

SAFEGUARDING SECURED CREDITORS' RIGHTS IN INSOLVENCY: A LANDMARK VICTORY BY CLIFFORD CHANCE BADEA

LEGAL AND CASE-LAW CONTEXT

Under the Insolvency Law no. 85/2014 ("**the Insolvency Law**"), secured creditors enjoy a privileged position when it comes to recovering their receivables, compared to non-secured creditors. As a rule, the proceeds from the sale of secured assets are distributed to the secured creditors after settling certain procedural costs, such as judicial receiver's fees, valuation fees, and utility costs.

According to the Insolvency Law, secured creditors should only bear procedural costs accrued up until the distribution of the sales proceeds. However, in practice, judicial receivers often set aside a portion of the sales proceeds (by retaining a provision amount – in Romanian, "*provizion*") to cover procedural costs expected to accrue after the sale of the secured assets. This has led to secured creditors shouldering the unreasonable burden of covering procedural costs both before and after their secured assets have been sold.

This practice has significantly diminished the creditors' recovery rate, as the Insolvency Law does not provide for a cap on the amount the receiver can set aside through the provision.

Although creditors have frequently challenged these retained provision amounts, they have faced inconsistent rulings from Romanian courts, including from the Bucharest Court of Appeal.

Those courts that rejected the creditors' challenges provided various rationales, such as:

- The Insolvency Law provisions allowing the judicial receiver to retain a provision prevail over the provisions regarding distribution of the sales proceeds to the secured creditors.
- The principles of the Insolvency Law (e.g., equal treatment, collectivity of the proceedings) require all creditors, including the secured creditors, to bear the procedural costs accrued before and after the sale of secured assets.
- The insufficient assets in the debtor's estate to cover future costs justify the judicial receiver's right to retain a provision amount.

Key issues:

- **Burden of procedural costs:** Secured creditors often bear procedural costs both before and after the sale of their secured assets due to judicial receivers' practice to retain provision amounts.
- **Reduced recovery rate:** This practice significantly diminishes the recovery rate for secured creditors.
- **Inconsistent court rulings:** Creditors face inconsistent court decisions when challenging these retained provision amounts.

FAVORABLE PRECEDENT SECURED BY CLIFFORD CHANCE BADEA

In one of the largest insolvencies in recent years in Romania, our client (the only secured creditor) faced a significant challenge when the judicial receiver retained a provision amount of over RON 4 million (~EUR 800,000), designated to cover future procedural costs accrued after selling the secured assets. This amount represented approximately 25% of the sales proceeds.

Our client challenged the provision retained by the judicial receiver. Both the Bucharest Tribunal and the Bucharest Court of Appeal upheld our client's challenge, confirming that, as a matter of principle, the judicial receiver does not have the right to retain a provision when distributing the proceeds from the sale of secured assets.

The main arguments upheld by the court were that:

- The secured creditors may only bear procedural costs accrued before the sale of their secured assets.
- The provision amounts are meant to cover only future procedural expenses (*i.e.*, after the sale of the secured assets), thus the receiver was not entitled to set aside any amount from the proceeds for this purpose.
- Allowing the receiver to retain a provision for future procedural costs would effectively deprive the secured creditors of their privileges in the insolvency proceedings for the amount set aside.

As a result of this favorable decision, our client fully recovered the amount set aside by the receiver.

RECENT CASE-LAW

The courts' practice on this matter remains inconsistent, even after our precedent from the Bucharest Court of Appeal. While some courts continue to allow judicial receivers to retain provisions from the proceeds of secured assets, we have noticed that the Bucharest Court of Appeal continued to rule in favor of secured creditors.

NEXT STEPS

Navigating insolvency proceedings can be complex and uncertain, even for secured creditors. In their pursuit of ensuring a high recovery of receivables, secured creditors will continue to face several obstacles due to the growing complexity of insolvency procedures, unclear or insufficiently tested legal provisions, and inconsistent court practices.

Overcoming these obstacles will continue to require the creditors to develop a suitable strategy before submitting their claims and to secure skillful and versatile legal representation throughout the entire insolvency process.

Key takeaways:

- **Successful challenge against the retained provision:** We obtained a major win for our client, with the Bucharest Court of Appeal denying the right of the judicial receiver to retain provision amounts from the secured creditors.
- **Inconsistent courts' practice continues:** Although the Bucharest Court of Appeal case-law seems to have aligned against retaining provisions, other courts continue to rule against the secured creditors on this matter.
- **Approach to overpass obstacles in insolvency:** Secured creditors should develop robust strategies and secure versatile legal representation in their pursuit to overcome inherent insolvency issues and maximize recovery of receivables.

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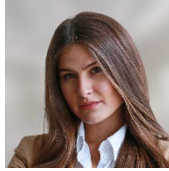
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