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**INSIDE STORY – MARCH 2017**

**The clash between criminal procedure
and insolvency in Romania**

For a couple of years now, the precautionary measures established during the criminal trial have given Romanian insolvency practitioners, judges, debtors and creditors a headache.

In the first semester of 2015, the number of insolvency procedures which involved criminal precautionary measures against the debtor’s assets were as low as 75.  A year later, from a total of 29,365 number of insolvency procedures, 377 of them involved criminal precautionary measures. At the end of 2015, the turnover of these debtors with assets encumbered by criminal precautionary measures amounted to 0.55% of the GDP.

The precautionary measure we are going to briefly explore in this report is sequestration. The big question Romanians pose themselves is whether the IPs can sell these types of assets encumbered by this precautionary measure established during the criminal trial or not. The answer and consequences will greatly differ depending on the respondent.

According to the article 249 of the Criminal Procedure Code, *the prosecutor, during prosecution, the judge of preliminary chamber or the Court of its own motion or at the request of the prosecutor, in the preliminary chamber procedure or during trial, may take precautionary measures in order to avoid concealment, destruction, alienation or evading pursuing assets that may be confiscated or subjected to extended confiscation or which may serve for the enforcement of the fine or legal costs or to repair the damages caused by the offense.* According to the Criminal Procedure Code, *the effect of the precautionary measure is sequestration, which withdraws the debtor’s right of disposal.*

According to the article 53 of the Law 85/2006 on insolvency procedure*, the assets alienated by the judicial administrator or by the judicial liquidator, while exercising his powers provided in this Law shall be acquired free of any encumbrances, such as any kind of privileges, mortgages, pledges or possessory liens, seizures. Exempted from this regime shall be the precautionary measures established during the criminal trial.*

The article 53 of Law 85/2006 on insolvency proceedings, as shown above, has been modified approximately four times since 2010, by the Code of Civil Procedure or the Code of Criminal Procedure, each legislation trying to clarify at least to some extent the mechanism of the sequestrations. There have been long debates on whether this regime exempts from the possibility of alienating the assets altogether or the fact that the assets can be alienated, but will be acquired free of any encumbrances.

**Regarding the possibility that the assets can be alienated:**

As seen above, the pursued assets may be confiscated or may serve for the enforcement of the fine, of the legal costs or to repair the damages caused by the offense. The prosecutor is obliged to state the scope of the sequestration. In most cases, the scope is to facilitate the State’s enforcement of the legal costs, the fine or the injured party’s enforcement of the claim. Another scope is to protect the public interest and here is where confiscation comes in. The confiscation applies to dangerous assets, assets that have been used in perpetrating the criminal offence; those assets have a particular regime which we are not going to explore today.

What we see in practice is that the prosecutors will set a sequestration early in the criminal process, in the investigations stage. Outside an insolvency procedure, this may protect the injured party or the State, by maintaining the assets in the debtor’s estate. But in insolvency, until the final settlement of the civil action in the criminal proceedings, and this may take a while, their claim falls under suspensive condition.  Meanwhile, the expenses necessary for the preservation and the administration of these sequestrated assets are increasing, and the IPs inability to sell is detrimental to the other creditors in favour of a conditional claim. When the final settlement of the civil action in the criminal proceedings is reached, neither the injured party nor the State will have a secured claim.  Furthermore, the Court may very well declare that there is no guilt, no prejudice and no claim.

Adding another element into the mixture, the Code of Criminal Procedure establishes the offence of evading sequestrations – *The* *evading of legally sequestrated property is punishable by imprisonment from 3 months to one year or a fine*. *If the act was committed by the custodian, the punishment is imprisonment from 6 months to 2 years or a fine*. Criminal procedure authorities all seem to agree that this offence may be perpetrated by the IPs, while IPs consider that it is their duty to sell the debtor assets, according to the insolvency law.

In this conditions, once a sequestration is in place, the insolvency procedure reaches a deadlock, the length of the procedure is considerably increased and the assets lose value over time.

**Regarding the possibility that the assets can be alienated but will be acquired with the sequestration:**

If we interpret that the article 53 of the Insolvency Law exemption refers to the encumbrances, that this is a special provision derogating from the general rule established by the Criminal Procedure Code, then what would that mean for the State or the injured party? What is the effect of sequestration then?

After discussions and some dissenting opinions, the majority agree that the provisions from the Romanian Civil Code and the Code of Criminal Procedure do not transform a sequestration established during a criminal trial into a secured interest. The security interest would create in favour of the creditor (in this case the State/injured party) the right to recover his debts, prior to any unsecured creditor or any creditors holding subsequent ranking security interests or other preference rights. Moreover, the secured creditor would have the right to enforce its debt irrespective of the holder of the secured asset (the right of pursuit).

However, what the sequestration does is having the debtor’s right of disposal withdrawn. Thus, by alienation, the asset sequestration is without effect. There have been some interesting jurisprudential approaches which state that the sequestration is then placed on the funds received, after distributing the funds to the secured claims, thus preserving the right for these conditional claims without damaging the other creditors. But the jurisprudence is conflictual.

With divided positions on the interpretation of article 53 of the Law 85/2006 on insolvency procedure, the insolvency procedures remain in a deadlock.

Still, we are hopeful as there have been recent discussions on the possibility of the exemption stated by article 53 being implicitly repealed by the new Insolvency Law 85/2014, but the Courts have yet to state a clear position regarding this matter. It is my opinion that over time, this amendment introduced by the Law 85/2014 will clarify the legal effects of sequestration, providing further protection for all participants to the insolvency procedure.

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