

## LIQUIDATION BY AND OUTSIDE THE LAW OF BANKRUPTCY AND OF INSOLVABILITY

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### **Abstract:**

*The trading society is constituted so that it has to develop an activity whose duration is established within the constitutive documents. Sometimes, the duration is lengthened even after the associates' decease, which formed the society. Since the antique duration, the problem of reaction towards a trader, whose inadequate activity affects the economic life, has appeared. In this way, the Roman law introduced the first regulations, which determined later the materialization of institution's bankruptcy, respectively the gross sale of debtors' goods in favor of creditors.*

*The bankruptcy represents an absolutely normal market phenomenon, in our country it did n't reached yet to be part of "game's rule"; any investor wishes to know not only the manner of entering within a business, but also of going out of it, the business being carried out with a society which is at bankruptcy. The number of bankruptcy is an essential indicator on evaluating the functionality level of an economy. "The economists show that it is normally within a market economy with percent of 2-6% for all companies to suffer bankruptcy within a year".*

*For establishing a financial decision in case of bankruptcy, the financial service proceeds on determining the most of financial information.*

*At the beginning, by the legislation research as concerns the companies, the bankruptcy law and other judicial provisions, the methodological information is established. Upon their basis, the information as regards the financial expenses and financial incomes are determined. The information as concerns the financial expenses refers to expenditure made in the view of process managing of bankruptcy and to eventual organizations and restructuring, being thus determined by the procedure of quotation. The payment obligations refer to amounts payment towards creditors and their proportion, the payment of wages for the staff and to the level foreseen by the law of bankruptcy, the payment of taxes remained towards the central and local budget.*

*The information as concerns the financial incomes are determined by the market value of the asset sold by public auction by the bankruptcy process managing. The financial decision as concerns the bankruptcy makes part of the documentation that attaches the company's bankruptcy, being the last financial distribution in the name of economic agent in discussion.*

**Keywords:** bankruptcy, state of failure, financial decision, creditor, judicial reorganization, insolvency and insolvability;

### **1. INTRODUCTION**

In the view of assuring not only the survival, but also the development, an enterprise needs financing sources on long term. For this thing, an economical entity refers either to internal financing or self-financing, or to an external financing, by the call to stockholders creditors. Those two solutions presented dispose of own financing modalities. The external financing, by means of stockholders performs two characteristic features:

1. *is residual*, because attracting the capital by transmission of shares occurs as being more expensive due to the risk assumed; at the same time, remuneration of own capital is residual, and the remuneration of stockholders is not considered a deductible expenditure; moreover, distribution of dividends is considered by some financial executives as being against self-financing, thanks to the fact that, both distribution of dividends, and self-financing have the same accomplishing basis – the net profit;
2. *is conjuncture*, because the economic entity has to own the moment of increasing the capital, in the sense of advancing or delaying the date of transmission of new shares and of establishing the value to which increasing will be performed.

Within a company's economic life, certain recessive and of failure moments can appear, which lead to putting under financial supervision, reorganization/restructuring and finally to liquidation. The failure can be interpreted in more ways, depending of problems involved or not by

the collapse and dissolving that company, associated with a loss in total investment of creditors. In this way, clarifying the following terms becomes necessary:

- **the economic failure** signifies the fact that a company's incomes do not cover the total costs, including the capital's cost;
- **the company's failure** refers to any company which stop its activity, having as result a loss for creditors;
- **technical insolvency.** A company will be considered technically insolvable if it cannot respect the current observations on their becoming payable. A company being in this situation is considered in technical stopping of paying the obligations. The technical insolvency denotes the lack of financial difficulties to customers;
- **the insolvency in bankruptcy** appears when within an enterprise, the total of duties exceeds the real value of assets. This situation is much more severe than the technical insolvency, because it generated the company's liquidation.

Within the Romanian regulations for the judicial reorganization and bankruptcy procedure, distinction is made between the insolvency and insolvability. The insolvency (inability of payment) comes when the debtor do not have necessary liquidities for paying his real, liquid and due debts. The insolvency or debtor's stopping of payment has to be delimited of so that called "financial constraint", which consists on just being lack of necessary liquidities for duties acquit. It is possible that, in short time, the debtor to cash the debts from his own debtors and to financially redress.

The insolvency doesn't mean insolvability, for as long as the debtors maintains in his patrimony goods which can be enforced executed, in the view of paying the duties towards the creditors. The insolvability consists on debtor's impossibility of respecting his obligations towards the creditors, both from liquidities' lack and other goods among which the creditors' debts have to be satisfied. Practically, the passive (duties) is bigger that the active (rights) of patrimony. In this way, the insolvability state regulated by the Romanian legislation is the same as the bankruptcy insolvability, while the insolvency is the same with technical insolvability, previously approached.

The economic failure of a company is caused by more factors, among which the following can be presented:

1. incompetence and managing failure (60%);
2. the unfavorable evolution of the market (about 20%);
3. the natural phenomenon, fire, calamities, Earth quakes (10%);
4. other causes (10%).

It can be observed that the main cause has in view the failures of managing processes and of knowing the market. Therefore, the managers have to identify in time the signals of deteriorating the financial situation of enterprise, such as:

- achieving the negative net financial results;
- existence of a negative working capital;
- the impossibility of reimbursement the credits to their normal date of payment;
- the bankruptcy of some providers or main customers for the enterprise;
- the reduced impossibility or non-availability of a manager;
- persistence of strikes.

The legal frame as concerns the commercial companies functioning, as well as the Law of enterprises' insolvability foresee the impossibility of declaring the bankruptcy state for the company, which is carried out, firstly by supervising activities, of reorganizing and restructuring-readjustment.

The bankruptcy is a judicial procedure in the view of reorganizing or liquidation of a company, when reorganizing or liquidation is organized by special courts. The bankruptcy can be of two types:

- **voluntary**, when the bankrupted company presents to judicial instance a request and no order of supervising exists, and the manager of real patrimony/syndics is directly named;

- **involuntary**, when the company's creditors presents to judicial instance a request and prove that the debtor do not respect the duties on date of payment. In this case, the instance institutes the order of supervision over the debtor and names the patrimony managers.

The creditors can anticipate the incapacity of debtor for respecting the obligations to date of payments, upon the basis of bankruptcy deeds, which this committed, being the following:

- **the false pretences transfer** represents a transfer of properties towards a third party, on inadequate conditions, with intention of prejudicing the creditors;
- **the preferential transfer** represents the money or assets transfer by a insolvable debtor towards a creditor, giving to creditor a bigger part of duties unto other creditors will receive to liquidation. The preferential transfer is also called "false pretences preference";
- **hiding or removal**. Hiding refers to hiding certain properties on intention of prejudicing the creditors; removing the properties also has in view the creditors' prejudicing;
- **assignation**. If a debtor makes a general assignation on creditors' benefit, there will be an act of bankruptcy. This will allow to creditors that do not trust within the assignation process to transform this transaction into an involuntary bankruptcy;
- **sudden leaving**. If the debtor disappears in the view of cheating or delaying towards the creditors, then a request of bankruptcy can be submitted;
- **admittance to a creditors' meeting**. The debtor will commit a bankruptcy act if at a meeting of creditors, he presents a declaration of assets and duties which show that he is insolvable or admits in write that is unable of paying the duties;
- **communication towards the creditors**. If the debtor communicates to any creditor that he suspended or will suspend the duties' payment, a bankruptcy act will take place;
- **order of officer of the court**. If the debtor do not redeem the goods that were sequestered by an execution order issued against him, there will be a bankruptcy act;
- **the technical insolvability** is the most commonly act of bankruptcy and takes place when the debtor is unable of respecting, in generally, the conditions of indebted contracts to date of payment.

In case a company reached to far in the view of rehabilitation, then it has to be closed. It is indicated that liquidation has to take place when the company values more dead than alive or when the possibility of achieving the profit is much more distanced. The clearance can take place both outside the Law of bankruptcy and by the procedure performed under the jurisdiction of a bankruptcy court.

#### **A) Liquidation outside the law of bankruptcy and of insolvability**

By this procedure, the costs as concerns the bankruptcy procedure are gained in time. Liquidation can be made on two ways: the mandate and voluntary liquidation.

**1. The mandate** represents an informal procedure in the view of clearing the duties and assures, usually to creditors, a greater amount in comparison to liquidation by law of bankruptcy. By mandate, the title over the debtors' assets has to be transferred to a third person, named **mandatory** or **trustee**. The mandatory has the task of liquidating the assets by private sale or public auction and then of distributing the creditors' encashment, proportionally. The mandate does not automatically absolve the debtors from obligations. If a company does not exist anymore and gets out of business world, it will not mean that it stops all the pretences about it.

The persons associated with the company can organize another enterprise, without previous duties and obligations, but maintaining permanently the danger that judicial instance to punish those persons. Form this reason, is important to achieve a declaration from the creditors, by which they declare that pretences were fully compensated.

The mandate presents certain advantages, meaning: more reduced time of solving and the lack of expenses and formalities, characteristic to an injustice activity. The mandatory disposes of properties with much more flexibility than a bankruptcy manager. The measures can be taken sooner, before those stocks be used or the equipments to become rusty. Also, because the mandatory is often familiar to the business relations of the debtor's company, better results are achieved.

**2. Voluntary liquidation.** In case a company reaches the bankruptcy, it can take a series of decisions. Such a possibility consists in performing a voluntary liquidation, without involving the bankruptcy process, accompanied by certain costs.

By understanding the voluntary way, the management takes a deliberate decision of selling the company, either to other company, or to a concern. If the managers take decisions towards stockholders interest, the voluntary decision has to be the most advantageous for the stockholders. This fact can be possible, in measure when managers own a certain number of company's stocks. As result, to a voluntary liquidation analysis, the percentage of liquidation is greater than the market value of company's stocks, which would continue the activity.

If the liquidation offers the best results for the owners of common stocks, then the stock price should increase on liquidation announcement. There are often certain leaks of information as concerns the liquidation and rumors concerning the possible fusions, fact that determines the growth of stocks' price before the effective date of the announcement. The scientific research proved that the price of stocks can grow with at least 20% over the general tendency of market, in a period of one month before the announcement date. Therefore, the voluntary liquidations represent also the patrimony's stocks growth.

#### **B) Liquidation by the law of bankruptcy and of insolvency**

The law of bankruptcy has three main functions during liquidation, meaning:

- assures the protection against the debtor's fraud;
- assures an equitable distribution of debtor's stocks towards the creditors;
- allows to insolvent debtors to be absolved of all duties and to establish new companies, without the hardness of previous debts.

By all these, liquidation consumes a lot of time, is expensive and has as effect the enterprise's closing. Putting an enterprise in liquidation status supposes accomplishing the following activities:

- managing the bankruptcy procedures by the experts within judicial and financial field;
- evaluating and selling the company's assets;
- establishing the priority order and of customers' satisfaction proportion.

Within any reorganization of financial duties by the Law of bankruptcy, the rule of absolute priority is applied, in accordance to which the financial duties which come to creditors with greater priority have to be totally closed, before any payment to creditors/owners with less priority.

If the reorganization is performed outside this law, the priority rule used will depend on the power of negotiating of duties and stocks owners.

These activities have a common character, as regards the manner of managing the requested services, by the process of liquidation and financial distribution, in measure of accomplishing the company's obligations towards the owners, budget, suppliers, and employees.

No matter the way chosen, reorganization or bankruptcy, recovering the activity for a company imposes with obligation type the selling, integral or partial, of the company's patrimony for the passive performing. A very sensitive problem is represented by the order in which the duties of debtors are paid, much more important as it is very possible that a part of the passive will remain unpaid and after the integral end of the patrimony and social capital.

Closing the passive has to be done in accordance to the reorganization plan, from the incomes achieved if continuing the activity, from the amounts achieved from selling of goods or from both sources. The debts payment has to be done on terms, in manners and in accordance to the measure established by plan. The payment program has to respect the order of satisfying the debts foreseen

by law. The payment program foreseen by program represents a concrete application of legal priority order for satisfying the debts.

The debts will be paid in the following order:

- taxes, postmarks and any other expenses afferent to procedure, including those for preserving and managing of goods form debtor's patrimony, as well as of remunerations coming form persons employees for accomplishing the procedure of judicial reorganization and o bankruptcy;
- the debts representing the credits, with afferent interests and expenses, offered to bank companies after the opening of procedure, as well the debts that result from continuing the activity of debtor;
- debts coming form work reports, for at most six months previous to opening the procedure;
- budgetary debts;
- debts representing the amounts given by the debtor to third parties upon basis of certain obligations of maintenance, allocations for minors or of payment ce rtain periodical amounts intended for assuring the existence means;
- debts representing the amounts established by the magistrate -syndic for the maintenance of debtors and of his family, if he represents physical person;
- debts representing the bank credits with the expenses and interests afferent to those resulted from delivering of products, services performing or other works, as well as from rents;
- other debts;
- debts subordinated, in preference order established by the law. The debts subordinated come from credits given to the debtor judicial person by an associate or stockholder owning at least 10% of the social capital, respectively of vote rights, within the general meeting of associates, depending on situation, by a member of economic interest group. Simultaneously, there are debts subordinated to those coming from acts with free title;
- debts of members, associates and stockholders, debtor judicial persons, coming from the residual right of their quality, in accordance to legal and statutory provisions.

The debts can be:

- **debts of first degree (bank credits)**, named as guaranteed debts with insurance of first degree;
- **debts of second degree (commercial credits, duties)**, named as guaranteed debts upon basis of the active left after paying the previous obligations.

The amounts had to be distributed between the creditors of the same priority degree will be proportionally offered with the amount for each debt, mentioned in the definitive table of creditors' debts.

On applying the liquidation procedure, two principles are aimed:

- fastness of operations;
- liquidation of goods in more advantageous manner, for satisfying the creditors' debts;

The last liquidation act is represented by the net asset's distribution between the associates. Such an operation is possible only if after the payment of company's entire passive, assets of companies left, whose value cannot be shared. Ulterior, the final accountant balance of liquidation will be done; which includes all the operations related to liquidation. It has to be signed by liquidator and accompanied by a report of censors. The balance sheet and the censors' report as concerns the liquidation are mentioned in Registry of Commerce and are published in Monitorul Oficial.

The bankruptcy mechanism doesn't have to be abuse used, in the view of making easy certain taking of control. The signs for starting the bankruptcy have to be also adequately established for not forcing the bankruptcy start of certain companies potentially available. The instances have to manifest a careful, responsible and professional attitude, thus offering to the enterprise time

interval, in the view of saving by reorganization, thus increasing the chances of supervising the business.

In the view of analyzing the efficacy of own efforts, we will succinctly present some results that come from paper analysis:

1. The enterprises have access to two types of financial resources: own and loan. The manner of combining of these two types of resources define the financing structure, both performing a cost.
2. Establishing a target financial structure has to base upon strategic financial decisions. In the view of defining it adequately, the behavior anticipations belonging not only to capital providers have to be taken into consideration, but also of financial decisional of the enterprise, which may manifest a larger or smaller opening towards the risks related to each financing source.
3. In the view of accomplishing an optimization of the financial structure of an economic entity, there have to be preliminarily certain preoccupations for improving the financing structure – especially of current financing.
4. Trying to accept a financial structure generally -available for all enterprises occur to be superflue, this because the multitude of factors that perform over the financial structure modify and individualize each enterprise.

## CONCLUSIONS

For establishing a financial decision in case of bankruptcy, the financial service proceeds on determining the most of financial information.

At the beginning, by the legislation research as concerns the companies, the bankruptcy law and other judicial provisions, the methodological information is established. Upon their basis, the information as regards the financial expenses and financial incomes are determined. The information as concerns the financial expenses refers to expenditure made in the view of process managing of bankruptcy and to eventual organizations and restructuring, being thus determined by the procedure of quotation. The payment obligations refer to amounts payment towards creditors and their proportion, the payment of wages for the staff and to the level foreseen by the law of bankruptcy, the payment of taxes remained towards the central and local budget.

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