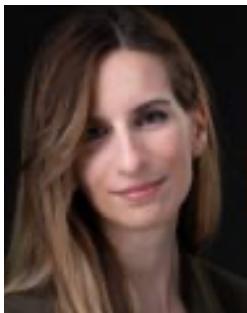


Haircut of claims in restructuring proceedings in Romanian legislation

Patricia Poulussen-Radulescu presents the conditions needed to implement such a measure in a restructuring plan, showcasing the potential benefits, as well as the effects of the plan's failure



PATRICIA POULUSSEN-RADULESCU
Project Manager,
CITR Romania

Beginning in 2014, Romanian legislation regarding insolvency proceedings has focused on granting debtor companies a real chance for restructuring. It was a shift in the legislator's mindset.

Coming after a tough economic crisis that shook the whole world, and following the European trends, Romania issued Law no. 85/2014 on Pre-insolvency and Insolvency Proceedings, that stated from the beginning its newfound scope: *'establishing a collective procedure for covering the debtor's liabilities, while granting, when possible, the chance for the recovery of their activity'*. This, plus including mechanisms for pre-insolvency proceedings in the Insolvency Law marked the mentality shift: while the scope is still to maximize the reimbursement of debts for creditors, a focus is given also to help debtors continue their business.

Furthermore, Romania transposed Directive no. 2019/1023 in July 2022 by amending Law no. 85/2014, granting more useful instruments for companies facing difficulty. The scope of the Law is refreshed and leans even more towards the need to give companies a real chance to overcome their difficulties: *the scope is to establish procedures that prevent debtors from entering insolvency, and to grant, when possible, a chance for recovery of their activity, for debtors that entered insolvency proceedings.*

We notice that restructuring proceedings in the Romanian Law follow the objective of the

European Directive, that is *'to contribute to the proper functioning of the internal market'*. Ensuring this objective can only be achieved by an insolvency practitioner (IP) by maximizing the value recovered for the creditors and implementing a mechanism that can ensure the business continuation and salvation.

The 'Haircut' of claims

One of the most efficient instruments provided by Law that can be used with this goal is the discharge of some debts, known also as 'haircut' of claims.

In certain cases, the debtor's liabilities are so overwhelming that the company cannot continue operating, even under a preventive or insolvency proceeding, without having some of them reduced. At the same time, maximizing the recovery of liabilities for the creditors remains an important focus, while keeping in mind the necessity to implement a just mechanism for all involved parties.

Under the current Law on Pre-insolvency and Insolvency Proceedings, debtors can be discharged of some of their debts through any of the following proceedings: composition agreement, restructuring agreement and reorganization plan.

Whilst the first two mentioned are preventive insolvency procedures, the reorganization plan is a procedural step within insolvency proceedings.

Regardless of the actual framework in which the haircut is being implemented, the steps that must be followed are in fact similar.

The main task is ensuring the scope of the Law is being met, namely maximizing debt recovery while granting the company a chance of revival. To achieve this, an IP must conduct an analysis and estimate how much creditors would receive in the *next-best-alternative scenario*, which in most cases is the liquidation of the company's assets. The IP must then compare it to the results of a restructuring process.

First step: getting to know the assets. To get a clear image of the recovery rates, all the assets belonging to the debtor company must be evaluated (*including the claims that the debtor company has against its own debtors*). The assessment is conducted by an independent valuator, who applies standardized valuation methods (*such as the cost or market approach*) and issues a valuation report. The report contains market and liquidation values for all company's assets. The values of the secured assets are reflected separately in the report.

Second step: examining the liabilities. In the meantime, the IP draws a picture of the liabilities of the debtor. For pre-emptive procedures, this is based on the company's financials and creditors' balance confirmations.

In insolvency, though, the debtor's liabilities are analysed and registered by an IP in a list of claims (known as *'table of creditors'*), based on a regulated procedure (*which includes the obligation for creditors to submit a formal request within a fixed term given by the syndic judge*).

Having, on one hand, the image of the assets, and, on the other, the value of the liabilities, the IP calculates how much is



One of the most efficient instruments provided by Law that can be used with this goal is the discharge of some debts, known also as 'haircut' of claims



estimated to be paid to creditors in the next-best-alternative scenario: in foreclosure, insolvency, or bankruptcy.

In all these scenarios, the IP takes into consideration the added costs of undertaking such procedures, from the fees of the body applying the procedure (*bailiff, judicial administrator, liquidator etc.*), lawyers involved in the recovery of the debtors' claims and any other fees that could arise. In case of secured creditors, their recovery would be of the asset value, from which the procedural costs are being deducted.

Most often than not, the result of the IP's simulation is negative, showing that liabilities exceed the value of the assets, so an important share of the debts could not be repaid in the next scenario.

Based on this analysis, the IP proposes a restructuring/reorganization plan, grounded in the continuation of the company's operations. The plan presents the potential results of its implementation, including a cash flow projection and a revenue and expenditure budget for a specified period. *The main objective of the plan is to demonstrate that its implementation will generate additional liquidity, which will cover a larger proportion of the company's debts compared to the alternative scenario.*

For what is not expected to be recovered – *as long as the creditors receive more than in the alternative scenario* – the IP may propose a debt reduction (haircut). On top of offering a higher distribution to creditors than in the alternative scenario, another condition for the plan's validity is that all claims within the same category must receive equal treatment. The claims are split in the following categories: employees, secured creditors, indispensable creditors, budgetary creditors and other creditors.

In order to implement a haircut, the proposed plan must be voted on by classes of creditors and then approved by a syndic judge. Budgetary creditors can approve such a plan only if it is in accordance with a prudent private creditor test. This test, essentially a



variation of the private operator test from the European legislation, must be conducted by an IP or an independent expert. It aims to demonstrate that through business restructuring, the budgetary creditor will recover more claims than in bankruptcy, and that a diligent private creditor would, in their position, approve the proposed plan.

In insolvency cases, the judge has the authority to assess the viability of the restructuring plan, even if creditors have approved it. The role differs in pre-emptive procedures: if the plan is approved by all the classes of affected creditors (*with an absolute majority in each class*), the judge is compelled to approve the plan. If the plan isn't approved by all the classes of affected creditors, but of the majority, the judge can conduct a more in-depth analysis before concluding over it.

A notable issue is that the current Romanian Law on Pre-insolvency and Insolvency Proceedings does not account for the time value of money in its recovery calculations. Instead, it focuses solely on the nominal value of the sum to be recovered, regardless of whether the recovery occurs immediately or at a future date. This approach disregards the potential opportunity costs and inflationary effects associated with

delayed recovery, treating present and future monetary values as equivalent. It takes into consideration only the additional costs that could occur through time passing but fails to incorporate fundamental financial principles. This is an issue especially when it comes to the vote of the budgetary creditors, who sometimes choose to delay their decisions taking into consideration strictly the nominal values of the potential recovery.

If the plan succeeds, the income coming from the haircut is registered in the debtor's accounts after exiting the procedure.

If the plan fails, then the reduced claims are reinstated at their original value, only deducting what was paid. This provision serves as a safeguard for creditors, ensuring that their rights are protected if the debtor's financial recovery efforts prove unsuccessful.

Summary

In conclusion, a debt haircut represents an optimal solution for business recovery in the Romanian legislation, striking a balance between protecting creditors' interests and ensuring the debtor's business continuity. ■



In order to implement a haircut, the proposed plan must be voted on by classes of creditors and then approved by a syndic judge

