

ON EFFICIENCY, BARGAINING POWER AND INFORMATION ASYMMETRY. A LEGAL AND ECONOMIC ANALYSIS OF ALTERNATIVE LEGAL METHODS OF CREDITOR PROTECTION FOR *IN BONIS* COMPANIES IN ROMANIA AND ENGLAND

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Abstract: *This study offers a comparative and economic analysis of Romanian and English creditor protection methods concerning in bonis companies. The focus of the analysis is on the rules of alternative or self-help rules as well as an exploration of the theory of appearance (error communis facit ius) and estoppel from a Romanian and English perspective, to determine what is the functionality and efficiency of these methods, including law and economics considerations. Thus, we are conducting both a comparative analysis of a continental and common law system as well as an economic analysis of law. We consider efficiency problems in regard to the underlining market failure of informational asymmetry in creditor protection scenarios. We concluded with the ways in which these alternative creditor protection methods are structured and can help remedy the problems faced in the bargaining process in the creditor-debtor paradigm, offering a new perspective on the dynamics of a form of creditor protection which has not been thoroughly considered.*

Keywords: *creditor protection, efficiency, information asymmetry, bargaining power, estoppel, theory of appearance.*

Introduction

This study offers a comparative and economic analysis of Romanian and English creditor protection methods concerning *in bonis* companies. Romania is a country that has a great potential to attract new investments by creating a flexible creditor protection system. The best example is the United Kingdom, which is considered a paradise for flexible creditor protection mechanisms. Analysing the measures of protection of the creditors of *in bonis* companies, it can be considered that there are three pillars in which they can be grouped. On the one hand we have strict rules imposed by the rules on share capital which present a standard method of protection (Bachner, 2009). At the other end of the spectrum are the so-called *self-help* methods, through which creditors can impose their own methods of protection. In this pillar we have the functionality of mandatory disclosure as well as the economic contractual clauses as a means of protection of creditors. Between the standard method and the method of complete deregulation, we have a third pillar, that of the restrictions imposed on the management bodies of the company, the shareholders, and directors. These vary in approach from strict rules, such as those on activating the unlimited liability of shareholders or those on directors' restrictions on share capital, to a more flexible approach, as in the case of fiduciary obligations of administrators. A somewhat novel element of the analysis is the comparison of the theory of appearance and

the British estoppel as a means of protecting creditors. These two elements do not actually fall into any of the pillars mentioned above but largely compensate for the shortcomings of the above pillars, with the aim of protecting the bona fide creditor.

This paper will focus on the analysis of the rules on alternative or *self-help* rules mentioned above as well as an exploration of the theory of appearance (*error communis facit ius*) and estoppel from a Romanian and English perspective, in an attempt to establish exactly what is the functionality and efficiency of these methods, including law and economics considerations. The analysis of self-help creditor protection and the underlying dynamics has been less analysed than the other pillar of creditor protection. Our aim is to offer new insights into a more flexible system of creditor protection, drawing from the comparative analysis of a continental (French-inspired) and common law system. Attention will also be paid to contractual clauses as a possible element of self-help protection for creditors.

Contractual negotiation - between effective means of protection and opportunism

Before beginning an analysis of the methods of protection of creditors regulated by law, we considered it necessary to analyse the economic contractual clauses as a mechanism for the protection of creditors. It should be emphasized that this subchapter does not aim at an analysis of the types of existing contractual clauses but rather at an analysis of them, generally approached, as an effective means of protecting creditors. This fact is all the more relevant from the perspective of the emergence of the notion of self-help which involves allowing the creditor to create his own "armour" based on bargaining power. This method is correlated with the mandatory disclosures, mentioned briefly before, because only based on an adequate information could we consider that efficient contractual clauses for creditor protection can be issued. Although not widely discussed in doctrine, this method is gaining momentum at European level. This is all the truer in the United Kingdom and the United States since those systems are based on deregulation and maximum flexibility in business transactions (Andreson, 2012).

Contractual clauses are methods of protecting creditors against the various forms of opportunism that debtors can achieve (Hall, 2008): diluting the mass of assets from which the debt can be recovered, underinvesting, and substituting assets. From an economic perspective, all these problems arise due to the fundamental conflict between creditor and debtor. Based on this mechanism, if the debtor makes a profit, the creditor satisfies his claim, and the debtor keeps the surplus (Mulbert, 2006). In case of non-performance, based on the contract, the debtor recovers his claim from the debtor's assets, of course, if there is no one with a higher rank or a privilege attached to the asset. So, any capital fluctuation towards the debtor favours the creditor and any capital fluctuation from the debtor favors the debtor who no longer must gratify the creditor. It should be noted, however, that the issue of capital redistribution (or economic distributional concerns in general) is not the only real problem with this paradigm. If this were the case, it would be possible to introduce contractual clauses blocking these *ex ante* redistributions. However, the problem is more complicated, because the opportunistic behaviour of the creditor could lead to the blocking of any capital flow in the company, either due to reaching an insolvency threshold, or due to the approach of more risky projects or the inability to

complete. a viable financing project (Mulbert, 2006). From an *ex ante* perspective, a joint effort is needed between creditors and debtors.

Contractual clauses could be the solution, limiting the actions that the debtor can take. However, it is almost impossible to create a contract that covers any risk and may not even be indicated because it could indirectly block a director to carry out an action that would be beneficial for each party to the contract. This is frequently discussed in the incomplete contract framework in law and economics literature (Schmidt, 2006). This can be avoided by negotiating and renegotiating the contract when needed. Thus, it must be understood that a company needs flexibility in dealing with certain transactions that can bring surplus profit to itself and therefore to the creditor. From this perspective, it is necessary to have renegotiation clauses that allow to reach a real dialogue between creditor and debtor and therefore to improve the situation of the company (Anderson, 2012).

However, in the real world, negotiations are imperfect. Firstly, there is an information asymmetry between the creditor and the debtor. If the debtor is better informed than the creditor about an investment project, it is hard to believe that the debtor will reach a consensus with the reluctant creditor (Trung Tran, 2020). Secondly, if there are several creditors, it is difficult to reach a consensus between them, as the baseline is the tendency of creditors to take advantage of the clauses inserted in the contracts of other creditors as a means of protection ("free riding"). Moreover, it is accepted that a creditor with a small debt (Anyangah, 2017) will not be willing to accept the new investment, being satisfied to maintain the state of the company at a level that allows it to satisfy the debt.

If these problems refer to the *ex post* scenario, some drawbacks can be identified with this *ex ante*. First, the creditor who had the greater bargaining power will keep part of gains for renegotiation. However, he may not want to diminish his bargaining position, so he will not be interested in new investment projects or other common development plans of the company *ex post*. Conversely, if renegotiation is aimed at avoiding the loss of debt at the time of insolvency and he believes that renegotiation can bring him greater profit, he will be more willing to initiate this procedure more so than to work for a relaunch of the company (Jenson, 1976).

Considering the above, some conclusions can be drawn regarding the methods in which creditors could turn contractual economic clauses into functional protection mechanisms. It is possible to act on the lack of information of the creditors. Another option would be to rethink the collective action of creditors in the renegotiation process. Mitigating the needs of all creditors is difficult to achieve. It was suggested that a formal renegotiation meeting be set up, which would not require the unanimous agreement of the creditors on a new project but only a (super-) majority (Cho, 2014). However, this option may not be the best, though applicable. A clear example of this (in the insolvency scenario) is the super-majority and reorganization voting requirements which have yielded mixed efficiency result. However, in a unanimity system, each creditor has a pivotal role, so it encourages everyone's involvement in the project and discourages "free-riding" which can lead to the passivity of creditors to the detriment of the company. Moreover, the majority could be used by a group of creditors to suppress the rights of other creditors. So, any departure from the rule of unanimity must be well thought out and considered *ex ante* (Armour, 2006).

The disagreement could also be resolved if there was a creditors' representative to negotiate on their behalf. Of course, it would require that its decisions be accepted

unanimously by creditors, but it would eliminate conflicts between them by creating a single voice. A more radical solution is to tackle the problem by creating sensitivity thresholds through contractual frameworks. If the debtor pays his debts, he keeps his company but if not, the creditor automatically takes control of his assets. Or the clauses inserted in the contract for the protection of the creditor could block the debtor through further diminishing his assets. A more sophisticated system could be designed, based on cash flow, where if the company is functional, a series of more flexible contractual clauses are activated, but if cash flow decreases, another stricter set of conventions comes into play. In this way, creditors are constantly protected, but debtors can also operate effectively. Obviously, real protection through contractual clauses can be achieved for voluntary (active) creditors. In the case of others, especially involuntary ones, this mechanism is not very useful. However, they could be protected by the protection provided by the restrictions imposed by the contractual clauses of stronger adaptive (voluntary) creditors (a form of efficient *free riding*) (Andreson, 2012).

As we have seen, insofar as it has the necessary bargaining power, creditors may end up blocking the company's activity through contractual terms or influencing it to the detriment of other creditors (Siems, 2011). For this method of creditor protection to be viable, a limitation of this power is needed to the scope in which creditor bargaining can pervert the control the creditors have over the actual company (Duracinska, 2017). Such a limitation was created by the English system by the notion of shadow director (CA, 2006, art. 170.5), whereby a third party to a company which by its action, contractual or otherwise, influences its activity can be considered the shadow administrator, in fact its, thus responding like any director. Although it is quite difficult to meet the standard of influence and interference imposed, this method does counterbalance the excessive power of stronger creditors (Mikaloniene, 2019) to the detriment of weaker creditors, thus streamlining the contractual framework to ensure both fairness and efficiency (Granato, 2017). However, the common law legal framework in the United Kingdom states that the influence which the creditor has over the company, transforming it into a *de facto director*, does not mean that all the director duties imposed by law apply to it. In this way, the English courts (*Ultraframe (UK) Ltd. v Fielding* [2005] EWHC 1638 (Ch)) could decide what debts to impose on the creditor, adapting it to the situation and giving flexibility to the mechanism.

This flexible checks and balance system could easily be extended into the Romanian framework, offering a proper checks and balance framework for efficient creditor protection. However, further efficiency concerns should be addressed in regard to the ability of courts to properly assess the level of liability of the shadow director as well as the uncertainty created by the flexible framework. While these concerns might be properly mitigated in a system of legal precedent as that of the English system (Deakin, 2017), this becomes more difficult to adjust for in a continental system like Romania.

Theory of Appearance versus Estoppel – a comparative and economic analysis

The idea of appearance as a means to producing legal effects, i.e., the theory of appearance under the French tradition or *error communis facit ius*, can be defined as the legal theory that consists in recognizing the legal effectiveness of acts that do not fully comply with the strictly legal conditions and which, for this reason, should be null and

void. in good faith and with increased caution. Thus, for those situations that appear, under all external conditions, as true situations are given legal effect and enforcement (Dogaru, 2002). In civil law, in some cases, appearance has legal effects. It is justified by common error or in order to compensate for disclosure needs (*error communis facit ius*). Given the dynamics of interpersonal relations, law must find the means and tools necessary to streamline legal relations between legal subjects. Absolute legal certainty is indeed a primary goal, but a balance must be struck between static security, which protects the interests of shareholders, and dynamic security, which protects the interests of stakeholders (Carpenaru, 2008). The enforcement of legal relations is particularly important in terms of economic interests, but this cannot be accepted by exceeding the boundaries of fairness and morality in human conduct. Thus, good faith appears as a determining condition in recognizing the legal effects that appearance produces in concrete situations. Economic interests, though strong, cannot in themselves justify the effectiveness of appearances, but only in so far as they are joined by a moral ideal, a purpose permitted by law, and good morals, evident enough to demonstrate honesty, the will to conform, the prudent attitude, essentially the good faith of the individual (Danis-Fatome, 2004).

The law does not specify the constitutive elements of the theory of appearance, so it remains a jurisprudential creation. The clarity of the conditions for the application of the theory of appearance is important, given its role in reducing the legal insecurity that is sometimes insinuated in civil law in general and in the field of contracts, in particular. In the attempt at theoretical substantiation, expressions such as "*common error*", "*legitimate error*", "*legitimate belief*" are used, underlining to the idea of good faith (Rabagny, 2001). The existence of good faith on the part of third parties is necessary and sufficient in the game of appearance. Although the effects recognized in some applications of the legal mechanism- which led to the consolidation of rights acquired under legal appearance - are extra-legal effects, the motivation for their recognition lies in the union of appearance with good faith. This results in a clear distinction between good and bad faith, with the scope of the recognition of legal effects under the idea of appearance being limited to situations where good faith cannot be questioned. The applications of the theory of appearance have been continuously developed since its creation.

In commercial law, the necessities of contractual certainty give rise to a wider recognition of the effects of appearance, sometimes sacrificing reality. In many cases, commercial law is not concerned with knowing the reality of the rights, but more so with the satisfaction with the appearance of their validity. In the case of commercial securities (e.g., promissory notes, checks etc.), the law imposes certain very strict formal conditions for the validity of the credit titles and, on this basis, admits their regularity, without worrying about their legal cause. Thanks to the recognition of the legal effects of appearance, on a large scale, the movement of goods is much facilitated in favour of the development of the commercial activity (Atanasiu, 2011).

In the Romanian legal framework, the protection of creditors of companies *in bonis* is regulated in art. 1921 and art. 817 of the New Civil Code (NCC). Art. 1921 is entitled "Liability of apparent partners" and states that: "(1) Any person who claims to be a shareholder or deliberately creates a convincing appearance in third parties in this respect is liable to bona fide third parties just as a shareholder; (2) The company will not be liable to the third party thus misled unless it has given sufficient reasons to the latter to consider

the alleged shareholder as such or if, knowing the manoeuvres of the alleged shareholder, does not take reasonable measures to prevent misleading the third party.”

Thus, misleading third parties in regard to the quality of shareholders represents an illicit deed that will attract the responsibility of the party under the conditions of art. 1921 NCC, i.e., by fulfilling one of the two conditions: either directly states that he has the status of shareholder although he never had it or lost it recently; or it induces this belief through its behaviour (indirectly). Clearly regulating the second condition is a beneficial element because it is often difficult or even impossible for creditors to verify the status of a shareholder. It is very possible for a known shareholder terminate its links with the company and to enter into a transaction with a third party (who had previously met him in his shareholder status) on the same day. It would be hard to believe that that third party, although doing all the necessary due diligence, will find out in time about the loss of the status. Another element that needs to be considered is the notion of "reasonable steps" that the company should take to stop the apparent shareholder in order to escape liability. This duty of action of the company derives on the one hand from the need to protect third parties in good faith and as a sanction attached to companies that allow the use of their image and reputation by the alleged shareholder to defraud the interests of creditors. Via this framework, we are implementing a legal fiction, in the sense that it creates a link between the apparent shareholder and the company as if bound by *affectio societatis*.

Indirectly, it could also be the concept of "reliance" and "confidence" in the sense that the image that the company has created or allowed to be created by the apparent shareholder is attributable to it, perhaps to create stability at the level of the business environment, being also one of the practical reasons for using the appearance in commercial law (Rabagny, 2001). But it is necessary to define more clearly what is the standard that the company must meet: is it a subjective one in relation to what it believed or an objective one? We assume from the word "reasonable" that it would be an objective standard, related to the diligence that a company in the same business would perform and with the same level of access to information as the company concerned. However, it is possible that the Romanian legislator would have allowed this looser interpretation because the business environment is a constantly changing and requires, for facilitation of transactions, a flexibility in approaching the relationship between professionals.

However, this approach works well in the case of at arm's length principle, but in the case of an imbalance between the parties, a stricter regulation of this notion would be beneficial. By law ferenda, it would be a solution to define more clearly what are the steps that the company can take (for example public termination or verbal termination of major shareholder leaving the company) to avoid the interpretability and instability of this measure of creditor protection. We should also mention that the injured third party could also resort to the provisions of art. 1349 NCC on tortious liability, because the solution of liability "as a shareholder" could present the inconvenience of not fully repairing the damage if we refer to the limited liability of the shareholder in certain types of companies (limited liability companies etc.). In an earlier version, art.1921 par. (2) regulates two hypotheses in which the company is liable to the third party misled according to par. (1). Art.1921 para. (2) part I provides that "the company will not be liable to the third party thus misled unless it has given sufficient reasons for it to mislead". Compared to the premise from art.1921 par. (1), the text from par. (2) seems to introduce another hypothesis, not entirely uncommon, namely the one in which the misled third party is the apparent

shareholder who considered, in good faith, that he is an associate. That version was amended to make it clear that the company "gave sufficient reasons to regard the alleged shareholder as such" the rule clarification that the third party is the one misled on the nature of the relationship of the apparent shareholder with the company. According to art.1921 para. (2) part II NCC, the company is liable to the misled third party and if, knowing the manoeuvres of the alleged shareholder, it does not take reasonable measures to prevent the misleading third party.

Art. 817 NCC, entitled "Apparent Director" states that "any person who, having full capacity to exercise, creates the appearance regarding another person that the former is the administrator (i.e., *director*) of his property shall be bound by all the contracts which the latter person concludes with bona fide third parties". The legislator enshrines in the New Civil Code another method of protection of creditors, namely the notion of the apparent director, regulating the situation in which a natural or legal person (i.e., a company) with full capacity to exercise that creates about another person the appearance of being the administrator of assets, will be held liable for all acts concluded with bona fide third parties. The regulation refers to the liability of "persons who have the capacity to exercise", so we believe that this regulation also applies to companies, commercial legal entities that have the capacity to exercise, i.e., the ability of the legal person to acquire and exercise subjective civil rights and to assume and fulfil civil duty, by concluding civil legal acts via its governing bodies. This logical and necessary legal construction is enshrined in general in Romanian Decree no. 31/1954 and is reconsidered and developed in the special legislation on different categories of legal persons.

As such, on the one hand, these mechanisms protect the good faith of creditors while, on the other hand, deter companies from defrauding the creditors' trust by creating the appearance of a legal relationship. It is the task of the company to prove either the bad faith of the third party, or the existence of an agreement or another legal or conventional provision that refute the acts concluded by the apparent director.

Via the appearance theory framework, the continental legal framework is growing closer to common law, through the connection to "*reliance*" - a notion which in English law refers to the trust granted based on objective and external reasons to a third party. Such conduct becomes a source of rights and obligations, and the actual contractual will is viewed as second best to this. The closest legal mechanism for the protection of commercial creditors in English law is *estoppel* or more precisely *agency by estoppel* and *partnership by estoppel*. Borrowed from the English language and used as such, the term *estoppel* has no linguistic equivalent in the legal texts of other countries (Merkin, 2011). In international law, *estoppel* is often used to eliminate contradictions in a state's foreign policy. In private law, *estoppel* declares inadmissible a statement which, although in accordance with reality, is contrary to the previous statement or position adopted by a party. English law protects both the *reliance* - the confidence given to an external and objective situation, and the trust given to a person - and requires the subject of law to have a coherent, consistent, and reasonable attitude.

Estoppel was originally a purely procedural mechanism, recognized in the Anglo-Saxon system as a principle of law and morality. It is an original Common Law institution and has no direct equivalent in French-inspired law or other legal systems on the European continent (Merkin, 2011). In essence, *estoppel* seeks to stop or prevent someone from contradicting the appearance that he himself has created, if this would harm another person.

Its scope is very wide, including civil, banking, insurance law, international trade law or labor law. Lord Denning described estoppel in *Moorgate Mercantile v. Twitchings* (1977) as "a principle of justice and fairness." He further describes it as follows: "It comes to this: when a man, by his words or conduct, has led another to believe in a particular state of affairs, he will not be allowed to go back on its words when it would be unjust or inequitable for him to do so".

Some authors considered that the basis of the estoppel principle is an implicit agreement concluded between the author of the representation and the one acting under it, in the form of an agreement or quasi-agreement. For example, Walter Cook, in his work "Agency by Estoppel" (Cook, 1905), that estoppel is based on the idea of a contract obviously concluded between the creditor and the apparent director, based on the doctrine of "consideration" in English contract law. This notion has the double drawback of distorting concepts in the field of contracts and emptying the concept relied on, since the mere existence of an agreement between the parties is sufficient. However, most authors see this as an application of the principle of good faith (Cooke, 2000). The misuse of estoppel, in the absence of actual harm created by the original representation, may give rise to controversial situations in the case law.

The main forms of estoppel covered by this paper are, as previously mentioned, agency by estoppel and partnership by estoppel. Agency by estoppel involves the creation of an apparent mandate or an apparent director where no such legal situation exists (Cooke, 2000). This situation is created by the behaviour of the agent or the principal (the company) that gives the impression of such a position to third parties or does not contradict it when it arises (there is a duty in this regard imposed on the management to rectify this situation if they should have known of it). In English law, this concept is also labelled "apparent authority" or the doctrine of "holding-out". In the case of *Rama Corporation Ltd v Proved Tin and General Investments Ltd* [1952] 2 QB 147, Judge Slade presents the three elements of agency by estoppel as: creating a representation, relying on that representation by third parties and a change in the position of third parties in the cause of confidence in that statement.

In *Freeman and Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480 in which an associate, Shiv Kumar Kapoor entered into a contract with an architectural firm although he was not authorized to do so. It was decided that, because Buckhurst's General Meeting of Shareholder knew and even allowed Mr. Kapoor to act as a director (although no legal contract was entered into), they were required to abide by the agency-based contract by estoppel. as long as the legal status of the company allows a director to conclude such acts. As far as English commercial law is concerned, a link between a person and a company may arise where no such link has been formally established. A person who, by his or her behaviour in his or her words, represents or allows himself or herself to be represented as a partner in a legal partnership is responsible for the appearance to a third-party creditor as if he was actually a real partner. This concept is called "partnership by estoppel" or "presumption of partnership" (Cooke, 2000).

Partnership by estoppel is a doctrine that allows courts to provide compensation to a plaintiff in such a situation. In essence, the doctrine requires a plaintiff to prove that the defendant led the plaintiff to believe that he was a partner in a company. This concept originally emerged from the practice of British courts or *common law*. Later, in some jurisdictions (for example, in the United States) this concept was codified. The plaintiff has

the burden of proof in partnership by estoppel. He must show that the defendant presented himself as a partner, that he relied on that alleged status, and that he suffered losses as a result. If these elements are present, the court should find a partnership by estoppel to have occurred (Cooke, 2000).

The proximity of the notion of estoppel to the theory of appearance is recognized, at the international level, by a large part of the doctrine. The two notions have in common their very essence, their roots in the goal of justice and fairness. The notion of estoppel is based, in fact, on two elements: on the one hand, the inconsistency of the one who promises, and on the other hand, the trust given to the author of the initial representation by the one who invokes the mechanism (reliance). Insisting on one or the other element, we are led to the analogy with the principle *non concedere venire contra factum proprium*, in the sense that no one can contradict to the detriment of another, encountered in German and Swiss law, respectively with the *theory of appearance* in French-based law (Chen, 2000). The resemblance to the theory of appearance lies as well in the fact that both result in punishing the apparent party who by his attitude consciously creates a situation that appears to be real in front of the one who invokes one of the two mechanisms and, on the other hand, the conferment of legal effectiveness to a situation based on good faith. In English law, the apparent situation must have been created consciously, intentionally, knowing that this could lead to an action on the part of the person misled by misrepresentation (Merkin, 2010). Thus, estoppel penalizes contradictory behaviour and tries, like the theory of appearance, to protect good faith were present.

In order to assess the extent of the duty of the liable party, the court will analyse the good faith of the one who invokes one of these mechanisms. The law takes into account good faith in order to clarify the fairness of the factual situation in question and thus to justify the creation of certain legal effects. It is checked *in abstracto*, relating the behaviour of the subject of law as compared to the prudent behaviour of a diligent person, the so-called reasonable individual. The estoppel mechanism gives binding force to an appearance of commitment (Moreteau, 1990). As in the case of appearance theory, this results in the maintenance of an apparent situation. Both mechanisms have somewhat extra-legal effects, their scope being in principle limited. Both aim to protect the parties who commit a legal error.

However, estoppel has applications that moves it away the theory of appearance, the differences being generated by its initial purely procedural function. It also differs in that it is applicable both when the appearance is contrary to reality and when it is true to it (Cooke, 2000). Initially, in the case of the estoppel, the victim must have suffered damage. The way in which estoppel evolved into American law led to the suppression of this condition, considering that the existence of damage was not absolutely necessary, which took it further away from the theory of appearance (Liew, 2020). Appearance theory consists in recognizing the legal effectiveness of acts which do not fully comply with the law, but are concluded in good faith, while the estoppel prohibits the exercise of a right by its holder as a sanction against by his inconsistent attitude. Thus, the principle of appearance looks at the actual situation, while estoppel focuses on the oscillating behaviour of the author of the appearance. In addition, estoppel is a tort rule (Knapp, 1998). Third parties are protected only to the extent that there is evidence of conduct attributable to the author of the representation. They must prove the contradiction in the behaviour of the interlocutor. The theory of appearance does not sanction either the intentional creation of

a deceptive appearance, or its subsequent denial, aiming only at the stability of transactions. It has detached itself from civil liability in order to become an autonomous mechanism (Pham, 1994).

The agency by estoppel also attaches particular importance to the conduct of the representative and to a lesser extent to that of the apparent trustee or third party, while the theory of appearance is centred on the *bona fide* third party deceived by the untrue situation presented as real. Our legal system protects the bona fide third party as long as circumstances have not required him to verify the extent of the apparent agent's powers. The mischiefs covered by agency by estoppel is also found in Romanian legislation. As we have seen, in Romania there is a protection of third parties against the actions of the apparent shareholders and that of the commercial companies that encourage or remain passive towards this fraudulent activity (as art. 1921 para. 2 NCC shows us). Also, third parties, creditors of the company are protected in the situation where the company create an appearance of the existence of an apparent administrator (as regulated in art. 817 NCC). It is interesting to note that this amendment to the New Civil Code seems to be close to the approach taken by English law. Although the notion of good faith is maintained in the sense that creditors will be able to demand the execution of contracts only insofar as they are in good faith, it seems that what is being punished is the conduct of the company and not necessarily the protection of good faith (Chitimira, 2017).

Similarly, a parallel can be observed between partnership by estoppel and the liability of the apparent partners regulated in art. 1921 NCC. It should be noted that the most obvious resemblance can be seen between this type of estoppel and the second premise art. 1921 because, as presented above, the company knew about the malicious manoeuvre and did not trying to remedy it, its actions would also be blocked by partnership by estoppel. Moreover, both notions aim at both the protection of good faith and the punishment of oscillating behaviour and the creation of a fraudulent situation on the part of society.

As for a possible equivalent for art. 1921 para. 1 regarding the apparent shareholder, we can observe another concept based on estoppel and on the doctrine of misrepresentation, namely *implied warranty of authority*. This notion, described by Lord Drummond Young in *Penn v Bristol & West Building Society* [1997] 1 WLR 1360, presupposes that when a person introduces himself, in his words and deeds, that they represent or have a certain status in a company vis-à-vis third party creditors and they, based on this false appearance, behave or contract in a way that they would not do if they did not exist. appearance then that person must comply with the obligation ("warranty"). If he does not have the suggested status, he will be liable for breach of the obligation, even if it was in good faith, considering that he had that status.

A clear difference between these forms of estoppel and the theory of appearance is that often the emphasis is not on the good faith of third parties but on the behaviour of the director or the company in particular. If the appearance was created and the third party relied on it even to a small extent, the duty is born. However, we observe the tendency of the Romanian legislation to start from the notion of good faith as a focal point then shifting to the oscillating or fraudulent behaviour in the case of the liability of the company (art. 817, art. 1921, para. 2 NCC). Although the condition of good faith of third parties is maintained, the main condition is the analysis of the company's behaviour, a departure from other situations of common error in which good faith of a party could cover any element.

absence from a contract, etc. (for example, in the case of the theory of the apparent state representative).

As a final remark, while the UK was part of the EU, the *acquis communautaire* included the First Commercial Law Directive (2009/101/EC) which required the implementation of an article on the protection of creditors in case of appearance or common error. For the first time this notion appears in the Companies Act 1989, being taken over in the Companies Act 2006 (art. 40) by which a company is bound by the acts undertaken by the shareholder or the apparent director in regard to the bona fide third party. In this respect, a relative presumption of good faith of the third party is created, even if he had known that, based on the articles of association, the director could not have carried out such a transaction. Although it considers the idea of good faith which in itself had not been discussed in the common law system, English law goes beyond the requirements of the directive (Article 10 (2) of the Directive referred to regulation on good faith), imposing a presumption as such. So, the onus falls on the company, which is punished for the negligent behaviour.

Currently, the parties can opt for the presumption existing in art. 40 CA but to the extent that they do not fall within such a framework, estoppel remains the main viable option. From an economics perspective, both the theory of appearance and estoppel are particularly significant in handling the market failure of informational asymmetry. The lack of information on the creditor side and the transaction costs associated with identifying the real status of the individual with which you are contracting creates adverse selection (the market for lemons problem). As such, because of adverse selection, creditors will be less incentivized to contract with companies as they cannot properly distinguish the *good* versus *bad companies* (the lemons), to the point that the quality of transactions in a market can degrade in the presence of information asymmetry between creditors and debtors, leaving only "lemons" behind. Frequent solutions for such problems relate to signalling or guarantee mechanisms that separate the good and the bad. Such alternative creditor protection mechanism can fully eliminate the problem in this regard, as even if information asymmetry exists, creditors are still offered protection even from the *bad types (the lemons)* thus functioning, from an economic standpoint, similarly to a guarantee.

Conclusions

This study offers a comparative and economic analysis between Romanian and English creditor protection methods concerning *in bonis* companies. Romania is a country that has a great potential to attract new investments by creating a flexible creditor protection system. The best example is the United Kingdom, which is considered a paradise for flexible creditor protection mechanisms. Analysing the measures of protection of the creditors of *in bonis* companies, it can be considered that there are three pillars in which they can be grouped. On the one hand we have strict rules imposed by the rules on share capital which present a standard method of protection. At the other end of the spectrum are the so-called "self-help" methods, through which creditors can impose their own methods of protection. In this pillar we have the functionality of mandatory disclosure as well as the economic contractual clauses as a means of protection of creditors.

Between the standard method and the method of complete deregulation, we have a third pillar, that of the restrictions imposed on the management bodies of the company, the

shareholders, and directors. These vary in approach from strict rules, such as those on activating the unlimited liability of shareholders or those on directors' restrictions on share capital, to a more flexible approach, as in the case of fiduciary obligations of administrators. A somewhat novel element of the analysis is the comparison of the theory of appearance and the British estoppel as a means of protecting creditors. These two elements do not actually fall into any of the pillars mentioned above but largely compensate for the shortcomings of the above pillars, with the aim of protecting the bona fide creditor. This paper will focus on the analysis of the rules on alternative or *self-help* rules mentioned above as well as an exploration of the theory of appearance (*error communis facit ius*) and estoppel from a Romanian and English perspective, in an attempt to establish exactly what is the functionality and efficiency of these methods, including law and economics considerations. Focus was given to contractual clauses as a possible element of self-help protection for creditors.

Considering contractual means of creditor protection, it has been shown that the best option to improve this protection mechanism is by conducting a real dialogue between creditor and debtor both *ex ante* and in the renegotiation phase. This can be done by reconfiguring the method of operation of the class of creditors or by creating contracts with sensitivity threshold clauses.

In the analysis regarding the comparison between estoppel and the theory of the Romanian appearance, we concluded that, in itself, both doctrines aim at the protection of good faith. However, as a distinguishing feature, it has been found that the estoppel mechanism differs from the theory of appearance in that it is applicable both when the appearance is contrary to reality and when it conforms to it. Initially, in the case of the estoppel, the victim must have suffered damage. The way in which estoppel evolved into British law led to the abolition of this condition, distancing it from the theory of appearance.

Moreover, a clear difference between these forms of estoppel and the theory of appearance is that the emphasis is often not on the good faith of third parties but on the behaviour of the director or the company. If the appearance was created and the third party relied on it to a small extent, the liability is present. However, we observe the tendency of the Romanian legislation to start from the notion of good faith as a focal point then shifting to the oscillating or fraudulent behaviour in the case of the liability of the company (art. 817, art. 1921, para. 2 NCC). Although the condition of good faith of third parties is maintained, the main condition is the analysis of the company's behaviour, a departure from other situations of common error in which good faith of a party could cover any element. absence from a contract, etc. (for example, in the case of the theory of the apparent state representative).

From an economics perspective, both the theory of appearance and estoppel are particularly significant in handling the market failure of informational asymmetry. The lack of information on the creditor side and the transaction costs associated with identifying the real status of the individual with which you are contracting creates adverse selection (the market for lemons problem). As such, because of adverse selection, creditors will be less incentivized to contract with companies as they cannot properly distinguish the *good* versus *bad companies* (the lemons), to the point that the quality of transactions in a market can degrade in the presence of information asymmetry between creditors and debtors, leaving only "lemons" behind. Frequent solutions for such problems relate to signalling or

guarantee mechanisms that separate the good and the bad. Such alternative creditor protection mechanism can fully eliminate the problem in this regard, as even if information asymmetry exists, creditors are still offered protection even from the *bad types (the lemons)* thus functioning, from an economic standpoint, similarly to a guarantee.

We conclude by emphasizing the benefit and efficiency of these mechanisms for the protection of corporate creditors not only in the insolvency proceedings but even more so when the companies are in good standing in trying to create a stable and functional business environment. Alternative self-help mechanisms are rarely addressed in the literature, although the business environment requires such flexible and effective measures to prevent practices that may affect the position of creditors. The purpose of the comparative analysis is to highlight the effectiveness of these mechanisms in both the continental and common law systems, as well as possible ways to improve the process.

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