priority criteria. For example, the real creditors or the secured creditor have priority compared to other categories of creditors. Prioritisation of the secured credits is based on the idea that the guarantees subscribed have exactly the role to facilitate collecting the debts, as well as to encouraging the credits.

In transition countries, the privileges for secured creditors are not similar to those from developed countries. For example, in Poland and Hungary, the privileges are not strictly respected. In both countries, the state's credits are privileged even if they are not secured. The main problem in respecting the secured credits is related to the fact that, by paying them, the enterprise can lose the key assets. Therefore, the option for reorganisation is negatively affected.

Table 8: Credits prioritisation

Country	Secured credits	Secured credits vs. unsecured credits
Bulgaria	Absolute priority	State-owned credits
Czech Republic	Relative priority, 70% are directly paid, 30%	State-owned credits

	becomes unsecured credits	
Hungary	Relative priority, 50% are directly paid, 50% becomes unsecured credits	State-owned credits
Poland	Within 30 days from Court decision	State-owned credits
Slovakia	Relative priority – a diminution of 30% may occur	State-owned credits
Romania	Relative priority, after state budget debts	State-owned credits

Source: Balcerowicz et al., 2003

As we can observe, in transition countries, the state has still an important word to say concerning the recuperation of budgetary arrears, passing out all the other secured credits.

Insolvency institutional framework in transition countries

Insolvency proceedings cannot be efficient without market economy institutions. For example, the legal system has to function excellent so that the insolvency declarations could be justly processed in due time.

The involvement of Courts in the insolvency process brings all the legal problems in transition countries. Important barriers are still persisting in various juridical systems from Central and South-Eastern European countries.

In the Czech Republic, some experts state that the more important implication of Courts slows down the insolvency proceedings. The judicial systems still face problems linked to their administrative capacity. Observing the lack of specialised personnel and the lack of minimal technical equipment, one can assert that the Courts from transition countries are overwhelmed and cumbersome.

One of the possible solutions is to involve more third-party neutral bodies, to deal with the procedural details. The first body is formed of insolvency experts, who can facilitate the Courts' obligations. The liquidation experts are remunerated for their activity by selling the debtor's assets, or by the state, if the debtor does not have sufficient resources. In some case, the experts are responsible for the result of liquidation and they are totally impartial.

Table 9: Insolvency experts in transition countries

Country	Required education	Remuneration	Responsibilities
Bulgaria	Only individuals – 3 years of relevant experience – public list	Flexible, fixed by the creditors' assembly	Exclusion of the list, fines and patrimonial responsibility
Czech Republic	The Court chooses from a public list of experts	Progressive compensation, related to the assets' value	Exclusion of the list, patrimonial responsibility, administrative penalties
Hungary	Public auction for listing, regulated professional profile	5% of revenues (liquidation) 1,5% of accounting value (reorganisation)	
Poland	University – accounting and management, 5 years managerial experience, public lists at the regional Courts level	Max. 5% of assets value, the Court fixes the remuneration, it can be paid in advance	
Slovakia	Regulated professional profile: only individuals with relevant experience, public list	Fixed by the Court, progressive official compensation related to the assets value	
Romania	Authorised accountant or economic, law, engineering, 5 years experience, public lists at regional level university degree	Flexible, fixed by the majority of creditors' assembly	

Source: Balcerowicz et al., 2003

We should remark that Romanian insolvency experts established a professional organisation playing a role in a new profession self-regulation – reorganisation and liquidation expert.

Figure 1: Organisation and regulation of liquidator institution in Romania

National Union of Reorganisation and Liquidation Experts (UNPRL) was established on 27th of November 1999. The Union activity is ruled by the Law no. 505/2002 for approving the Government Ordinance no. 79/1999 regarding the organisation of liquidation and reorganisation experts' activity and by the Rule of organisation and functioning approved by order of Ministry of Justice.

According to the law, the Union is juridical entity of public utility, autonomous and non-profit, members being the reorganisation and liquidation experts – judicial administrators and liquidators.

The members of the Union have the right to practice the activity of reorganisation and liquidation expert throughout the entire territory of Romania. By the Romanian legal system, only the Union's members can exert activities specific to voluntary liquidation operations, judicial reorganisation and bankruptcy operations. The premises of a new profession were created, by regulating the experts' activity, deployed individually or in professional commercial societies or remunerated by the profession. Starting with 2000, upon the Union request, the occupations of "judicial administrator" and of "liquidator" were included in Occupation Classification in Romania. *Source: www.liquidation.ro*

Even if the activity of reorganisation and liquidation experts is only at its beginnings in Romania, it is not unlikely for liquidators to have a more and more important role in the insolvency proceedings, going that far to be able to predict the difficult situations of enterprises and to have prerogatives in the anticipated commencement of the insolvency procedure.

A comparative analysis and the EBRD classification

The European Bank for Reconstruction and Development (EBRD) looks closely at the market exit process and it provides expertise for improving the bankruptcy procedure. The EBRD vision is in many respects concurrent with the World Bank or IMF recommendations, but EBRD is also involved in project-based financing aimed at supporting the transition process in 27 states from the Central and Eastern Europe (CEE) and from the Community of Independent States (CIS). This specific involvement is reflected by the significant financing EBRD provides to the private sector in the transition economies. Hence, the EBRD perspective on the insolvency procedure is somehow more favourable to creditors rather than to debtors.

In the EBRD vision, an insolvency procedure not only implies a strict legal environment, but also sustained efforts to implement it. As early as in 1997, the EBRD started a legislative survey focused on the perceptions of insolvency experts and

practitioners in the CEE and CIS states. The survey encompassed both the legal framework and the degree of its implementation.

The EBRD regarded the following as the key characteristics of a functional and effective insolvency system:

- ✓ The initiation and the duration of the procedure;
- ✓ The alternative solutions to liquidation;
- ✓ The management and activity of enterprises during the insolvency procedure;
- ✓ The prioritisation of creditors;
- ✓ The barriers to the implementation process;

Following its 1997 survey, the EBRD ranked the countries in which it operates in five categories, by the effectiveness of their insolvency procedure: fully effective, adequate, almost adequate, inadequate and fully non-effective.

Table 10: Countries' ranking by the degree of effectiveness of their insolvency system

Country	Fully effective	Adequate	Almost adequate	Inadequate	Fully non-effective
Czech Rep.		X			
Hungary		X			
Estonia		X			
Poland			X		
Romania			X		
Bulgaria		X			
Slovak Rep.			X		
Russia			X		
Ukraine				X	
Albania					X

Source: EBRD Legislative survey, 1999

In the following years, the results of the EBRD survey were not radically different, as only small changes occurred. It is noteworthy that for most of the countries which received the “adequate” rank, Romania included (Romania has recently advanced to the “adequate” rank), the ranking was higher for the bankruptcy legislation as such, than for its effective implementation. Therefore, one of the findings of the EBRD survey is that the setting of the insolvency legal framework (design, priorities, specific features) is often less important than the effort to implement that system.

To complement its legislative survey, the EBRD recently undertook another investigation, focused only on the legal dimension of insolvency, and not accounting for its implementation process. Using the expertise of its local experts from 27 transition economies, the survey reviewed the bankruptcy legislation based on its compliance with

a number of specific criteria considered by the EBRD methodology. The approach was a functional one, as it started with assumption that a bankruptcy legislation should fulfil some main roles, most important of these being: providing for alternative solutions (e.g.: liquidation or reorganization), offering both the creditor and the debtor the freedom to choose between those options, and providing for an effective and fast administration of the entire procedure. Furthermore, the EBRD methodology defined five critical elements for insolvency legislation:

- ✓ The initiation of the procedure and its effects;
- ✓ The existing assets;
- ✓ The involvement and prioritisation of creditors;
- ✓ The reorganization process
- ✓ The full liquidation/bankruptcy procedure

Apart from these five key elements, the EBRD report also looked into the perception of the insolvency process' actors, because the insolvency legislation must be clear to them in the first place, without uncertainties and with easily projected juridical effects. The legislation surveyed was that valid as of January 1st, 2003.

Table 11: The degree of fulfilment of the EBRD principles

Degree	Country
Very high	None
High	Albania, Croatia, Moldova, Romania, Serbia and Montenegro
Average	Bulgaria, Czech Rep., Estonia, Poland, Russia, Slovakia etc.
Low	Armenia, Belarus, Hungary, Latvia, Slovenia etc.
Very low	Bosnia-Herzegovina, Lithuania, Ukraine etc.

Source: Insolvency law assessment project, EBRD 2003

A detailed analysis of the fulfilment of the elements EBRD considers as critical for an effective insolvency procedure, indicates that the provisions of the Romanian legislation are clearly above the transition economies average.

Generally speaking, the Romanian legislation¹⁶, even if it does not fulfil all EBRD criteria, is nevertheless evaluated with the maximum mark among the 27 countries surveyed. It is also surprising the large difference between this survey and the EBRD legislative survey mentioned before. As the methodological difference between the two surveys is that the first one also accounts for the effective implementation of the

¹⁶ As of January 2003 (Law64/1995 republished in 1999, and modified by OG 38/2002, but without considering the Law 149/2004);

legislation, it reinforces the conclusion that Romania's problem is not one of legislative design, but rather one linked to the effective implementation of the existing legislation.

2.5 Legal framework for bankruptcy from the point of view of the *acquis communautaire*

The main benchmark at the European Union level for bankruptcy area is given by Council Regulation (EC) 1346/2000 of 29 May 2000 concerning insolvency proceedings. The Regulation is already applicable to all Member States, being in force since 31 May 2002.

Seeing that entrepreneurial activities have more and more cross-border components, the European Union had to regulate, at Community level, more and more aspects related to business environment. As the market-exit proceeding can affect the Internal Market, it was necessary to adopt a Community act in order to coordinate legal provisions related to assets of insolvent debtors. It is also obvious the fact that, if the assets management would be different among Member States, it will lead to transfers among EU countries, infringing the principles of common market.

EC Regulation is the outcome of over 40 years of analysis and practice and by its 47 articles enforces the international jurisdiction of a court from one Member State, aiming at opening the insolvency procedure, automatic recognition of proceeding in the other Member State, as well as at cross-border acknowledgement of “liquidator” rights.

Subsequently, we will present the main characteristics of insolvency proceedings at Community level, as defined in EC Regulation.

Field of applicability

The field of applicability of EC Regulation is defined in Art. 1 (1) which stipulates that for recognise an insolvency proceeding at Community level, four criteria are needed in a cumulative manner:

1. The proceeding must be collective, so that all creditors involved can solve their requests only on the base of this procedure, individual actions not being allowed;
2. The proceeding must be initiated by the debtor state of insolvency and not by other reasons. Testing the debtor insolvency should be done in conformity with the legislation of the state where the proceeding is opened;
3. The proceeding should entail the partial or total divestment of the debtor. Forbidding the right of administration is one example;

4. The proceeding must appoint a “liquidator”. In fact, this request is a logical consequence of the previous condition. The transfer of prerogatives from debtor to liquidator is done in order to control the debtor’s shares, in terms of preventing any decision that could negatively affect the degree of creditors’ reimbursement.

In order to apply the EC Regulation, the above conditions are not sufficient, it is also necessary to be in accordance with one of the national procedures listed in Annex A and Annex B. Thus, only the procedures of the member states mentioned in Annexes can benefit from the EC Regulation.

The main objective of the EC Regulation regarding insolvency is to be contained by a Community law measure, generally applicable, binding for all debtors, whether the debtor is a natural person or a legal person, a trader or an individual. As an exception, the insolvency Regulation does not apply in the case of financial institutions¹⁷ (Wessels, 2003).

The Regulation stipulates that the jurisdiction is the charge of a national court from the Member State where the debtor has the centre of its main interest, or its headquarters as a legal entity. The other states would have jurisdiction only if the debtor has an establishment on their territory.

The Regulation establishes the juridical framework regarding the law that should be applied, replacing the common provisions of private international law.

Article 4 of the Regulation emphasises that, as a rule, the law of the state where the proceeding is opened should be the applicable law (*lex concursus*). There are also exceptions of the rule, for specific cases stipulated in the EC Regulation.

Table 12: Exceptions for applicability of law (others than *lex concursus*)

Object of the exception	Applicable law
Contracts related to immovable property (art.8)	Law of the Member State within the territory of which the immovable property is situated. (<i>Lex rei sitae</i>)
Rights and obligations of parties to a payment or a settlement system or to a financial market	Law of Member State applicable to that system or market

¹⁷ Insolvency proceedings for insurance companies are stipulated by Parliament and Council Directive 17/200 (OJ L 110, 20/04/2001), and for credit institutions regulations are given by Parliament and Council Directive 24/2001 (OJ L 125, 05/05/2001). Unlike the regulations, the directives should pass through a legislative implementation in each Member State of the EU. The deadlines for implementing these Directives were 20 April 2003 for insurance companies and 5 May 2004 for credit institutions;

(art.9)	
Contracts of employment (art. 10)	Law of Member State applicable to the contract of employment
The debtor rights over the immovable properties, ships or aircrafts subject to registration in a national register	Law of Member State under the authority of which the register is kept
Debtor acts concluded after the opening of insolvency proceedings, in order to protect third-party purchasers	Law of Member State within the territory of which the property is situated or under the authority of which the register is kept
Effects of insolvency proceedings on lawsuits pending	Law of Member State in which the lawsuit is pending

Source: Wessels, 2003

The EC Regulation regarding insolvency proceedings is an important step ahead in establishing a juridical framework in order to facilitate interactions and harmonisation of different systems of insolvency in the EU. Given the diversity of bankruptcy legislations (see Chapter 2.1. Legislative types) it is clear that their harmonisation at Community level for creating an unique bankruptcy proceeding would be totally unpractical.

Thus, the aim of the Regulation is to replace the various bilateral agreements of mutual recognition of bankruptcy proceedings, and not to standardize a type of proceeding.

But the Regulation has also some weak points. Despite the fact that the Regulation is binding effect, being directly and unconditionally applicable to Member States, most of them have to amend the internal law of insolvency in order to implement the provisions of the Regulation. The need for these amendments denotes that we cannot yet discuss of a total and veritable harmonisation in the insolvency area at Community level. Member States do not show much interest to bring into line their insolvency legislations, following their own policy in the field.

Furthermore, the territorial limit of Regulation applicability – only at Community level – it is an important shortcoming, especially in the context of business globalisation. Therefore, a global regulation for cross-border insolvency is desirable. Six years ago, a world standard was developed in cross-border cooperation field, called UNCITRAL Law Model for cross-border insolvency. Even if the Law Model does not have a binding character, it has as main objective to stimulate the harmonisation process of national insolvency laws.

The implementation of UNCITRAL Law Model is supported by international institutions, such as the World Bank, the IMF or the Asian Bank for Development. The solutions provided by the UNCITRAL Model seems to be optimal for the present circumstances. According to Art. 3 of the Law Model, the international obligations of the states adopting this law are respected, which means that the provisions of the EC Regulation are still applicable, while the juridical framework proposed by UNCITRAL would regulate the system of relations between the EU Member States and third countries.

Harmonisation of Romanian legislation with EC Regulation regarding insolvency

The Romanian legislation was mostly harmonized with the provision of EC Regulation no. 1346/2000, by adopting the law no. 637/2002 regarding the international law practices in the insolvency area and by the recently adopted law no. 149/2004 regarding judicial restructuring and bankruptcy.

Law no. 637/2002 defines the applicable law in international civil law relations for insolvency, proceedings to be followed in such cases, as well as cooperation proceedings between Romanian authorities and the international one in order to solve international and European insolvency cases.

2.6. Recommendations of good practice in European insolvency field

In March 2000, Lisbon European Council established as strategic objective for European Union to become until 2010 “the most competitive and dynamic knowledge-based economy in the world”. In this context, the European Commission was given the mandate to initiate an open cooperation for helping the Member States develop their own economic policies. The methodology of the cooperation process establishes a series of recommendations at European level, in order to reach specific objectives within the deadlines, recommendations to be transposed in regional and national laws customized to local conditions.

Thus, at the Feira European Council, in June 2000, the Charter of Small Enterprises was adopted. It emphasizes the importance of market-exit process for economic competitiveness and it considers necessary an evaluation of national bankruptcy legislations for underlining the good practices, as model to be followed.

Enterprises Directorate – General from the European Commission created a methodology known as the best procedure, based on coordination process mentioned above. The proposed methodology consists in analysing the elements identified as essential for reaching the objectives of Lisbon Agenda and in defining the benchmarks & performance indicators, actual status and operational targets for improving the present situation.

In this context, in 2002, in the field of insolvency and bankruptcy was launched a project named “*Restructuring, Bankruptcy and a Fresh Start*”, aiming to evaluate the way to be followed for optimising the market-exit proceedings at European level.

The project was finalised in September 2003 and it resulted in a series of recommendation and observations. They are not binding but they could be considered part of the so-called *soft acquis*, meaning that the recommendations should not be ignored in order to reach the common goals of the *acquis* itself¹⁸.

Mainly, the recommendations mentioned above aim four broad action lines:

1. Early warning;
2. Legal system;
3. Chance for a new beginning;

¹⁸ Romania has signed at Maribor the European Charter for Small Enterprises and it is interested in preparing in advance for the Lisbon Agenda, in the view of becoming a Member State in 2007;

4. Social attitude.

Regarding the early warning, the main recommendation made by the experts reunited under the aegis of Enterprise Directorate – General of the European Commission was to create mechanisms or institutions to counsel entrepreneurs, for early prevent the bankruptcy. At the same time, it is very important to have transparent information on alternatives to be followed in financial crises.

The recommendations regarding the legal system aims to streamline and speed up the insolvency proceeding, so that the entrepreneurs not to be discouraged by the idea of bankruptcy. Obviously, in possible, a grater stress should be put on judicial restructuring which would save the firms temporarily found in difficulty.

Also, the recommendations highlight the importance of giving a new chance to those entrepreneurs which gone bankrupted due to a general unfavourable context and not to intentional prejudices. As a result, it is recommended to eliminate any barriers which can lead to discrimination between entrepreneurs gone bankrupt in their trial to start a new business. A study asked by the European Commission and done by Boston Consulting Group shows that the entrepreneurs with a bad experience in terms of bankruptcy have more success in second business than the entrepreneurs having their first business.

Last, but not least, the recommendations sustained by the European Commission illustrates the necessity of eliminating the social stigma related to bankruptcy. Therefore, the market-exit through bankruptcy should be regarded as a normal step in the life of any economic agent, being a good act for the market and for the economy, as it makes available resources that re-enters in a short time in the economic cycle and they could be used in a more efficient way.

For each of these action lines, specific measures are proposed. They are, more or less, defined in concrete terms, but they are sustained by examples of good practice from the EU Member States.

For Romania, the study coordinated by the European Commission suggests that there should be taken action in the following domains:

- ✓ Entrepreneurs information regarding the bankruptcy proceeding and its implications, as well as the access to counselling, in acceptable conditions, for financial difficulties and ways to be followed;

- ✓ Transparency of accountability information and of financial data that would allow signalling the financial health of firms;
- ✓ Through available trainings, to promote the new beginning for entrepreneurs gone bankrupt, to change the negative mentalities at the address of economic agents involved bankruptcy processes;
- ✓ In the final decision of the syndic judge, it should be mentioned the “pardonable behaviour” of entrepreneurs bankrupted due to external causes, and not due to their detrimental behaviour.

3. Romania: where do we stand?

3.1. The regulatory framework of bankruptcy

Romanian legislation regarding bankruptcy has suffered many substantial changes after 1989. Presently the regulatory framework is provided by Law No. 64/1995 regarding the proceedings of judicial reorganization and bankruptcy, with the subsequent additions and modifications, of which the most important are: Law No. 99/1999, Law No. 82/2003 for the approval of GO 38/2002 and Law No. 149/2004.

In fact, the last regulatory modification is has been enacted very recently: the Law No. 149/2004 is in force since May 12th 2004¹⁹. This law has been anticipated for quite a while, as it is the result of the approved law draft (PL 322/2003), which was forwarded to the Chamber of Deputies by the Ministry of Justice in 2003.

The debates concerning bankruptcy are related to several EU accession negotiations chapters, such as Free movement of services, Competition Policy and Enterprises Law.

Consequently, if we want a dynamic view of the legislative development regarding insolvency and bankruptcy in Romania it would be useful if we refer to three legislative reforms:

- the legal framework until 2002, provided by the old version of Law No. 64/1995, consolidated and republished in 1999 after the approval of Law No. 99/1999;
- the legal framework during 2002-2004, which contains the modifications introduced in 2002/2003 by GO 38/2002 (approved by Law No. 82/2003);
- the current legal framework defined by the modifications introduced by Law No. 149/2004.

The methodology for the analysis of the legislation regarding bankruptcy is not concordant, but there are similar research fields among insolvency law experts, similarities that produced important foundations on which the investigation of the efficiency of a certain legal framework can be based. In the following we will refer, in

¹⁹ Published in the National Gazette of Romania No 424 May 12th 2004;

a more or less random order, to the key aspects of bankruptcy legislation, but this time by way of direct explanation of legislation in Romania.

The first question that arises when we analyse the bankruptcy legislation in Romania is undoubtedly connected to identifying **the purpose of this type of legislation** from the point of view of public policies. The European Bank for Reconstruction and Development (BERD 2003) recognized three possible instruments for bankruptcy legislation.

1. The policy of the new beginning – which allows the honest but bankrupt entrepreneur to restore his business, by cutting back his liabilities due to the misfortunes encountered by his previous affairs
2. The policy of equity – which promotes the even distribution of the bankrupt debtor's possessions among creditors.
3. The rescuing policy– which disposes the restructure and rehabilitation of an enterprise in order to preserve the employment, reimburse creditors, bring profit and produce value.

Although Romanian legislation secures the *de jure* framework for the fulfilment of these three economic policies purposes, the previous experience shows that the practice of bankruptcy in Romania has been focused more towards the rescuing policy, concerning particularly the fate of recently insolvent state enterprises (see 3.2 Insolvency, bankruptcy and the State as a shareholder and creditor).

A second problem refers to procedural details as part of the legal framework. In this respect, a debate arises on the bankruptcy initiation proceeding. At the moment, the reorganization/bankruptcy proceeding in Romania can start with the petition forwarded by either the insolvent commercial agent himself or by the creditors in the following situations:

- creditors have not been paid for at least 30 days;
- the commercial agent's debts that arise from work or civil actions are larger then six national average wages as determined by law;
- the commercial agent's debts that arise from commercial activities exceed 3000 euros²⁰.

²⁰ The minimum amount of commercial debts that can get the bankruptcy proceeding started has been recently reduced by Law no 149/2004 from Euro 5000 to Euro 3000. This is a welcomed change, in the

It is important to mention that Romanian legislation does not contain legal premises for the automatic initiation of bankruptcy, similar to other European countries that had or still have such stipulations. In Romania the proceeding begins only on the premises of a petition forwarded by the debtor or creditors.

A third important problem in the analysis of the legal framework regarding insolvency and bankruptcy is the choice between liquidation and judicial reorganization. As we earlier anticipated, this choice may be founded on different economic policy priorities. In conclusion, it is important to achieve a balance between protecting creditors' interests and supporting the reorganization, favourable to employees.

The European and international trend is to modify the bankruptcy legislation towards encouraging the judicial reorganization process²¹. In Romania, proposals seem to be oriented exactly the opposite way, encouraging the creditors. The explanation of these proceedings is based on our country's previous experience, which shows that the practice of judicial reorganization hasn't been a success solution in many cases. On the contrary it transformed itself in a very strong barrier to market exit, with negative implications on both creditors and structural reforms.

According to the last regulatory changes introduced by Law No. 149/2004, the maximum period for carrying out the judicial reorganization, in the event of its approval, has been shortened from three to only two years. At the same time, a greater control is secured over the liquidators and administrators in order to avoid abuses and uneconomic behaviour.

Beyond current or future procedural regulations, it is important to emphasize the fact that through liquidation, non-competitive commercial agents that due to business cycles or to their own managerial deficiencies are not able to perform a lucrative activity are removed from the market. Liquidation plays a role in the improvement of the market economy and the smoothing of commerce, something that for the Romanian economy's present stage and also in view of European integration is not only necessary, but indispensable for a good development of its market economy. In these circumstances the

sense that it will impose either a greater severity in the payment of obligations, either it will lead to the more rapid market exit for agents that cannot pay their debts;

²¹ One of the reasons behind this world-wide reorientation is the fact that through reorganizations certain untangible assets, that in the case of bankruptcy would have disappeared, can be kept (Hart, 2003), but also section 2.1 Legislative typologies;

role liquidation plays must be properly understood and must be separated from any negative connotations that our society might have imposed on it.

In the context of Romania's likely EU accession (2007), we can appreciate that the tendency to prefer liquidations, in the detriment of judiciary reorganization, could prove to be a mere transitory phenomenon. The trend could reverse when the legal system will be more efficient, administrators and syndic judges more competent, the institutions authorized to intervene stronger – in order to re-establish the trust in the proceeding of judicial reorganization. More so, it is not stated that the reorganization has to be enacted at all costs, it must not allow (see 1.1. Principles, goals, effectiveness) the rescue of untenable companies – and in Romania there still is a large number of such companies.

In addition, Romania is in the process of adapting to the UE procedural standards (EC Regulation 1346/2000), and, as the legislative reform at the community level progresses (see 2.1.), if it will take place, it will probably try to adapt to the new practices in adjacent fields, for example, corporate auditing.

Figure 2: Case studies – partial liquidation and sale as a consequence of bankruptcy

The liquidation of the enterprise EUROBIOFORT SA.

The bankruptcy procedure for EUROBIOFORT SA was initiated in 1998 at the request of BANCOREX SA. The court named C Reconvertire și Valorificare Active SA (presently Moore Stephens RVA SA) as liquidator, which together with the executive management of the company, has succeeded in conserving the companies' assets as well as the productive activity at the level of solvable clients and profitable economic contracts. Based on Law No 64/1995, in the year 2001, liquidator has organized the auction for the sale of fixed assets, terrains, small assets, sale of goods at a value of ROL 1930 million. This has enabled the company to continue its activity, to keep its employees and to reduce its debts. At the end of the year 2001, the company had total revenues of ROL 9,5 billion and gross profit of ROL 20 million. (Source: www.rva.ro).

The judicial liquidation of SC SUINPROD SA

SC SUINPROD SA Popești Leordeni is a centre for rearing and growing pig, placed on the Bucharest beltway. Total area is around 16ha. The centre consists of two small slaughter houses, stables etc. At the moment of bankruptcy, the company had outstanding debts of around ROL 22 billion, its activity being stopped in 1994. As part of the liquidation strategy, the judicial liquidator has chosen to sell the entire complex. He focused on finding a specialized investor that might be interested in re-launching the activity and making it efficient. Due to the efforts of the liquidator, the company was sold at an auction for USD 400000 to the company PICOVIT ROM SRL București. Currently there are over 20000 pigs at the new owner. The company mainly supplies Bucharest City. Out of the resulting revenues, over 80% the fiscal debts were paid and the centre was put to use by the Romanian meat-processing sector. (Source: www.rva.ro)

3.2. Insolvency, bankruptcy and the State as a shareholder and creditor

A key point that cannot be overlooked by the analysis of insolvency and bankruptcy in Romania is the investigation of the State's behaviour as a shareholder and/or creditor. In a transition economy, such as the Romanian economy, the state partnerships and liabilities are mostly related to the privatisation process and the restructuring of public enterprises, as we already noticed in the analysis on the transition countries (chap. 2.4).

On one hand, there is a number of enterprises that are non-competitive, that cannot be privatised and constantly produce losses as they are kept floating by state support. The political decision to keep some enterprises in public hands, because of their strategic importance or in the hope of a future restructuring and privatisation deal has direct consequences on the avoidance of initiating proceedings of insolvency.

On the other hand, the enterprises that have been privatised sometimes encounter difficulties, generating post privatisation pressures so they still receive support or even be bought back by the state. In all these situations the enterprises register important debts to the state, debts that at a macroeconomic level are translated into significant arrears.

The avoidance of bankruptcy through the artificial preservation of enterprises in the business environment is the result of the weak budgetary constraint policy that has contributed to the overall lack of fiscal discipline in Romania. Besides the negative consequences on the business environment, proved by disloyal competition between the honest entrepreneurs that pay their debts and those that create arrears, there are negative consequences at the macroeconomic level too, particularly regarding the budgetary deficit, the fiscal collection process and external deficits²².

The fact that the state's policy as a creditor is ambivalent is puzzling. The State either plays the part of the benevolent parent, accepting the errors and the lack of competitiveness of some enterprises and overlooking their debts or suddenly flexing its muscles in order to prove that the state's objectives come first by emphasizing the importance of immediate return of public debts.

Unfortunately, this *Ianus Bifrons* type of policy, in other words the one where the state changes its appearance according to political and social circumstances or as a result

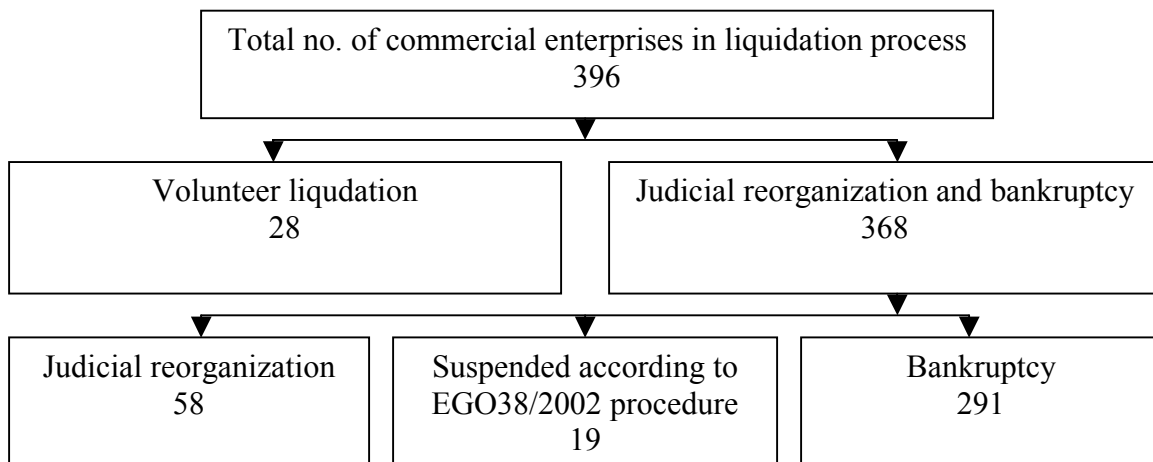
²² The arrears cause internal demand, and implicitly the deficits, to 'swell';

of external institutional pressure, entails negative consequences that transform the state in a special market player that does not obey common law.

In other words, it is enough for the State to decide that an enterprise must not go bankrupt in order for this enterprise to be rescued without any economic motivations and without a transparent proceeding that might be applied to other similar future events. We deal here with a discretionary selection, meaning that the choice of saving enterprises is made on an individual basis and does not follow any distinct objectives of an economic policy.

For example, the Activity Report of APAPS for 01.01.2001-10.11.2002 (APAPS, 2002) clearly mentions the institution's objective to articulate special requirements, which would allow a fast reconsideration of the privatisation process and, in extreme situations the annulment of some contracts in order to prevent the enterprise's degradation or the initiation of bankruptcy process. This discretionary state decisions whether or not to avoid bankruptcy has a negative impact on Romanian economic competitiveness.

Figure 3: The position of APAPS portfolio commercial enterprises registered to be liquidated at 30.04.2004



Just the same, at the other end, when the state is the creditor, the law that applies is an exceptional one. The Romanian bankruptcy legislation doesn't differentiate between particular creditors and the state as a creditor. Bankruptcy is a common proceeding with a syndic judge acting as an arbiter and seeking to reimburse creditors according to their liabilities. But, if the State is one of the creditors, it creates an exceptional position for itself, defending itself from the other creditors using the two agencies APAPS and AVAB

recently united as AVAS to create regulations that go beyond the judicial framework settled by The Ministry of Justice.

Liquidation and bankruptcy of APAPS' portfolio enterprises

The Romanian government, via APAPS, found three ways to solve the situation of unattractive APAPS enterprises that do not have a chance of total privatisation: volunteer liquidation, judicial reorganization and bankruptcy.

Volunteer liquidation is a solution that shareholders can use when there are no possible means to restructure and to stop the deterioration and depreciation of actives²³.

The State as a main shareholder decided to initiate the dissolution and volunteer liquidation proceeding for 123 enterprises between 1994 and 30.04.2004. The results have been quite poor as after 9 years only 51 enterprises have exited the market. As for the rest, 36 enterprises have been forced to start the judicial liquidation process, 2 companies were saved through privatisation, 6 enterprises have been transferred to the relevant Ministries, while 28 companies are still caught up in the volunteer liquidation proceedings (APAPS, 2004). Cancellation period included, the average period of liquidation is 3 years, but in practice there are situations where the proceedings started more than 5 years ago (ex. SC Archim SA Arad – 8 years; SC Integrata de In SA Botosani – 7 years) (APAPS, 2003). Major delays are due to lingering litigation whether the enterprise is the plaintiff or the offender.

The volunteer liquidation is supposed to be the easiest way to dissolve non-competitive companies, but complicated administrative and judicial proceedings combined with a lack of strong political determination led to a costly quasi-failure.

The other two options APAPS has in order to better use the State's assets, judicial reorganization and bankruptcy, are under the common law concerning insolvency. Common law is mainly settled by Law No. 64/1995 and its subsequent revisions. For these two situations, judicial authority prevails over politic decisions. Given the circumstances, APAPS observes 902 commercial enterprises that presently deal with the proceedings of judicial reorganization and bankruptcy. Only 368 are part of APAPS portfolio, whereas for the rest of them, APAPS is solely a creditor (APAPS, 2004).

²³ The legal framework for this procedure is given by Law 31/1990 republished, Law 137/2002 and its implementing norms approved by GD 577/2002, and by Law 44/1998 approving EGO 88/1997;

Among the APAPS portfolio enterprises, considering that the State is the main shareholder, 310 companies started the bankruptcy proceedings, while judicial reorganization has been initiated for only 58. It is interesting that for 19 companies that were on their way to bankruptcy the Government forwarded requests for the suspension or delay of proceedings in view of last minute privatisation. This was allowed by the derogation stipulated in the Emergency Government Ordinance No. 32/2002. This practice highlights again the selective policy of the Governments that enjoys privileged judicial approach. Liquidation executors assert that bankruptcy law is “crippled” by Executive interference if the company is state propriety or most of its debts are budget oriented. Emilian Radu, the former UNPRL executive, explains that the Government can always come up with new ways to elude the standard proceeding, and this happens because of the initiation of the special administrative framework when new privatisation options arise²⁴.

Out of 500 companies in liquidation proceedings that APAPS has credited, 254 have been transferred to branch ministries such as MAAP, MFP or MTCT, and therefore comply with their administrative and procedural jurisdiction. At the same time, 240 commercial enterprises portray failures of the privatisation process. In other words, these companies are privatised state enterprises that subsequently initiated the bankruptcy proceedings. The other 40 companies place themselves as APAPS shareholders, but in the end they start liquidation proceeding.

Between 1997-April 2004, APAPS was creditor for 1200 companies facing judicial reorganization or bankruptcy, while the total debts reached ROL 2650 billion and USD 70 million. Out of this total, APAPS managed to recover ROL 500 billion, which means a return percentage of 10% of lei and dollar debts together. This percentage needs no further explanation; it represents the generated loses. Once more, given the depreciation of assets in most enterprises that are still supervised by APAPS, it is very likely that this return percentage will not be significantly improved.

²⁴“Bankruptcy proceedings will be immediately suspended if the companies in question are affiliated to special programs or buying intentions are declared. The liquidation agent packs his bags, the creditor have to wait. Will they buy it? ... A buying intention can be fabricated even by the company’s administrator, he can ask his American friend Bob: Please Mr. Bob could you send a buying offer, and this is how we waste another 6 months...” Former UNPRL president’s allegations, daily paper Adevarul quote;

3.3. Insolvency, bankruptcy and state-aid policy

State-aid in Romania

An important aspect of our case on bankruptcy in Romania is the situation of public enterprises that prove to be non-competitive and become insolvent. In various such situations, the government has intervened through state support schemes in order to keep those companies on the market.

In general, we can easily notice that the state-aid volume is very high in Romania, up to 6% of GDP for the latest year for which we have data (2001²⁵). Moreover, it seems to rise in both absolute and relative numbers, in other words it evolves in the exact opposite direction to the European integration process.

Table 13: State aid in Romania, 1998-2001

	1998	1999	2000	2001	Trend
Billion Euro	1,2	1,5	1,6	2,8	↗
% GDP	3,1	4,4	4,1	6,3	↗

Source: Competition Council (2003)

If we would decide to ignore the SIDEX privatisation, then the total amount of state aid would rise to only 1.8 billion Euros in 2001, or 4.1% of GDP. SIDEX is doubtlessly an exceptional case of state support, it took place only once (we refer to the exact moment of privatisation); but the effects will prevail for more than one year (except the conversion of debts into shares, where the different facilities extend up to 3-5 years), and more important, this special bargain is not an isolated situation.

Regarding the nature of state support, it seems that the portion of income concessions has risen, such state support like deductions and discounts have substantially grown. Indirectly this shows a chronic incapacity of payment of long overdue debts. In a functional market economy these companies would already face liquidation proceedings. On the Romanian market, though, they persist despite the macroeconomic consequences: contribution to budget and current account deficit, hidden unemployment, negative example and unlawful competition.

²⁵ Analysis is obviously biased due to lack of data for 2002, but these data haven't been made public yet.

Another way to prevent public companies from bankruptcy is converting their debts into shares: if it were not for this conversion into shares that are subsequently sold below the nominal value – as a method of privatisation - probably no investors would have been interested in taking over the big public loss-making enterprises.

Table 14: State aid structure, according to its type

	1998	1999	2000	2001
Total, % out of which:	100	100	100	100
Income concessions	42,5	54,1	69,2	52,9
- Deductions and discounts from fiscal duties	11,7	10,1	15,0	6,0
- interest rate for budget credits	0,7	0,8	0,6	0,9
- deductions and discount from penalties	10,6	27,6	38,7	38,0
- state warrants	19,5	15,6	14,9	8,0
Budget expenses	57,5	45,9	30,8	47,1
- subsidies, allowances and subsidized interest rate	43,5	39,0	25,6	27,6
- debt conversion	14,0	6,9	5,2	19,5

Source: Competition Council (2003)

On the other hand, the Government is both creditor and debtor at the same time and will not attain its goals unless it weakens the budgetary pressures and if the new investor manages to turn the enterprise to profit. A recent study (Voinea, 2003) shows that SIDEX is one of these fortunate examples (Table 15) but so far, this is a particularly isolated event. Debt conversion and exemptions from fiscal duties have been largely used in 2003, for companies like Tractorul, Roman, Aro, Siderurgica, Tepro, but it is too early to make any assertions in this direction.

Table 15: The net effect of state aid in LNM Group taking over SIDEX.

Earnings, billion. USD		Loses, billion USD	
The acquisition price	70	Erased debts (by conversion into shares, and selling the shares for 9 cents a dollar)	770
Losses under the government annual management	300	Interest rate for older than 3 years social securities	15
3 years aggregates	900	Compensations for laid-off employees (payable until November 2004)	47
Total	970	Total	832
Net effect	Positive, starting with the third year after the acquisition (2004)		

Source: Voinea, 2003

Whereas the state support for local objectives or fishery and agriculture is of high importance in the EU, this is not very significant in Romania. On the contrary, most of state support goes to horizontal and sector based objectives, mainly the manufacturing industries (51.3% of total amount of state support in 2001).

Analysing state aid for horizontal objectives, the first noticeable aspect is that of substantial aid for restructuring and rescue (approx. half a billion euros in 2001, meaning more than half of horizontal state support). Restructure and rescue assistance is the one that disguises bankruptcy and prolongs the agony of state companies. This assistance does not include the costs of privatisation preparations. These are called “other objectives” and add up to 11% of total state support in 2001 (descending from 25% in 1999).

Just as unfortunate is the fact that horizontal objectives, especially the pro-active ones (research and development, professional training) encouraged by European legislation are completely neglected in Romania (Table 16).

Table 16: The structure of state-aid depending on final objectives, in million Euros

	1998	1999	2000	2001
Agriculture and fishery	82,8	115,6	242,3	145,7
Horizontal objective, of which (selective):	761,4	872,9	950,6	834,7
- saving - restructuring	203,3	464,7	451,5	472,9
- research-development	1,5	5,6	8,8	7,4
- professional training	8,3	0,0	0,0	0,0
Sectoral objectives, of which:	321,5	462,8	400,6	1717,7
- steel	12,5	30,3	69,7	1078,4
Regional objectives	0,0	37,0	40,3	84,0

Source: Competition Council (2003)

More so, the state-aid intended for saving and restructuring companies are on an increasing trend both as part of the horizontal objectives, as well as in total state-aid. For this second statement, we have revised the Council of Competition data by categorizing the measure of cancelling the SIDEX debts as a rescue-restructuring measure, which in fact it was. It can be observed that the sector based state-aid for steel has strongly departed in 2001 from its previous level, and it is natural to include that cancellation (conversion) of debts in the category of rescue-restructuring because it was part of a privatisation agreement in the absence of which SIDEX would have still been on the verge of bankruptcy.

Table 17: State-aid for rescue-restructuring

	1998	1999	2000	2001	Trend
% of state-aid for horizontal objectives	26,7%	53,2	47,5	56,6	↗
% of total state-aid	17,4	31,2	27,6	17,0	→
% of total state-aid, revised estimate	17,4	31,2	27,6	44,6	↗

Source: adapted from the Competition Council (2003); for the revised estimates, the data in Voinea (2003) were used.

The rescue and restructuring state-aid measures are liked by the EU only in a few very specific situations, and only as an exception (not as a rule). Thus, referring to rescue packages in the EU:

- are granted as guarantee or loans at a market interest rate
- are limited to the amount strictly necessary for the survival of the company
- are granted only once
- have to be justified by serious social issues and must not entail negative effects for other member states

Regarding restructuring aid in the EU:

- it has to be founded on a viable restructuring program
- it must not distort competition (compensation measures are applied, such as productive capacity reductions)
- are limited to the minimum necessary amount
- are granted only once
- are closely monitored

In Romania, the most disregarded rule is probably the one referring to the single occurrence of state-aid: far from being granted only once, there are numerous cases in which the state-aid has been recurring – for example, failed privatisations, in which facilities like cancellation of debts and debt-for-share swaps were offered at the beginning of the privatisation process, the state finding itself anew as a majority shareholder (the most recent case is Rafo Onești); or granted on a regular basis – as it is with the perpetually loss-making public companies.

But the rescue-restructuring aid is not the only field in which Romanian practices are out of line with the EU norm. Table 18 reflects other discrepancies.

Table 18: State-aid characteristics, comparison between Romania and the EU

	Romania	EU 15
% of GDP, yearly average 1998-2001	4.5	1
Trend 1998-2001, total aid	Increasing	Decreasing
Trend 1998-2001, aid for manufacturing, absolute volume/number of employees	Increasing	Decreasing
Priority objectives (excl. agriculture)	Sectoral	Horizontal
As part of horizontal objectives, greatest weight represented by:	Saving-restructuring	SMEs and research and development

Thus, in the period 1999-2001 the manufacturing industry has benefited from an average of 42,3% out of total state-aid, compared to 22% in the period 1997-1999; in the EU, the respective average has decreased from 31% in 1997-1999 to 27% in 1999-2001. The preferred type of state aid for the manufacturing industry in Romania, namely reducing and cutting the payment delay fines and the relevant fines, represent 55,8% of total state-aid in Romania in the period 1999-2001, compared to 0,5% in the EU. In addition, in the EU the yearly total of state aid per employee in the above mentioned sector has decreased constantly, from Euro 1123 in 1997 to Euro 710 in 2001, while in Romania it has increased constantly, from Euro 202 in 1997 to Euro 799 in 2001.

Regarding the horizontal objectives, in the year 2001, the EU has granted 22,1% of the total amount to SMEs, this compared to 2,1% in Romania; 19,1% for research and development, compared to 0,9% in Romania; 18,0% for environmental protection, compared to 1,5% in Romania.

Romania's situation, although unsatisfying, is not unique; other transition countries are faced with the same problems. As we can see from chapter 2.4, and from Annex II, Poland is in a similar situation.

In the context of the approaching final negotiation with the EU, the following realizations are of great concern:

- state-aid, in stead of being a decreasing phenomenon, is increasing²⁶. Although it should be mentioned that here we are considering both direct support (budgetary subventions) as well as indirect assistance (rescheduled debts, etc).
- as part of state-aid, the relative weight for rescue and restructuring is increasing, rather than decreasing. This situation is indicative of a possible mass-bankruptcy phenomenon in several sectors. From here derives the fear of many companies of the rigorous implementation of competition policy;
- as part of state-aid, the relative weight of penalties exemptions and reductions is increasing, showing a generalized inability to pay the long-overdue debts (premise of bankruptcy);
- as part of state-aid, the pro-active ones, encouraged by the EU – such as aid for research and development, and career training, are quite neglected in Romania.

²⁶ Although estimation techniques may seem doubtful, because both historic and present liabilities are being weighed.

These trends need to be reversed in a short time-span and, as this reversal takes place, more and more companies, particularly public ones that do not restructure, are threatened by bankruptcy.

Even the EU finds itself in a situation in which it is rethinking state-aid. Simultaneously with the expiration of the CECA agreement, in 2002, the rescue and restructuring aid for the metallurgic industry became illegal. More so, at the end of 2003, when the current regulations expire, the EU will reform the state-aid policy in an even more restrictive direction, aiming to provide, at a European level, a single definition of a company in difficulties, and how the efficiency of the compensatory measures can be evaluated; on the other hand, companies that are part of a group may become eligible for state-aid.

We have to mention that although the Commission argues in favour of state-aid reform, there are Member States that practice active industrial policies; either for saving various companies that are considered to be of strategic importance (Bull, Alsthom in France; or banks in Germany), either to promote ‘national companies’, seen as examples of excellence in the process of economic development (Nokia, in Finland). In these situations, sometimes the Commission becomes more lenient, avoiding conflicts with Member States, particularly with the more developed ones (France, Italy, Sweden, Finland etc).

This double standard is observed even in the rough treatment applied by the Commission in the relationship with the new member states. For example, on May 19th 2004, less than a month after the accession of Poland, the European Commission has decided to investigate whether or not the state-aid for the restructuring of the steel-plant company Huta Czysta SA has violated EU regulations. It is the first such investigation in any of ten new member states. The Commission believes that the liquidation of the company was avoided by convincing the creditors to accept a restructuring plan (until 2006) and by cancelling some of the debts.

The same stringent conditions will be applied in Romania, and there will be serious problems in this field if Romania does not accelerate the reform of the manner in which the state supports economic development. In particular, this reform is related to the implementation of the regulations regarding insolvency and bankruptcy, to the formulation of the clearest possible criteria for direct state-aid (budgetary subventions)

as well as for the cases in which the state can allow the postponement of budgetary obligations.

4. Main ideas and recommendations

- ✓ The analysis of bankruptcy institution supposes, on one hand, **the evaluation of legal and procedural framework** of insolvency regulations and, on the other hand, the **investigation of implementation process's efficiency** of the proceeding thus enforced.
- ✓ Concerning the **legal framework**, one can observe that **there is not a universal bankruptcy code, a unique law applicable at worldwide level**. National laws regarding bankruptcy are still, in a large measure, an adaptation of each country's specificities. Yet, there are **basic principles**²⁷ in mostly all legislations regarding the insolvency proceeding which are based on the logic, the basic aims of bankruptcy. Moreover, several **good practices** in the field are accepted for their role in reaching more easily the aims of the bankruptcy proceeding.
- ✓ In the last few years, insolvency legislations, at international level, were constantly renewed, changes being caused by two important factors: **pressure of legislation harmonisation** and **adjustment at national specificity**.
- ✓ The harmonisation trend in the insolvency field is the result of institutional cooperation at regional and international level, as well as the result of informal pressures from partner countries. In the last years, a series of international institutions (IMF, World Bank, UNICITRAL²⁸, European Commission etc.) drawn up **recommendations, conventions, consultancy mechanisms** or other cooperation agreements, in order to establish common practices for bankruptcy proceeding. These institutional mechanisms aimed the bankruptcy field in a direct way, as well as indirectly through regulations and linked agreements in fields such as **competition policy** (see EU regulations²⁹).
- ✓ The most advanced exercise of harmonisation has been achieved in the field of **cross-border cooperation on insolvency problems**. For this specific case, at European Union and international level, compulsory and, respectively, voluntary regulations, have strengthened the international cooperation regarding the bankruptcy.
- ✓ In transition economies, **the insolvency proceeding is linked to two fundamental processes: reorganisation and privatisation**. The reorganisation

²⁷ The "golden" principle is that structurally non-viable firms must exit the market. Another principle is the existence for all competitors of equal (symmetric) conditions;

²⁸ UNICITRAL – United Nation Commission on International Trade Law;

²⁹ Competition policy commissioner, Mario Monti, is also known as a wild Cerberus of market rules;

presupposes the change of former state enterprises into market-oriented firms, capable to take their own decisions to maximise the profit and to take responsibilities for their management decisions. If the enterprises are taken out from the protector shield of the state, their capacity to take radical measures for reorganisation in order to survive on the market is more reduced. It is the same for the privatisation process, where the firms must prepare for the market competition, and not to wait for the investor to miraculously fix the disastrous result of several years of inefficiency.

✓ **Romanian legislation regarding bankruptcy is harmonised with the *acquis communautaire* in the field of cross-border insolvency.** Moreover, the legislation in force is in accordance with UNICTRAL recommendations, which have not only a regional perspective, but a universal one of cross-border cooperation in the insolvency area.

✓ Concerning the general legal framework of insolvency proceeding in Romania, it mostly respects the regional and international guidelines and principles. **Through the new adopted regulations, Romanian insolvency legislation corrects a series of uncertain or inefficient features.**

✓ **The present trend to relatively favour liquidation against judiciary reorganisation** may be considered as one of the few elements of divergence with the international trend, **but this could be only a transitory stage.** This option can be reversed when the juridical system would become more efficient, the administrators and syndic judges would become more skilled, institutions able to intervene would become stronger – in order to ensure the trust in the judicial reorganisation proceeding. At the same time, the reorganisation should not be done regardless its cost. It must not permit to safeguard the firms without any chance to become competitive.

✓ Concerning the **implementation of regulations** regarding the insolvency, **Romania's track record is rather poor.** The failures in the implementing process could be explained by a series of **hindering factors.**

✓ **Juridical system is not fully consolidated,** obstacles hindering the fluidisation of juridical proceeding. These obstacles are related to human and material resources within the system, as well as to general mentality regarding the state of law. Moreover, the expertise in commercial area is relatively small.

- ✓ **Related legislation** in commercial area is sometime ambiguous, leaving ways opened for interpreting the law, which corrupt, procedural and juridical, the decisions taken.
- ✓ **State involvement** has reduced the application area of the general insolvency law only to the private sector. The public sector received a character of exception, being separately regulated for avoiding mass bankruptcy and the potential negative consequences at economic and social level.
- ✓ Avoiding the bankruptcy of firms through artificial support from the state is the **result of a soft budgetary constraint policy**, supporting the lack of fiscal discipline in Romania. Apart from negative consequences on business environment brought by **unfair competition** between truthful tax-payers and those creating arrears, there are negative consequences at macroeconomic level especially regarding the **budgetary deficit, the process of fiscal collection and external deficits**.
- ✓ **State-aid policy is affecting, in a direct way, the insolvency and bankruptcy field**. In Romania, in the total amount of state aid, **the aids for safeguard – reorganisation were growing in the last years**, instead of decreasing. This observation shows that we are facing, in reality, with a frequent insolvency in important areas of public sector, and even of recently privatised enterprises. Thus, the **risk of mass bankruptcy** in some sectors of the economy is still present.
- ✓ **The amount of aids for erasing, reducing and re-phasing the debts and penalties is growing**, which demonstrate an **aggravation of payment incapacity** for long outstanding debts. Moreover, passing from direct subsidies to support through exemptions and re-phasing, leads to a **reduced transparency** and to the fact that the state cannot plan in advance the amount of state aid³⁰. This fact is in obvious **contradiction with the acquis communautaire**. The state aid should be redirected from the category of safeguard measures to the areas of measures encouraged by the European Union, such as the research and development, vocational training etc., fields which are in the present time neglected in Romania.
- ✓ After the recent efforts to improve legislation regarding insolvency, **in the case of Romania, defining the insolvency legal system** (legal provisions, priorities,

³⁰ Because the state cannot foresee the exact level of future arrears.

characteristics) is less important than the effort required for implementing the system.

✓ **The field of bankruptcy should not be regarded *stricto sensus*, only from the point of view of legal proceeding.** Measures for improving the market-exit process should be taken in others domains too, such as **financial and banking sector, competition, entrepreneurs and public opinion education, respect for the law** etc.

✓ Bankruptcy policy in Romania should take into account the **EU' recommendations for informing entrepreneurs** concerning bankruptcy proceedings, for **ensuring a counselling framework** regarding the situations of financial difficulty and ways to follow, for creating of a **more transparent framework regarding accounts information and financial data**, allowing warning alarms about financial health of enterprises, for **promoting a new start** for bankrupted entrepreneurs, as well as for changing the negative mentality at the address of firms which became insolvent only for conjuncture reasons.

✓ **State aid policy should be re-thought**, in order not to prolong the existence of firms not able to face the market competition pressure and having no chance of recovering.

✓ **On the other hand, we cannot apply *ad literam*, in all cases, the community rules in the field of competition;** it is not the case to be “more catholic than the Pope” when we deal with social and economic exceptionally situations. The important thing is that the state aid for safeguard – reorganisation to really become the exception which confirms the rule and not an instrument used for postpone unpopular decisions.

✓ **Strengthening the judicial sector** is necessary, through an **appropriate endowment** and through **judges' education**, specialised in bankruptcy field, within the framework of the new **commercial courts**, stipulated in the law project regarding the judicial reorganisation.

✓ **Creation of a veritable guild of professionals in liquidation and reorganisation** is another important priority, in order to relieve the judicial sector of additional burdens related to bankruptcy proceeding. Liquidation and reorganisation expert must focus the necessary economic and judicial expertise in order to find efficient solutions for insolvency situations.

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Legislation:

- ✓ Law 64/1995 regarding judicial reorganisation and bankruptcy procedure, republished in 1999;
- ✓ Law 82/2003 approving GO 32/2002 amending Law 64/1995;
- ✓ Law 149/2004 modifying and complementing Law 64/1995 regarding judicial reorganisation and bankruptcy procedure and other legal acts with impact on this procedure;
- ✓ Law 637/2002 regarding international law relation in insolvency area;
- ✓ Council Regulation (EC) 1346/2000 of 29 May 2000 concerning insolvency procedures.

ANNEX I: Brief descriptions of the insolvency regimes in selected transition economies

Hungary. The first insolvency legislation, adopted in 1986, was not implemented *de facto*. A new law was passed in 1991, providing for an automatic trigger of the insolvency procedure: all firms with overdue debts for more than 90 days were forced to start a reorganization or liquidation procedure in the first 8 days after exceeding the maturity (plus those 90 days). Moreover, the assets were frozen (automatic stay on assets), hence the creditors were not able to use them, and the managers were allowed to keep their positions during the reorganization procedure. The result was a wave of 22000 cases in that year only. Most of those ended up in liquidations (73%). The large number of cases put an unusual pressure on the juridical system, leading to the modification of the insolvency law in 1993, by giving up the automatic trigger procedure. A state agency was set up to deal with commercial debts collection and with settling cases off courts. In the first five years of functioning, that agency only recovered 16% of the total claims in its portfolio. However, the off court procedure was successful, reducing the number of firms which applied for the formal insolvency procedure. Johnson (1999) considers that the insolvency legislation in Hungary favoured the managers of the bankrupt firms due to the low creditors' protection, the lack of creditors' access to the debtors' financial information, the low competence of the syndic judges and of the administrators.

Poland. Under the Polish insolvency law (last changes were brought in 1998), the state enterprises are treated separately, the normal procedures not applying in case the state representatives forward formal objections. There is an interesting provision in the Polish legislation: the donations made by a firm or by a shareholder, in the last year preceding the bankruptcy, are null and are subject of creditors' claims. The payments made for non-due debts in the last two months preceding the bankruptcy are also null. However, the creditors are not sufficiently involved in the liquidation/reorganization procedure and in the end they recover only about 20% of their claims – in the case of liquidation, respectively 10% of their claims – in the case of liquidation of state enterprises (Johnson, 1999).

Czech Republic. An automatic trigger was introduced in legislation in 1998: the managers were forced to initiate the bankruptcy procedure if the respective firm failed to pay its debts. The reorganization or rescue of the firms which initiated the bankruptcy procedure is very rare, the secured creditors can not automatically recover the debtors' assets used as collaterals, and the revenues obtained from selling the assets are rather used for paying the liquidators. Johnson (1999) considers that the procedural transparency is very low, as well as the institutional capacity of the juridical system. In fact, the Czech Republic is, among the transition economies, the country where the bankruptcy procedure is most expensive and most time consuming.

ANNEX II: Experiences regarding state-aid policy in Poland and Spain

Poland

✓ The dynamic of state aid, as percentage of GDP, was decreasing. The state-aid per employee decreased from EUR 751 in 1996 to EUR 260 in 2003;

1994	1996	2002
4%	2,6	1,3%

✓ State aid accorded in the 90s proved to be inefficient especially in sensitive sectors:

- Coal – annual massive state aid (subventions and debts erasing); the productivity increased, but based on a sharper decrease of jobs then the production. In 2002, the sector continued to record loses from exploitation
- Steel – there were two special aid-programmes, in 1992 and in 1998. Out of 25 producers in 1992, 7 were liquidated or are in bankruptcy proceedings. The metallurgic sector continued to receive state aids in 2002, but to a lesser extend (only 1% of the amount of state aid from that year)

✓ The largest producer of tractors (Ursus) received a lot of state aids, but a report of the Supreme Court of Audit showed that Ursus did not regain the efficiency and it dilapidated a part of aids;

✓ Per total, the failure of state-aid policy in the 90s, leaving the enterprises in the same status of quasi-bankruptcy was due to the bad correlation between giving the state-aid and a medium and long term restructuring policy;

✓ Direct subventions never represented the majority of state-aid, as it is the case in the European Union, where the direct subventions are, in average, 60% of the total. In Poland, as in Romania, the majority of state aid represents cancelling fiscal obligations;

✓ The first Polish legislation regarding the state aid was elaborated in 2000, amended in 2002, when the obligation of state-aid efficiency analysis was introduced. One year later, all the enterprises reporting the analysis received only 0.6% of the state-aid, therefore there it does not exist an up-dated impact study

✓ More interesting is that Poland, contrary to Romania, still has state-aid for textiles sector. In 2002, it amounted to 1.05% of the total aid. The majority is for transport (20%), agriculture (15%) and extracting industry (13%). Small percentages are given, as in Romania, for the research and development, environment (1.39%) and vocational training.

Spain:

✓ In 2002, the state-aid amounted to EUR 5313 million (0.4% of GDP), compared to EUR 4049 million in 1992. The main sectors: coal extracting industry (20%) (in average, it received each year for the period of 1994 – 2002 over EUR 1 billion), agriculture (12.4%), regional development, research and development. The figures do not include one of the most financial supported sector: railway transportation (EUR 813 million in 2002);

✓ Direct subventions represent almost 90% of the aid, ensuring more transparency in analysing them;

✓ An important role in restructuring the energetic sector and other sensitive sectors was played by the local banks, which had or took over minority, but significant stock shares and they contributed to the management improvement;

✓ In 1998, when the Minister of economy and Finance was the current IMF Director, Spain created an ingenious financial engineering: taking into account that the budget was under pressure because of social obligations such as pensions, severance payments and other wage-related obligations amounting to EUR 8.1 billion accumulated in state-owned enterprises registering important losses (from extracting industry, ship construction, steel industry), the debts were passed to private administration, through creation a state fond of EUR 6.1 billion, obtained from previous privatisations and, following a selection process, 6 local assurance companies were chosen to manage this fond, in order to pay the obligations that day onwards.
