Clifford Chance
Badea Association

BRIEFING

# No fault, no inflation indexation: Romanian courts confirm that a debtor cannot be penalised for a criminal garnishment

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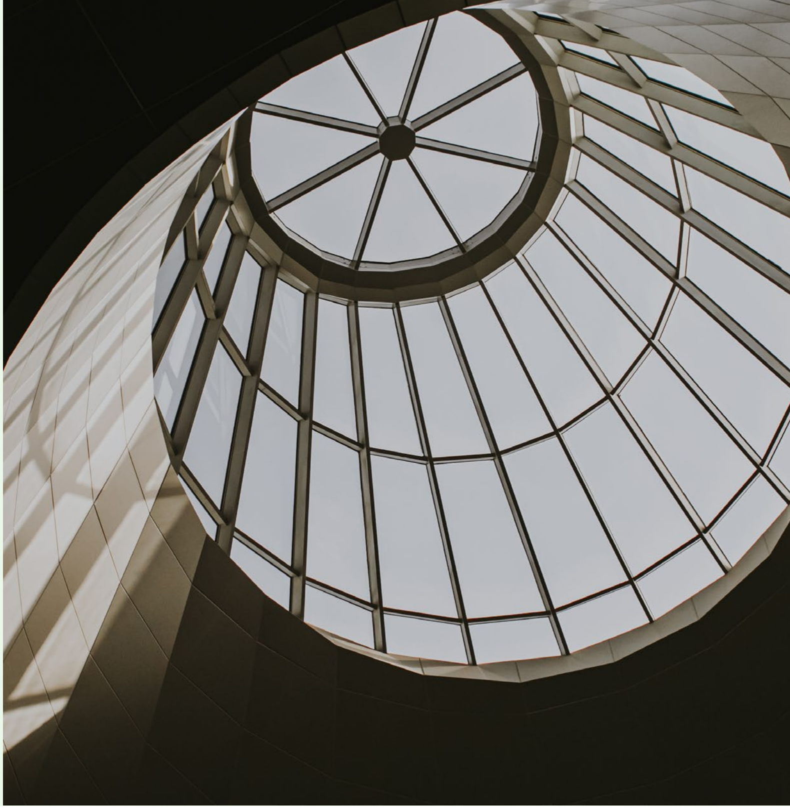

**Main highlights**

The court confirmed that no inflation indexation accrued while the debt was frozen under a criminal precautionary measure, avoiding an increase of nearly 50% of the principal debt.

**Criminal precautionary measures create a legal impossibility to pay**

During the garnishment period, the principal debt was frozen "in the hands of" the Client as third-party garnishee and remained at the disposal of the prosecuting authority. As a result, the Client neither had the right nor was under an obligation to make payment to the creditor.

**No liability for inflation indexation while its debt was frozen under a criminal garnishment**

Absent any fault on the part of the debtor, which is a prerequisite for civil liability, no inflation indexation could accrue during the period in which the debt was frozen.

For more than five years, the Client's principal debt to its creditor (approx. EUR 4 million) was frozen as a result of a criminal precautionary measure. Once that measure was lifted, the Client paid the principal amount in full. However, the creditor subsequently sought to enforce additional amounts representing inflation indexation accrued during the period in which the precautionary measure had been in place, amounting to approx. EUR 2 million.

The Client successfully challenged the creditor's claim for approx. EUR 2 million in inflation indexation, with the Romanian courts definitively ruling that no such amounts were due. The courts held that the debtor could not be held liable for the non-payment of the debt while the principal amount was frozen under a criminal precautionary measure, as the debtor was not at fault during that period.

## Context

The Client was the debtor of an approx. EUR 4 million obligation established by a court judgment in favour of a former capital markets broker (the "**Broker**") following the annulment of a series of sell-out transactions. In parallel, criminal proceedings were initiated against the Broker's employees in connection with the unauthorised sale of client assets.

The Broker subsequently commenced enforcement proceedings against the client to recover the principal. From the outset, however, payment of the principal debt was prevented by two successive circumstances that were entirely outside the client's control:

- First, the Client challenged the enforcement, and the courts suspended the enforcement proceedings pending final resolution of Client's challenge.
- Second, and most importantly, a precautionary measure (*garnishment*) was imposed by the prosecutor in the criminal proceedings against Broker's employees.

Consequently, the principal owed by the Client to the Broker was garnished / frozen in Client's account and held at the disposal of the criminal authorities pending final resolution of the criminal proceedings.

The garnishment remained in place for over five years, until it was lifted by a final court decision, that brought the criminal proceedings to an end. Throughout that period, the Client was legally prevented from paying the amount to the Broker.

After the garnishment was lifted, the enforcement proceedings resumed and the bailiff recalculated the outstanding debt, adding approx. EUR 2 million to the principal amount of approx. EUR 4 million. This additional amount represented inflation indexation applied to the principal during the period in which the debt had been frozen.

The Client challenged the enforcement, and both the first-instance court and the appellate court upheld the challenge, finding that the Client was not at fault during the period in which the garnishment was in place. As a result, the courts held that the Client was not liable to pay the additional inflation indexation amount that accrued during the garnishment period.

## Court's key reasoning

The heart of the dispute, and the point of broadest relevance, is the effect that a criminal precautionary measure (seizure or garnishment) has on a debtor that is simultaneously exposed to civil enforcement.

### Criminal garnishment "freezes" the principal and removes debtor's power to pay

Once the precautionary measure was imposed, the Client was under a legal obligation to retain the amount and hold it at the disposal of the criminal authorities. As long as garnishment was in place, the Client was prohibited from transferring the principal to the Broker.

### Paying during the freeze is not just prohibited – it can be a criminal offence

Had the Client paid the principal to the Broker while the garnishment remained in force, it could have faced criminal liability for removing assets subject to seizure. The courts therefore held that the inability to pay resulted from a legal prohibition rather than a commercial choice. As the courts further affirmed, **the Client could not be expected to comply with the criminal precautionary measure while simultaneously making payment to avoid inflation indexation**.

### No fault means no inflation indexation for the freeze period

The courts emphasized that inflation indexation serves to compensate a creditor for losses caused by a debtor's delay in payment. However, such liability requires, among other elements, the debtor's fault. Because the Client was legally prevented from paying the debt, it committed no wrongful act and could not be regarded as being at fault. Accordingly, inflation indexation could not accrue during the period in which the debt was frozen.

## The freeze does not amount to payment, but it defeats the claim for inflation indexation

While the first-instance court characterised the consignment of the principal as an "indirect payment", the appellate court did not adopt this reasoning. The appellate court clarified that the precautionary measure neither extinguished the principal nor constituted a recognised form of payment. The decisive factor was instead the absence of any fault or negligence on the Client's part, which precluded the Broker's claim for inflation indexation.

## The risk arising from criminal precautionary measures cannot be shifted to the debtor

The Broker argued that the Client was responsible for the consequences of the freeze (i.e., the indexation amounts) because it chose to challenge the enforcement rather than immediately pay the principal debt once it became due. The Tribunal rejected this argument, holding that the garnishment arose from the conduct of the Broker's own employees, who were the subject of the criminal proceedings, and not from any conduct attributable to the Client.

The Tribunal further found that the Client merely exercised its legitimate procedural rights, including its right to challenge the enforcement, which could not be regarded as fault or negligence. The court also noted that, had the funds been frozen in the Broker's own accounts rather than in the Client's, the Broker would have been in the same position, namely unable to use the funds and unable to claim inflation indexation for the relevant period.

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