THE CONCEPT OF INSOLVENCY (CESSATION OF PAYMENTS, STATE OF DEFAULT OR BANKRUPTCY STATUS). A HISTORIC AND COMPARATIVE LAW ANALYSIS.

O Conceito de Insolvência (Cessação de Pagamentos, Estado de Incumprimento ou Estado de Falência). Uma análise histórica e comparativa do direito.

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ABSTRACT

This paper analyzes the processes of dissemination of ideas, institutional transplantation, and monitoring of European legal models that influenced Ibero-American—particularly Argentine—Commercial Law and, specifically, Insolvency Law during the XIX and the XX centuries. The fundamental thesis of the author states the relevance and scientific legitimacy of the so-called *broad thesis* on the "State of Cessation of Payments" (or “State of Default” / “Bankruptcy Status”) and its legal consequences. Throughout this study, these consequences derived from this *broad theory*—which are part of the principles applicable to this doctrine of the “State of Default”—have been highlighted to correctly interpret the legal texts *de lege lata* and *de lege ferenda* for Argentina, other Latin-American and European jurisdictions.

The working method consisted of a qualitative analysis of the legal sources of comparative doctrine, legislation, and jurisprudence - European and American - on the concept of insolvency and its founding theories.

The results consist of the correct definition of the so-called "State of Cessation of Payments" or also "Insolvency", from the legal point of view and therefore the formulation of interpretations *de lege lata* in accordance with this concept, as well as future texts *de lege ferenda*.

Keywords: Insolvency Law - Insolvency Status (State of Default) - Legal Concept of Insolvency - Comparative Insolvency Law - History of Insolvency Law

Part One

1. Overview and Introduction

This paper analyzes the processes of dissemination of ideas, institutional transplantation, and monitoring of European legal models that influenced Ibero-American—particularly Argentine—Commercial Law and, specifically, Insolvency Laws from the 19th century to the present.[1]

In the 19th and 20th centuries as well as so far in the 21st century, the influence of Italian and French insolvency laws has prevailed in the sanctioned legislative texts, the doctrine, and the jurisprudence, especially in Buenos Aires City's Commercial Court, the only one of its kind in Argentina.

The first part of this paper explores the significance of the study of the notion of "Cessation of Payments" or "Bankruptcy Status" or "State of Default" (COP hereinafter) as well as Argentina's legal and historical bankruptcy framework in general. The second part examines the historical evolution of the concept in Argentina's legal sources of bankruptcy proceedings, especially after the legislative reforms of 1902 and 1933, as well as the theories developed on the subject—mainly by Raymundo L. Fernández and Mauricio Yadarola-, among others. The dominant European ideas that underpinned these legal developments will also be discussed, as well as those formulated before and after each legislative reform during the period under consideration. The third part features an interpretative analysis of the laws in force since 1862, as well as their assessment by the jurisprudence and doctrine prevailing at the time, including, where appropriate, considerations on current laws. Finally, the fourth part offers some thoughts for future laws, delving into the ethical issues at play in applicable theories and highlighting the importance of this period and the economic problems underlying the COP. This final section also proposes a legal text *de lege ferenda* and details the key conclusions drawn from this research.

The primary purpose of this work is to study the concept of the debtor's COP, analyzing its definition as *the debtor's inability to pay his debts on a permanent and general basis, as evidenced by revealing non-exhaustive facts, which are conceptually different from the mere arithmetical imbalance between assets and liabilities and which must be assessed in each case prudently by the judge, after summoning the debtor*.

[1] This researcher is indebted to the libraries of the following institutions located in Buenos Aires: *Universidad de Buenos Aires, Corte Suprema de Justicia de la Nación, Biblioteca Nacional, Colegio de Abogados de la Ciudad de Buenos Aires, Colegio de Escribanos de Buenos Aires, Biblioteca del Congreso Nacional, Instituto de Investigaciones de Historia del Derecho,* and *Universidad Austral* for the use of their resources.

This study not only covers the historical facts, but also the conceptual nuances, the systematic aspects, the applicable theories, as well as the ethical and economic questions that arise in bankruptcy proceedings, along with their practical consequences and their link with current Law. Thus, it follows the guidelines established by modern European trends on legal historians' practical profile—in this case, focusing on dogmatic Law, which is this author's area of expertise.[2]

The fundamental thesis of this paper is to affirm the relevance and scientific legitimacy of the *broad thesis* regarding COP and its consequences. Throughout this study, other consequences derived from this *broad theory* have been highlighted—as they are part of the principles applicable to this COP doctrine—in order to correctly interpret the legal texts *de lege lata* and *de lege ferenda* in Argentina. This theory adequately combines the legal, ethical, and economic issues inherent in insolvency and supported by European and Latin-American comparative Law as well as COP historical background. These analyses may prove useful for the doctrine in other countries, especially within the scope of Continental European Law and U.S. Law.

1.1. The Importance of the Topic at Hand

The importance of the subject studied here lies in the fact that it is the cornerstone of the entire bankruptcy legal system—not only in Argentina but in other countries as well. Thus, once its existence has been verified, it triggers all the consequences of substantive and procedural law that exceeds all the private law regulating the debtor′s *"in bonis*" situations—i.e., regarding the debtor′s

[2] Paolo Grossi, "El punto y la línea (Historia del derecho y la derecho positivo en la formación del jurista de nuestro tiempo)", a masterly lecture he delivered when he received an honorary degree from the University of Seville (1998), in *Revista del Instituto de la Judicatura Federal*, Mexico DF, nº 6, 2000, pp. 149-164. This author shares Grossi's opinion on the necessary interdisciplinary methodological consideration between the historian of law and the dogmatic or specialist in positive law. For other methodological considerations, see Paolo Grossi, "La formazione del giurista e l'esigenza di un odierno ripensamiento metodológico," in *Quaderni Fiorentini per la storia del pensiero giuridico moderno*, Giuffrè Editore, Milano, Vol. 32, 2003, 25-53; *ídem*, Storia del diritto positivo nella formazione del giurista di oggi, *Rivista di storia del diritto italiano*, LXX (1997). On the "primacy and creativity of praxis" as opposed to the "primacy of law," see "Il diritto tra norma e applicazione. Il ruolo del giurista nell'attuale società italiana," *Quaderni Fiorentini per la storia del pensiero giuridico moderno*, Giuffrè Editore, Milano, Vol. 30, Volume I, 2001, 493-507; and also, by the same author, *Metodología jurídica de la modernidad*, Ed. Trotta, Madrid, 2003. In my opinion, the Argentine authors associated with the so-called "broad thesis" on the COP agree with this position, which goes beyond the exegesis of the legal texts historically in force. Also, on the need for interdisciplinary dialogue between the historian of law and the dogmatic jurist, see Rigoberto Gerardo Ortiz Treviño, *Anuario Mexicano de Historia del Derecho*, Universidad Nacional Autónoma de México, México DF, Vol. XVIII, 2006, ps. 463-485, especially pp. 467, 471, 473 and 480. I have found the methodological considerations presented by José María Díaz Couselo very useful, in "Las ideas de Ricardo Zorraquín Becú sobre la historia del derecho," *Revista del Instituto de Historia del Derecho Ricardo Levene*, nº 28, 2000, pp. 39-75. It should be noted that the author of this paper is not a law historian but a specialist in Commercial Law. However, he takes into account the history of law and its methodological considerations. The dialogue between historians and specialists can be very useful. As will be noted in the case of the COP, current realities are rooted in historical developments and comparative law, while future prospects are enriched by earlier notions.

obligations, contracts, rights in rem, privileges, nullity, ineffectiveness, revocable acts, civil or patrimonial liability, criminal liability, etc., as well as the debtor's general financial and personal situation. Particularly important is the relationship between the COP notion and the consequences of the state of bankruptcy on the acts carried out by the debtor during the *period of suspicion of* bankruptcy—i.e. their nullity, voidability, ineffectiveness, or revocation vis-à-vis third parties.

More specifically, the COP principles—if correctly focused—have a noticeable impact on the following topics of insolvency law, among others: the unification of insolvency proceedings for traders or merchants and non-traders; the crisis in the conception of commercial acts as a determinant of commercial matters; the different forms adopted by the principle of credit protection; insolvency judges' roles, their characteristics and limitations, especially at significant milestones, such as the judicial approval of the proposed plan accepted by creditors, the resolution of the verification of claims, the continuation of business operations, and the extension of bankruptcy state to third parties; the continuing dichotomy between the public and the private realms concerning debtors' and creditors' legal and economic interests, as well as their respective manifestations in laws and beyond, especially in doctrine; the contrast between the concept of COP and other similar—yet not identical—notions such as *"crisis*" and *"temporary or financial distress;"* the substantial and procedural consequences or effects of bankruptcy proceedings, both reorganization and liquidation; the justification and regime of out-of-court settlements; the objective and subjective assumptions of direct and indirect bankruptcy declarations; the classification scheme used for debtors' bankruptcy behavior; contractual and non-contractual obligations and privileges; the regime of the so-called *'suspect period*' before bankruptcy and its consequences for the nullity, voidability, revocation, or unenforceability of acts performed by the debtor during that period; determining the starting date for the *suspect period*; the possibility to apply criminal penalties for offences related to debtors' 'insolvency'; and, finally, establishing the causes for the COP and its multiple legal consequences in bankruptcy.

Yet, this approach will not be limited to the study of the evolution of the positive law on the COP, but also to an assessment of COP jurisprudence and doctrine over time, according to prevailing justice criteria. The examination of the link between historical positive law and the ethical principles of insolvency law will also play a key role to overcome the limitations of purely positive legal approaches.

This growing doctrinal and jurisprudential consolidation pertaining the *broad thesis* of the concept of COP is perpetuated to the present day, since the principles arrived at previous periods are now fully valid and have also been adopted in the Argentine legislative texts of 1972, 1983,

1994 and later, which in no way altered these principles. On the question of the COP everything was achieved in the first half of the 20th century in Argentina.

2. Regulations Applicable before 1902

In a brief historical reference we will mention the positive background of the Argentine Insolvency Law.[3]

In the Viceroyalty of the Río de la Plata, the *Bilbao Ordinances*—published and enforced by decree on December 2, 1737—were applied in the matter of Insolvency Law in today's Argentine territory.[4] Predominantly criminal rather than civil or commercial in nature, these regulations were implemented by the *Consulate Court*, established in 1793 and set up on June 2nd, 1794 as a court specialized in Commercial Law in Buenos Aires.

The first commercial rules applied in Argentina, the *Bilbao Ordinances* were interrupted from 1836 to 1858,[5] and they ceased to apply completely when a law passed on September 10, 1862 approved the 1859 Commercial Code drafted by jurists Dalmacio Vélez Sársfield and Eduardo Acevedo for the Province of Buenos Aires for the entire country.[6] This code maintained the close relationship between bankruptcy and the crime of bankruptcy, as well as the corresponding order for debtors' immediate arrest for bankruptcy and the presumption of fraud that every bankruptcy proceeding carried with it.[7] On June 26, 1872, Argentina enacted Law number 514, abolishing imprisonment for debts, except when debtors were declared bankrupt.

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[3] See, among others, García Martínez, Roberto and Fernández Madrid, Juan Carlos, *Concursos y Quiebras*, Ediciones Contabilidad Moderna, Buenos Aires, 1976, Volume I, p. 121 ff. These authors conduct an interesting study of every bankruptcy institution, based on the laws of 1902, 1933 and 1972. For the history of universal and Argentine Insolvency Law, see Osvaldo J. Maffía and María Ofelia B. de Maffía, *Legislación concursal, Introducción histórico-crítica*, Victor P. de Zavalía, Buenos Aires, 1979, pp. 71-99.

[4] *The Bilbao Ordinances*—which regulated the subject of bankruptcy in the 56 articles of Chapter XVII, under the title *"Of the arrears, bankruptcies and the manner of proceeding in their bankruptcies*"—ruled in the current Argentine territory until 1862, when the Commercial Code was enacted.

[5] On March 29, 1836, Rosas issued a decree abolishing all universal or bankruptcy proceedings. This executive order remained in force until March 24, 1858, when another decree issued by the Governor of the Province of Buenos Aires, Valentín Alsina, revoked it. The text of this latter executive order can be found in Fernández, Raymundo L. *Tratado teórico-práctico de la quiebra. Fundamentos de la quiebra.* Buenos Aires, 1937, nº 178, n. 75 (which will be cited from now on as Fernandez, *Tratado..., cit).* Also see Abelardo Levaggi, "El supremo decreto de Rosas del 29 de marzo de 1836 sobre Esperas y Quita," *Revista del Instituto de Historia del Derecho Ricardo Levene*, Buenos Aires, 1980, p. 57 ff.

[6] In 1856, when the Province of Buenos Aires was separated from the Argentine Confederation, the governor of the Argentine Confederation, Dr. Valentín Alsina, entrusted jurists Vélez Sársfield and Eduardo Acevedo with the elaboration of a draft for a Commercial Code, which was presented to the government on April 18, 1857 and approved in 1859.

[7] See García Martínez and Fernández Madrid, *op. cit. at* n. 4, Volume I, p. 125.

During the 1890s and 1900s, several reform projects were presented. It should be noted that, after the fall of President Juárez Celman (1886-1890), commercial legislation had to be revised, especially in bankruptcy matters. The reforms began with the system of moratoriums, modifying article 1592 of the Commercial Code, which did not allow for moratorium extensions. Following this amendment, the possibility of extension for two consecutive times was established by Law 2,889. As in other countries, the moratorium ended up failing in Argentina.

3. Overview of the 1902 Insolvency Law Number 4,156

The 1902 law was mainly the result of a commission consisting up of Carlos Pellegrini, Manuel F. Mantilla, and Dámaso E. Palacio, who made a draft bill that, with some changes, was passed and registered under number 4,156 on December 30, 1902. This law introduced the preventive agreement with creditors and the adjudication of assets as preventive solutions to the failure—solutions that ceased to remedy it, as they had in the Commercial Code of 1889. The reorganization agreement was structured according to the plans crafted by Italian scholar Leone Bolaffio and the Italian General Commission; it also drew inspiration from the English *Bankruptcy Act* of 1869, which had been repealed almost twenty years earlier, due to technical deficiencies, when the English *Bankruptcy Act* of 1883[8] was enacted.

The moratoriums, which had produced poor results, were abolished. The official and judicial control of the bankruptcy trial was also abolished, and the apparently failed English system of 1869 or the creditors' autonomous or voluntary regime was introduced by deferring the most important solutions of the bankruptcy trial to their majority vote.[9] The other two main features of the 1902 law were the incorporation of the creditors' preventive agreement and the adjudication of assets as preliminary solutions to payment defaulting.[10]

[8] See *idem*, p. 133.
[9] *Ibid*. According to these authors, this failure was based on the indifference shown by most creditors regarding debtors' fate, the abuses of the trustees appointed by them, the unification of creditors' vote into a few or a single person, the collusion of bankruptcy businessmen—typically a creditor—with debtors to the detriment of the other creditors, a creditor's self-appointment as insolvency trustee, the appointment of the supervisory committee, and the setting of trustees' fees.
[10] See, among others, Héctor Cámara, *El concurso preventivo y la quiebra,* Depalma, Buenos Aires, 1982, Vol. I, p. 7, note 7.

4. Problems Arising from the 1902 Insolvency Law

The main criticism of this law hinged on the clandestine nature of debtors' relations with their creditors, which led to patrimonial abuse and fraud. However, despite the frauds committed under its system, Law Number 4,156 remained in force for 30 years. Merchants did not really care about their commercial failure because, when they became insolvent, they were not punished as harshly as they had been under the laws of 1862 and 1889—which imposed arrest and immediate criminal prosecution, divestment, automatic interdictions, etc. A reorganization plan and the adjudication of assets not only prevented insolvent individuals from declaring bankruptcy, but also, in many cases, these measures enabled them to avoid some of the dire consequences with the actions carried out by the "bankruptcy businessman" a debtor relied on in this situation. Bankruptcy businessmen proliferated in commercial courts and, with impunity, taught dishonest merchants the art of organizing their insolvency to defraud their creditors and escape justice. As Castillo pointed out, merchants thought that the upside of the law lay in its kindness towards honest debtors, while its downside lay in the power it conferred to creditors to judge dishonest debtors and to resolve disputes over the legitimacy of claims and privileges.[11]

Other authors mention the following negative characteristics of this law: a) creditors' meetings were set up by intermediaries considering the solutions privately discussed and agreed upon, going to court only as a formality, and b) creditors with the highest interests generally took the initiative in these proceedings, which was taken advantage of by those who sought to obtain advantages with the threat of bankruptcy, thus fueling a conflict of interests that could not have an acceptable solution in the meeting regulated by the law.[12] In a nutshell, the bankruptcy process established by the law of 1902 bred clandestineness.

5. Reform Projects after 1902

From 1908 to 1932, nine reform bills were submitted to Congress for consideration. Special mention should be made of the draft national Insolvency Law penned by Dr. Juan Carlos Cruz and Dr. Félix Martín y Herrera in 1916, which, although of extra-parliamentary origin, was well

[11] See García Martínez, / Fernández Madrid, *op. cit.* at n. 4, Volume I, p. 134.
[12] Ramón S. Castillo, *La quiebra en el derecho argentino*, Buenos Aires, 1940, Volume I, p. 32; Enrique Ruiz Guiñazú, *La quiebra en el derecho comercial argentino,* América Unida, Buenos Aires, 4th edition, 1926, p. 29; Héctor Cámara, *El concurso preventivo y la quiebra*, Depalma, Buenos Aires, 1982, Vol. I, p. 8.

received.[13] Also noteworthy are the proposals of the 1924[14] *Special Reform Commission*. The moralizing eagerness of the proceedings is evident in these projects.

The reference to the English Insolvency Law of 1869 was also brought up by congressman Carlos G. Colombres when he presented a draft legislative resolution on August 12, 1932 in the Lower House, advocating the reform of the Insolvency Law of 1902. In his speech, Colombres highlighted the repeal of the English *Bankruptcy Act* of 1869 by the Insolvency Law of 1883 in order to overcome the aforementioned clandestineness, which Argentina's Insolvency Law of 1902 inherited and which made it prematurely obsolete by transplanting an obsolete law in the country of origin itself, England.[15] Colombres also mentioned other initiatives required to improve the bankruptcy system in force until then, which had enshrined the principle of creditor voluntarism without distinguishing legitimate from illegitimate interests.[16]

On September 24, 1932, the Senate approved the motion, and Senators Castillo, Sánchez Sorondo, and Laurencena were appointed to the parliamentary committee. In turn, the Lower House appointed Carlos G. Colombres, Bernardo Sierra, Juan P. Pressacco, Adolfo A. Vicchi and Luis A. Ahumada. Castillo was appointed president of the Commission, and Sierra was named its secretary. Castillo presented his project, which was made public, and, after 23 meetings, he formulated his definitive project, which provided the legal text for Law Number 11,719 of 1933.

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[13] See García Martínez, / Fernández Madrid, *op. cit. at* n. 4, Volume I, p. 136-137. For a text of the project, see Félix Martín y Herrera, *Estudios sobre la legislación de quiebra*, Buenos Aires, 1917, p. 123 ff. and *Revista Jurídica y de Ciencias Sociales*, Buenos Aires, 1916.

[14] See García Martínez, / Fernández Madrid, *op. cit.* at n. 4, Volume I, pp. 135-136. The main flaw in the 1902 law is summarized by the document released by the 1924 *Special Reform Commission*, consisting of José Antonio Amuchástegui, Ezequiel S. de Olano, Rodolfo Moreno (h), Miguel J. Culaciati and José Hipólito Lencinas. The document read, *"The evil is in having removed the judges and given the creditors the power to verify claims without the necessary judicial control. The Commission has given this point the greatest importance, considering it to be the main axis in which the whole gear of the trial moves and to solve it correctly, the majority of the provisions of the draft are aimed at*", quoted in *idem*, p. 135.

[15] See García Martínez, / Fernández Madrid, *op. cit.* at n. 4, Volume I, pp. 137-138. This comparison was counterproductive and teaches not only that not all transplants are good but also that the text to be transplanted must be evaluated beforehand; and, on the other hand, that it may be worse to transplant a law that has already become obsolete in the country of origin than not to do so. Hence the need for comprehensive and complete sources of information on comparative law—especially in countries with less well-equipped libraries—as well as for a thorough case-by-case study. Likewise, this example is a clear exponent of the necessity of the historical method to make comparative law, as sustained, among others, by Helmut Coing in *Las tareas del historiador del derecho*, (methodological reflections), translated by Antonio Merchán Alvarez, Publicaciones de la Universidad de Sevilla, 1977, pp. 90-94.

[16] See speech on August 12, 1932, transcribed in García Martínez, / Fernández Madrid, *op. cit.* at n. 4, Volume I, p. 138.

6. Overview of the Insolvency Law Number 11,719 of 1933

From the principle of creditors' and debtors' voluntarism or absolute autonomy established by the 1902 law, a massive turn was made, returning to a tutelary protection of the State in accordance with the 1862 and 1889 Commercial Codes and formalizing the bankruptcy process, with public interests prevailing over private concerns. This was a largely successful attempt to bring order, regularity, and submission to the judicial authority.[17]

7. Assessment of the Insolvency Law Number 11,719 of 1933

Some authors criticized the improvement of the 1933 system, including Yadarola[18] who stressed the irrelevance of extending the legal scope to non-registered merchants, the confusing concept of cessation of payments, and the tolerance for derisory agreements—and others, like Cámara, who criticized the excessive delays in liquidation, the extinguishment of unfinished procedures, the lack of balance between creditors' interests and those of the economy in general, and the inefficiency of liquidators who only accept that role.[19] Other criticisms were collected in a resolution of the Eighth National Convention of Professional Councils in Economic Sciences in 1965, while some authors even wrote preliminary reform drafts in 1967[20].

8. Commercial Law Congresses

It is important to mention the First National Congress of Commercial Law, held in 1940 in Buenos Aires City, which promoted the revision of the Insolvency Law when dealing with the eighth topic, whose debates and conclusions were important due to participants' hierarchy and the importance of subsequent projects.[21] A key outcome of this event was the proposal to unify

[17] The success of the 1933 reform can be seen in the Explanatory Memorandum of the 1936 Executive Power Project, in *Diario de Sesiones, Cámara de Senadores de la Nación*, 1936-II, p. 37. This system was in force for almost 40 years, until the enactment of Argentina's Insolvency Law no. 19,551 of 1972. It featured a few reforms by Decree 1793/56, Law number 16,587, Law number 18,832, and Law number 19,290. Its fundamental changes can be seen in, among others, García Martínez, / Fernández Madrid, *op. cit.* in note 4, Volume I, p. 142-144. Castillo summarizes the fundamental reforms of the new regime in op. *cit.* in note 13.
[18] See Mauricio L. Yadarola, "Algunos aspectos fundamentales de la nueva ley de quiebras," *Revista Crítica de Jurisprudencia*, Buenos Aires, 1934, T. III, 433 ff., cited in *AAVV. Libro Homenaje a Mauricio L. Yadarola*, Córdoba, 1963, Vol. II, p. 115 ff. See also, by the same author, the article entitled "El concepto tecnico-científico de cesación de pagos," in *Jurisprudencia Argentina*, t. 68, Doctrine Section, p. 89.
[19] See Héctor Cámara, *El concurso preventivo y la quiebra*, Depalma, Buenos Aires, 1982, Vol. I, p. 10, note 14.
[20] See G. Ball Lima, *Anteproyecto de reformas a la ley 11.719*, Buenos Aires, 1967.
[21] The works on Insolvency Law by Héctor M. Enz, Luis Juárez Echegaray, Jorge S. Castro, Eduardo Cordeiro Alvarez, Agustín N. Matienzo, Francisco Orione, Eduardo F. Maglione, Marcos Satanowsky, Antonio F. Villar

bankruptcy processes for all types of commercial and civil debtors. The congress made 25 proposals for the reform of the Insolvency Law. Specifically with regard to the COP, it suggested that "the principle should be maintained that the cessation of payments provides the foundation for bankruptcy."[22]

This academic meeting also declared as a fundamental basis for a bankruptcy reform that: "1º. The doctrinal concept of the 'state of bankruptcy' must be removed from Article 1 of the law in order to rule out the possibility of virtual bankruptcy being understood as contemplated in our law. (…) 2º. Non-compliance as an externalization of the cessation of payments for bankruptcy proceedings should not limit the judicial criterion in the timely establishment of the effective cessation of payments. (…) 14º. A declaration of bankruptcy must be made, without exception, in all cases in which debtors have relied on the courts to summon their creditors in order to seek a reorganization agreement and have not been successful in this regard, whether or not their requests have been granted or withdrawn or, for any other reason, an agreement has not been reached.[23] Clearly, these academic and professional experts adopted a broad notion of the COP and viewed the Law in force in 1940 as attached to that notion, since they proposed its maintenance.

9. Projects and Standards after 1933

In order to incorporate new proposals into the Argentine bankruptcy system after the 1933 law, several reform projects and new legislative texts were presented: the 1950 National Bankruptcy Bill, the 1953 National Bankruptcy Bill, and the 1969 preliminary draft.

With regard to the laws enacted after 1933, mention should be made of articles 1, 77, 78 and 79 of the 1972 insolvency law No. 19,551, the 1983 Insolvency Law No. 22,917, the 1995 insolvency law No. 24,522 and the partial amendments to Laws No. 25,563 and No. 25,589 of 2002, Law No. 25,972 of 2004 and Law No. 26,684 of 1 June 2011. These rules continued the best tradition on the broad concept of COP, as shown *below*.

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and Emiro A. Seghizzi, Mauricio L. Yadarola, Juan J. Britos, Aníbal Pereira Torres and Carlos Juan Varangot were published by Universidad de Buenos Aires' School of Law and Social Sciences, *Actas del Primer Congreso Nacional de Derecho Comercial*, Buenos Aires, 1943, Vol. I, pp. 517-606. A copy can be found at the library of the Buenos Aires City's Bar Association.

[22] Universidad de Buenos Aires' Law and Social Sciences School, *Actas del Primer Congreso Nacional de Derecho Comercial*, Buenos Aires, 1943, Vol. I, Bases para la reforma del derecho concursal, paper by Mauricio L. Yadarola, suggestion 4, p. 589. This was not a suggestion for a reform but a reaffirmation of the criterion already in force.

[23] See Universidad de Buenos Aires' Law and Social Sciences School, *Actas del Primer Congreso Nacional de Derecho Comercial*, Buenos Aires, 1943, Vol. II, p. 83-84 and 258. Malagarriga, *Tratado elemental de derecho comercial*, Tipográfica Editora Argentina, Buenos Aires, 1952, vol. I, in pp. 35-36, makes a series of interesting reflections and considerations on the debate on this issue at this meeting.

Part Two

Historical Evolution of the "Cessation of Payments" / "Default State" Concept (COP)

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In order to go beyond the mere linguistic or logical-grammatical analysis of the successive laws in force, this study intends to review COP's historical evolution with the help of the most outstanding authors in Argentina's literature of the first half of the twentieth century. The importance of the position of a significant part of this doctrine in the subsequent legal development of the concept should also be stressed.

10. The Economic and Legal Notion of COP

10.1. Economic Notion

Credit is an essential element in modern economies, especially in commercial business because it allows, through the use of outside capital over a period of time—usually a year—[24] the carrying out of operations on a larger scale than those enabled by cash alone. This brings increased business volume, and, therefore, additional benefits for individuals and society at large. At its core, *in personal terms,* credit is the confidence that an individual will strictly live up to his or her commitments in the agreed upon manner, place, and time. In the so-called *real* credit, the creditor seeks security in the special assignment of certain assets (mortgage, pledge, and even assets first seized by a creditor). There is no such effect on *personal* credit, but creditors take two factors into account: (a) the *objective* capacity of the assets—i.e., the availability of sufficient assets to enable the debtor to make timely payment, regardless of whether or not there is an mathematical imbalance between the debtor's assets and liabilities; and (b) debtors' *subjective* capacity—their personal reputation, professional competence, and business activity, which will ensure the preservation and useful use of their assets and the realization of future profits.[25] Credit is therefore an indispensable asset because it allows debtors to obtain the goods required for their businesses.

As long as the balance between debtors' resources (realizable value, generally within one year) and the obligations to be fulfilled is maintained, debtors are in a state of solvency or *in bonis*. When such equilibrium is broken, either by lack of sufficient realizable assets or by the loss of third-

[24] See the concepts of *current assets* and *current liabilities* and their links to insolvency, *state of default* and business crisis, in, for example, Pablo van Nieuwenhove, Insolvencia, estado de cesación de pagos y crisis empresarial. Soluciones judiciales y extrajudiciales, in *Revista del Derecho Comercial y de las Obligaciones*, Buenos Aires, Depalma, 1983, (year 16, nos. 91 to 96), pp. 563-573.

[25] See, among others, Raymundo L. Fernández, *La cesación de pagos en el derecho argentino y universal*, Buenos Aires, 1939, nº. 7, pp. 25-26. Henceforth, it will be cited as Fernández, La *cesación*…, cit.

party credit, debtors fall into *a state of default*, insolvency[26] or bankruptcy.[27] In this case, economists speak of a decrease or loss of *working capital*[28].

10.2. Legal Notion

As noted above, the failure, economically considered, consists of debtors' financial or economic inability to meet their obligations (usually considered within the period of one year). This is economic bankruptcy—also improperly called *de facto bankruptcy*. In order for such a state to produce legal effects, a judicial declaration of bankruptcy must be made, as this transforms economic bankruptcy into legal bankruptcy. Although a court decision does not create a bankruptcy status—which, from an economic point of view, precedes it and provides its factual basis—it is essential that it be issued in order for bankruptcy to exist both legally and in fact, since it merely recognizes and declares its prior existence.[29] Most authors reject the so-called *virtual bankruptcy,* and the few who accept it tend to do so to refer to the criminal consequences of economic bankruptcy.[30]

When a debtor fails to live up to its obligations, the creditor can obtain a ruling that declares its right and to enforce it upon the debtor's assets (mainly through asset seizing and auctioning). These are known as *individual actions* because each creditor acts separately and independently of the others. The purpose of an individual action, as a means of enforcement, is to compel the debtor to do what it has agreed to do: to give, to do, or not to do.

When debtors' financial incapability becomes *permanent* or stable and *general*, denoting the impossibility of fulfilling their obligations, creditors may limit themselves to individual actions or may—like debtors—provoke collective bankruptcy proceedings. This is to ensure that all of a

[26] We use the word *insolvency* here as a synonym for the *state of default*, but it should be noted that many authors and legislations—especially Anglo-Saxon ones—use the term insolvency to refer to the merely arithmetical imbalance by virtue of which the debtor's liabilities are greater than his assets. We prefer to use—as Argentine doctrine calls it—the term *state of default (SOB) or "Cessation of Payments"* (COP) *("Estado de Cesación de Pagos"* in Spanish*)* to refer to economic imbalance—that is, the state by virtue of which the debtor is powerless to perform his obligations in a stable and generalized manner—and to use the term *insolvency* specifically to refer to purely arithmetical imbalance. That's how we do it in this paper, unless otherwise indicated.

[27] See, among others, G. Bonelli, *Del falleimento*, 2nd ed., Milan, 1923, Vol. I, nos. 2 to 5 and Mauricio Yadarola, *Revista Crítica de Jurisprudencia*, 1934, p. 436.

[28] See Pablo van Nieuwenhove, *op. cit.*, pp. 564-565.

[29] Fernandez criticizes some French writers of the mid-19th century, such as Renouard, because they argue that the so-called *virtual bankruptcy* is a possibility—that is, one that does not require a judicial declaration by the competent civil or commercial judge. Fernandez does not concur—neither do we— because no effect can be followed from a failure to declare a state of economic bankruptcy. Fernandez, *Tratado..., cit*. 364.

[30] On virtual bankruptcy or *de facto* bankruptcy or undeclared bankruptcy, see Fernández, *Tratado*..., cit., 364-431.

debtor's assets are liquidated, and all debts are paid in full if the money obtained is sufficient for this purpose; or, if not, partially and *pro rata*, according to the categories and privileges, respecting the basic principle of bankruptcy or default—i.e. equality between all creditors or *par conditio creditorum*. This procedure, which, even when initiated at the request of a creditor, entails a class action, requires not the *non-fulfillment* of an obligation but the debtor's COP or state of insolvency.[31]

11. COP's Importance

COP's relevance has been anticipated in Section 2 of this paper. Debtors' financial or economic powerlessness is the raison d'être of bankruptcy proceedings. Without it, collective insolvency actions, instituted as a defense not against breach of obligations but against insolvency, would be inconceivable. Its purpose is to liquidate an indebted estate or patrimony that is incapable of normal business development and beneficial to debtors, creditors, and the general economy, while, at the same time, ensuring equal treatment for creditors: *ius paris conditionis creditorum*. This assertion is not only the basis of the entire Argentine or foreign comparative bankruptcy systems, but also fundamental to refute the errors regarding the COP, as has been highlighted by the most qualified Argentine doctrine of the 1930s, which echoed numerous European sources from the mid- and late 19th and early 20th centuries—mainly Italian, French, and Belgian scholars, as well as German, English, and North American ones.

Thus, this Argentine doctrine departs from the notions stated by some Italian and French authors of the time, who identified COP with the non-fulfilment of an obligation, as the so-called *materialistic theory* and the *intermediate theory* do, as illustrated below.

This concept of cessation of payments (COP)—identified as the lack of assets to fulfill obligations in a stable and generalized manner—is also fundamental to distinguish this state from the purely arithmetical imbalance between the debtor's liabilities and assets.[32] This is because not only do many authors identify the COP with insolvency (i.e., with the arithmetic imbalance), but also because there are several laws that require, as a prerequisite to initiate bankruptcy proceedings,

[31] Fernández explains this difference in concept between *individual* and *collective* actions as key to understanding the entire insolvency process, stressing the distinction between default and insolvency, which was precisely the objective of the insolvency process that arose first in Roman Law and more specifically in Italian cities' statutory law, as noted by Alfredo Rocco in *Il Fallimento. Teoría generale ed origine storica*, Turin, 1917, no. 2. See Fernández, *La cesación...,* cit., 28, note 7. As noted later, this constitutes the core of the so-called *materialistic thesis*.

[32] The period generally considered for defining the *state of default* is one year, if the concept of current assets and current liabilities is taken into account. See Pablo van Nieuwenhove, op. *cit.*, pp. 564-565. However, there is a need for further elaboration on the economic consideration of this time frame and its relationship with the COP.

the verification of the aforementioned purely arithmetical imbalance—such as, for example, for civil debtors, legal entities or successions and also for commercial bankruptcy.[33] Thus, comparative legislation has often adopted and still adopts the arithmetic criterion for civil and commercial tenders, as noted below.

On the other hand, this concept not only has implications for the economic rationale of the bankruptcy judgment—as noted earlier—but also for the ethical assumptions of possible abuses that can be verified not only by debtors but also by creditors and even third parties, as will be explored later.

Finally, this concept is instrumental for the regulation of all the legal effects of the COP, mainly as regards the legal consequences that go beyond the Private Law regulating debtors' *in bonis* situations, with respect to obligations, contracts, rights in rem, privileges, nullity, unenforceability, civil or property liability, and their general patrimonial and personal situation, etc.

Of particular importance is the understanding of the COP as regards the determination of the initial date of the *period of suspicion of bankruptcy*, as well as the regime of valid or revocable acts carried out in that period. If the COP is identified with the breaches of obligations, the start of the period may not be brought back beyond the first maturity of a defaulted obligation, and no act prior to it may be reversed. This poses legal issues, since, on the one hand, it may involve the declaration of bankruptcy of a subject or legal entity who is not in bankruptcy from an economic or financial point of view—which is the case, for example, of the so-called *extension of bankruptcy* in French, Italian and Argentine Laws. On the other hand, it may not allow the initial date of default (the beginning of the *suspicion period*) to be brought back to a time prior to the first maturity of an obligation in default, which makes it difficult or even impossible to revoke debtors' acts which may prove highly detrimental to creditors.

Finally, if the COP is construed as a state of patrimonial impotence that may manifest itself not only in the case of non-compliance but also in other types of acts characteristic of such a state, the acts performed by the bankrupt party prior to that first non-compliance may be revoked for the sole purpose of establishing the date on which the economic state of patrimonial impotence began, with greater flexibility and the evident greater moralization of the often discredited bankruptcy framework.[34]

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[33] Indeed, in 1939, Fernandez brought up the cases of the Hungarian law, art. 84; the Croatian law, arts. 73 and 219; the Spanish law on civil procedure, art. 1158; the law of Chile of 1929 and of Peru of 1932; art. 692 of the Portuguese Commercial Code of 1888; arts. 207 to 209 and 215 of the German *Konkursordung* of 1870 and section 3 of the United States *Bankruptcy Act* of 1898: cf, p. 32 notes 13 to 15.

[34] This is particularly the case when the debtor creates new security rights in favor of new or old creditors that did not have them—often required by banks—which makes the right of unsecured creditors illusory, to the detriment of the equality among creditors. In such cases, it is practically impossible for a civil code revocation action to

12. Definition of the COP

12.1. Comparative Legislation

One of the most difficult matters for lawmakers is to determine when the debtor is in a state of bankruptcy. In this respect, there are great differences between the laws of the first half of the 20th century: some laws refer to the inability to pay; others, to insolvency, and yet others, to the *cessation of payments*. Some of them require that civil debtors have insufficient assets in relation to liabilities. In some countries, bankruptcy is a common institution for civilians and merchants; in others, most of it is just for merchants or traders. Finally, there are those who, without equating them, legislate bankruptcy for commercial traders and civil bankruptcy for the rest—with important differences for non-merchants. The comparative norms in force until 1937 have been systematized as follows:[35]

a) Countries that only recognized commercial bankruptcy and generally designated the state of default as *cessation of payments*: French Commercial Code (art. 437), Belgian Commercial Code (art. 437), Italian Commercial Code (art. 683). In Portugal it is called *impossibility to pay*.

b) Countries that legislated bankruptcy proceedings for merchants in the Commercial Code and other bankruptcy proceedings for civil subjects in the Procedural Codes, such as Spain (where, at that time, civil bankruptcy and procedural issues were legislated even for merchants in the Civil Procedure Law, arts. 1130 to 1317), Argentina (civil bankruptcy was regulated in the Procedural Code of the nation's capital and in the Procedural Civil and Commercial Code of every province, with the exception of the Insolvency Law of 1933, which attempted to extend bankruptcy proceedings to non-merchants as a first step towards the adoption of common bankruptcy for merchants and civilians, an aspiration of national doctrine) and other Latin American countries. In some cases, when the norms ruled civil insolvency, they no longer required a COP but insolvency, in the sense of an arithmetic imbalance whereby debtors' liabilities exceed their assets.

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succeed, so that the trustee and the creditors are forced to accept such a state of affairs, where the dividend they obtain is derisory, and the Insolvency Law is discredited. See, for example, Fernández, *La cesación..., cit.* no. 5, p. 23, n. 3. Nowadays we have in the present Argentine Bankruptcy system the legislation on the *Actio Pauliana* within the Insolvency Law, apart from the Civil and Commercial Code.

[35] See the landscape described by Fernández, *La cesación... cit.,* nº 22*,* p. 35-36 regarding the legislations before 1937 in France, Belgium, Italy, Spain, Argentina, Germany, Austria, Mexico, Sweden, England, United States, Portugal, and the former Yugoslavia.

c) Countries that had adopted the common bankruptcy for civilians and merchants, legislating it as one. This criterion had three alternatives:

1. For civil parties, an imbalance between assets and liabilities was required. For commercial subjects, the COP was required.[36]

2. A single general and doctrinaire formula on what was to be understood by payment inability (sometimes referred to as "insolvency") and cessation of payments, leaving it to the judicial discretion to determine when debtors were considered in such a state—for which purpose the court would necessarily take into account their status as civil or commercial persons.[37] However, in the case of legal persons and successions, they were bound by the arithmetical imbalance.[38]

3. Listing of the various acts which gave rise to bankruptcy and which were generally the same for civil and commercial persons, usually referred to in Anglo-Saxon law as *"acts of bankruptcy,"* which could in fact be regarded as falling within the broad concept of cessation of payments, as in the paradigmatic case of England[39] and the United States (art. 3 of the *Bankruptcy Act* of 1898),[40] the Portuguese Code of Commerce of 1888 (art. 692), and the Mexican Code of Commerce of 1890 (arts. 945 to 1037 (substantive rules) and arts. 1415 to 1500 (procedural rules)) which adopt the arithmetical imbalance.

12.2. Convenient Legislation

For authors such as Fernandez,[41] the best system is to establish the inability to pay or insolvency or cessation of payments as the general rule for bankruptcy for both civilians and merchants, enabling judges to assess the facts in each case.

[36] See, for example, Sweden's Law of 13 May 1921; Norway's Law of 6 May 1899; Denmark's Law of 29 March 1872; Chile, Insolvency Law Nbr. 4558 of 4 February 1929, amended by Decree dated 23 June 1931.
[37] See Germany, *Konkursordung* 1877, as amended in 1898, art. 102, which reproduced art. 94 of the *Konkursordung* 1877; Austria's law 1914, art. 68; Yugoslavia's law 1929, art. 67, sub. 1; Netherlands' Insolvency Law of 30 September 1893, art. 1.
[38] See Germany, *Konkursordung* 1898, arts. 207-209 and 215; Austria's law of 1914, art. 69; Yugoslavia's Law of 1929, art. 68.
[39] See *Bankruptcy Act* of 1883, replaced by the Bankruptcy Act of 1914 and amended by the Act of 1926. Not significantly changed, Article 4 was included in the last compilation as Article 1.
[40] On the general characteristics of the U.S. system of 1898, see Fernández, *La cesación..., cit.* p. 32-33, note 15.
[41] See Fernández, *La cesación..., cit.*, p. 43. This is the system of, for example, the old German law (arts. 207 to 209 and 215 of the 1877 *Konkursordnung* with the 1898 reforms), the Austrian law (art. 68 of the 1914 law), and of the former Yugoslavia 1929 law (art. 67 (1)).

In this system, it does not matter in any way whether merchants or commercial traders or non-traders are on an equal footing, but is compatible with such discrimination and even more so, since the court must consider the different *modus operandi* of merchants vis-à-vis non-merchants—particularly as regards the acquisition of credit for ordinary commercial purposes—and establish the state of insolvency for each of them. The legislative tendency in the early and mid-twentieth century was to establish common bankruptcy for civilians and merchants without express distinctions or to expressly establish some differences in terms of disclosure of the state of insolvency, revocability of the acts of the bankrupt, etc.[42] For this view, the requirement of a purely arithmetical imbalance—debtors' assets smaller than their liabilities—to declare a debtor's bankruptcy is unnecessary, inadequate and inconvenient.[43]

I share this opinion insofar as: a) the COP from the economic (as both debtors' economic and financial issues) point of view—its causes, its manifestations, and its definition—remains identical for all types of debtors, whether civil or commercial, individuals or companies; b) there is nothing to prevent us from considering the different economic-financial peculiarities of merchants and non-merchants and from discriminating against them for the purposes of judicially verifying the COP's existence or not;[44] c) it is more convenient not to require civil debtors' merely arithmetical imbalance as a necessary and sufficient requisite, because, even in the case of an exclusively arithmetical imbalance, such debtors may not be in *COP,* an economic-financial concept independent of the previous one.

[42] See Fernández, *La cesación... cit.,* no. 26, p. 43, and U. Navarrini, *Trattato di diritto fallimentare*, Bologna, 1934, Vol. I, no. 39, note 2.

[43] See, for Argentina, the argument made by Raymundo L. Fernández, *La cesación..., cit,* Also see, among many others, Lisandro Segovia, *Explicación y crítica de la ley de quiebras,* Buenos Aires, 1892, vol. III, nº 4434; Manuel Obarrio, *Estudio sobre las quiebras*, ed. Anotada por Carlos Malagarriga, Buenos Aires, 1926, vol. I, nº. 1; E. Ruiz Guiñazú, *La quiebra en el derecho comercial argentino*, 4º ed, Buenos Aires, 1926, p. 202; J. E. Mayorga, *Breve contribución al estudio de las quiebras*, Tesis, Córdoba, 1909, p. 24; M. F. Armengol, *Fundamentos y crítica de la ley de quiebras*, 2º ed, Buenos Aires, 1914, p. 247; Félix Martín y Herrera (h), *La convocación de acreedores y la quiebra en el derecho argentino,* Buenos Aires, 1st ed, Buenos Aires, 1923, II, no. 187; Francisco García Martínez, *La convocación de acreedores y la quiebra*, Buenos Aires, 1934, no. 2 (and his later work of 1953); A. S. Carranza, *La nueva ley argentina de quiebras*, 2º ed., Buenos Aires, 1937, I, p. 23; F. Orione, *Exposición y crítica de la ley de quiebras. La convocación de acreedores*, Buenos Aires, 1934, nº. 1; Salvat, *Tratado de derecho civil argentino, Parte General*, Buenos Aires, 1914, nº. 1517; Mauricio Yadarola, *Revista Crítica de Jurisprudencia*, 1934, 436. Pertaining to the jurisprudence on this position see the following sentences: Cám Nac. Comercial, 8 March 1917 in *Gaceta del Foro* 43, 331; 11 August 1922, *Gaceta del Foro* 40, 143 and *Jurisprudencia Argentina* 9, 309; 19 August 1925, JA 17, 253; 28 April 1926, JA 19, 1016; Cam. Nac. Civ. 2º, 20 July 1932, JA 38, 1139; S.C. Tucumán, 17 July 1933, JA 42, 1246.

[44] This issue will need to be considered in the future, as it appears to have different characteristics for merchants and non-merchants. We have found no sources on this subject in Argentina, except for an *obiter* reference in Fernández, *La cesación..., cit*. nº 8, p. 26.

On the primacy of the *economic* concept of the COP over the mere *arithmetic* imbalance there is nourished doctrine in the first half of the twentieth century on the question[45].

12.3. Historical Evolution of the COP

From Roman Law, through medieval Statutory Law to Modern Law, the approach has evolved from one based on the breach of an obligation to the modern concept of *COP.*[46]

In the first codification of Commercial Law, the French Code of 1807 provided in art. 441 that the time of the start of bankruptcy *"is fixed either by the withdrawal of the debtor, or by the closure of his stores, or by the date of any act which establishes the refusal to comply with or pay commercial obligations.*" The apparent precision of this list was lost at the end: *"all the acts referred to above shall not, however, prove the start of the bankruptcy until there has been cessation of payments or declaration of the bankruptcy.*" The case law, after much hesitation, ended up considering it non-exhaustive or—to put it in other words—that the state of bankruptcy could be revealed by other facts.[47] As for the French law of 1838 (art. 437), which amended the 1807 Code and inspired almost all subsequent legislation on the subject, it abolished all enumeration and adopted the general doctrinal formula *"cessation of payments*" to determine the state of bankruptcy, leaving it up to the judges to assess the revealing facts.[48]

12.4. State of Default and "Acts of Bankruptcy"

COP's manifestations are closely related to its concept. Therefore, the position adopted on this concept will decisively influence the regime for this economic-legal status. This section explores the different positions held by a number of authors and of the comparative legislation.

The Insolvency Laws of the first half of the 20th century can be classified into two main groups, apart from civil bankruptcy:

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[45] See, among others, Yadarola, *Revista Crítica de Jurisprudencia*, 1934, 436; G. Bonelli, *Del fallimento*, 2nd ed. Milan, 1923, vol. I, nos. 2, 4, 5 and 36 (Argentine authors attribute the broad thesis to Bonelli: cf, for example, Adolfo A. N. Rouillon*, Régimen de concursos y quiebras*, Astrea, Buenos Aires, 13th ed., 2004, pp. 42-52 for the topic of the COP and p. 45 for this statement); F. Martín y Herrera, *La convocación de acreedores y la quiebra en el derecho argentino*, Buenos Aires, 2nd part, 1923, vol. II, nº 187.

[46] See Fernández, in *La cesación... cit,* pp. 57-62. In the Statute of Siena of 1262, the word *'ceasing*' appeared for the first time to designate the bankrupt merchant, a term which was later used in other statutes such as that of Florence in 1415 and which gave rise to the modern formula: *'cessation of payments*'. Both texts can be found in Fernández, *Tratado..., cit*., nº 106, n. 21 y 22. The French Ordinance of 1673, title XI, art. 1 already spoke of this *state of cessation of payments.*

[47] See Fernandez, *Tratado... cit.,* no. 108, n. 30.

[48] It reads: *"Every merchant who stops his payments is in a state of bankruptcy."*

1. Those listing the acts that triggered the declaration of bankruptcy, called *"bankruptcy acts"* (e.g., in England, the United States, Sweden, Brazil, Mexico, etc.).[49]

2. Those that adopted a doctrinaire and general formula, including all the acts and circumstances demonstrating debtors' inability to meet their obligations, leaving it up to judges to assess them in each case, and calling it *cessation of payments* (France, Belgium, Italy, Spain,[50] Argentina, and almost all the Ibero-American countries)[51] or *inability to pay* or *insolvency*—not in the arithmetical but in the economic sense.[52]

In Argentina, the use of the *cessation of payments* formula constitutes a legislative tradition, since it was adopted by the Commercial Codes of 1862 and 1889, the 1902 law and article 1 of Law Number 11,719 of 1933—a tradition that was continued in the 1972 Insolvency Law Number 19,551 and subsequent ones in 1983 and 1994.

The exhaustive list of *'acts of bankruptcy'* is considered to be a drawback in that: (a) the state of bankruptcy is a complex economic state, which can be revealed in many different ways; (b) many of the debtor's acts, because of their ambiguity, may be open to different interpretations—those which, for some, are evidence of a lack of financial strength, for others, may not be so—and (c) it cannot be confined to a list of simple facts which is as complex and which may have such different nuances as the COP or bankruptcy.[53] I agree with this stance.

The system of *default* was adopted in an eclectic manner by the French Commercial Code of 1807, which established some cases of bankruptcy, but with deficient technique, according to French authors. The French law of 1838, as noted above, adopted the general *cessation of payments* formula, which was later reproduced in almost all legislation.[54]

In reality, the basic condition required for the deficiency is the same: the inability to pay. The casuistic enumeration lacks value because it almost completely suppresses judges' power of appreciation, as judges must limit themselves to declaring bankruptcy when the facts have occurred.

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[49] See art. 1 of the English *Bankruptcy Act* of 1883, partially amended by the *Bankruptcy Act* of 1914; art. 3 of the U.S. *Bankruptcy Act* of 1898; art. 2 of the Swedish law of 13 April 1883; art. 1 of the Brazilian Insolvency Law of 1929; art. 945 and 952 of the Mexican Commercial Code of 1889.

[50] See art. 874 of Spain's Commercial Code of 1885.

[51] See art. 437 of the French law of 1838; art. 437 of the Belgian law of 1851; art. 683 of the Italian Commercial Code of 1883; art. 1 of Argentina's Insolvency Law Number 11,719 of 1933.

[52] Thus, for example, art. 102 of the 1877 *Konkursordung*, as amended by the German law of 1898 law; art. 69 of Austria's 1914 law; and art. 68 of the former Yugoslavia's law of 1929 law. See also the current art. 2 of the Spanish Insolvency Law 22/2003 of 9 July [BOE 10 July 2003, number 164, page 26905].

[53] See Fernández, *La cesación de pagos*, cit., nº. 50, p. 65, n. 8.

[54] The countries that adopted the classic formula of *cessation of payments* in this period include: Belgium, Commercial Code, art. 437; Italy, Commercial Code of 1883, art. 683; Portugal, art. 692 of the Commercial Code of 1888; art. 1st of the Dutch Insolvency Law of 1893; Argentina, the Commercial Codes of 1862 and 1889, the Law of 1902 and 1933; art. 102 of the German *Konkursordung* of 1877; Austria, the Law of 1914, art. 68 and art. 67 of the 1929 Law of the former Yugoslavia.

On the other hand, laws using a general formula leave the determination of the scope of the facts revealing such a state to judges' discretion. Thus, many authors understand that the scope of the law is the same in *essence*—whether it adopts the general system or the *"bankruptcy acts" system*—because the COP covers *all the acts* listed in other laws.

13. Applicable Theories and Their Critiques

The European comparative doctrine has formulated different theories or doctrines about the concept of the COP. The Argentine doctrine has followed, in general terms, the concepts of Italian, French, and even Belgian authors, but not all of them, nor has it followed the terminology used by these authors or the respective legal texts sanctioned. On the contrary, in many cases it has only collected the foundations set forth, redefining them and developing a different system. This has been the case of Raymundo L. Fernández, the leading author who has dealt with the issue of *COP* in the Argentine doctrine with unparalleled depth.[55] Authors have streamlined the doctrines applicable to the topic in three major doctrine, which are analyzed below: the *materialist*, the *intermediate,* and the *broad*, according to the terminology coined by Fernandez.

There is a fourth theory, especially advocated by some Italian authors of the first half of the 20th century, called *"of the equivalents,"* but it actually has the characteristics of the "*intermediate*" and even some elements of the *"broad"* theories.[56]

13.1. Materialistic Theory

This thesis defines the COP as a breach—a material interruption of payments—and this status can only be accredited by defaults. A single breach is sufficient to declare bankruptcy, regardless of the amount of money involved. Without a breach, a bankruptcy cannot be declared, even if other more or less unequivocal facts are found, such as express or implicit confession, requests for moratoriums or withdrawals from creditors, flight or concealment, business closure, the debtor's suicide, etc. This thesis is based on the importance in trade of a strict compliance with obligations—even minimally— whereby non-payment is the most eloquent and categorical

[55] See Raymundo L. Fernández, *Tratado... , cit...* This book is more than 1,190 pages long. Other authors such as Yadarola agreed in 1935 with Fernández's views, as noted below.

[56] See Fernández, la *cesación de pagos*..., cit. pp. 72-74 and note 12. This thesis of equivalents states that the *cessation of payments* is the material and effective interruption of payments —i.e., without defaults, there can be no cessation, but bankruptcy also takes place when other facts *equivalent* to cessation, also easily ascertainable and of precise significance, unequivocally demonstrate the state of the debtor's financial incapacity. It is based on articles 683, 686, 855 and 705 of the Italian Commercial Code of 1883.

revealing fact of the COP and the prohibition of the examination of the debtor's assets prior to bankruptcy. Thus, any default—even a single default—necessarily determines a debtor's bankruptcy.[57]

This theory is criticized on the following grounds. a) It disregards the historical origin of the institute. b) It refutes the economic and legal bases of the collective procedure, whose purpose is to defend debtors, creditors, and the economy in general—not from defaults but from insolvency or COP. c) It contradicts and prevents the purpose of preventive bankruptcy proceedings, which is to overcome the COP. d) It deprives the insolvency process of its reparative character by preventing the defaulter from going back to the time of the cessation of payments beyond the time of the first default and thus neutralizes the revocability of the detrimental acts performed by the debtor in the *period of suspicion*, which is detrimental to creditors and to the morality of the business. e) It erroneously identifies a fact, such as non-compliance, with debtors' economic state, which is an economic (both economic and/or financial) state of generalized powerlessness for the fulfilment of obligations. f) It does not distinguish between non-compliance and non-payment, since they are conceptually and practically independent: non-compliance does not constitute the COP but is a consequence of it, and therefore there may be COP without non-compliance and non-compliance that does not matter for a COP. g) This conception leads to unfair consequences because: 1) it involves declaring the bankruptcy of a person who may not be economically bankrupt; 2) there may be plausible, legal, and legitimate grounds for default at maturity—e.g. when the credit is in dispute or due to the debtor's involuntary acts such as forgetfulness, negligence on control of payments, etc.; 3) individual enforcement is faster, cheaper, and simpler than the universal process; 4) it is necessary to discriminate between small and large or single and multiple defaults; 5) the practical outcome for the creditor in most cases will be detrimental in the case of collection of a bankruptcy dividend instead of individual enforcement, not only because of the costs and the lower value of the liquidated bankruptcy assets, but also because of the lower dividend to be charged and the delay. h) The objective of the insolvency proceedings is the defense against insolvency and the equal treatment of creditors, not an individual means to collect a debt. Otherwise, insolvency proceedings and their purpose would be distorted. i) *A fortiori*, and similarly, the criticisms made of the intermediate theory that we will discuss in this paper are applicable. j) It establishes little less than a *legal and de jure* presumption of debtors' inability to pay their debts, when this may not necessarily be deduced from a breach. k) It is an excessively rigid and automatic view of the COP. l) It removes

[57] Fernandez, *La Cesación ..., cit*. p. 74-81.

the margin of discretion for judges, who can and must assess the cause of the breach and, if necessary, verify whether or not there is a state of insolvency.

Obviously, a default can be taken into account as a revealing fact, among others, with greater or lesser importance, when assessing debtors' potential insolvency. A single breach may be sufficient to declare bankruptcy, but only after verification of the debtor's economic or financial situation in court.

Despite the solid refutation of this thesis, numerous European[58] authors and most Argentine[59] authors of the first half of the 20th century supported it. Few legal texts have expressly affirmed it.[60]

13.2. Intermediate Theory

This thesis defines the COP as a debtor's inability to satisfy his obligations purely manifested by default. The COP is not a mere material interruption of payment but a financial condition, which is permanent and general in nature and can only be accredited by default. There is no COP without default. This theory does not allow other facts —other than breach— to reveal the COP, such as debtors' express or implicit confession; flight; office, warehouse or factory closure; and or fictitious, deceptive or fraudulent means used by debtors in order to materially continue payments, thus disguising their real economic incapacity. All these facts do not reveal the state of bankruptcy, unless there is a material interruption in payments.[61]

[58] See Bolaffio, *op. cit*., vol. I, Nos. 6 to 8.
[59] See J. M. Moreno, *Estudio sobre las quiebras*, volume II of *Obras Jurídicas*, Buenos Aires, 1883, Nos. 1 and 3; E. Quesada, *Estudios sobre quiebras*, Buenos Aires, 1882, Nos. 233 and 258; L. Segovia, *Explicación y crítica del código de comercio*, Buenos Aires, 1892, vol. III, Nos. 4433 and 4434; M. Obarrio, *Estudio sobre las quiebras*, annotated edition by Carlos Malagarriga, Buenos Aires, 1926, vol. I, nº 6; M. F. Armengol, *Fundamentos y crítica de la ley de quiebras*, 2nd ed, Buenos Aires, 1914, p. 238; Carlos C. Malagarriga, *Código de comercio comentado*, 3rd ed, Buenos Aires, 1927-1929, vol. IX, no. 12 (although he apparently changed his mind in later works); H. Bunge Guerrico, *Interpretación de la ley de quiebras*, 2nd ed., Buenos Aires, no. 7, 8 and 116; J. P. Pressacco, *El nuevo régimen legal de las quiebras*, Buenos Aires, 1933, nos. 3 and 4; A. S. Carranza, *La nueva ley argentina de quiebras*, Buenos Aires, 1933, 1st and 2nd eds, commentary to articles 1, 2, 11, 41, 52, 57 and 58 of the 1933 Insolvency Law; F. Orione, *La convocación de acreedores*, nº 1 and *La quiebra*, I, nº 13; J. D. Pozzo, *Manual de la ley de quiebras nº 11.719*, Buenos Aires, 1937, numbers 29 and 48.
[60] Especially in Ibero-American countries, lawmakers have followed this thesis. See art. 1 of Brazil's 1929 Insolvency Law; arts. 1572 and 1578 of Uruguay's 1865 Commercial Code and Chile's 1929 Insolvency Law Nbr. 4558.
[61] See Fernandez, *La Cesación..., cit.* p. 81-87.

This theory is based on the same grounds as the materialist theory, also stating that since default may be due to other causes that do not involve a permanent and general economic difficulty, the judge must assess, in each case, whether the debtor is in fact in COP. And, finally, it points to the need for a literal interpretation of the rules.

Arguments against this doctrine are very much the same as the ones set forth against the theory referred to above. The main one is that, admitting that the COP is a permanent and general state, it can manifest itself not only by non-compliance (indirect indicator) but also by means of direct indicators, such as debtors' confessions, whether express (when filing for bankruptcy or a reorganization procedure) or tacit (in the event of flight, concealment or closure of business offices or factory). Any revealing fact, if relevant, is suitable to prove the COP, not just default. Debtors may be in COP and still continue to pay using fictitious, deceptive or fraudulent means, thus disguising their true economic or financial inability until eventually interrupting material payment.

13.3. Broad Theory

This thesis defines the COP as debtors' inability or powerlessness to meet their obligations in a general and permanent way, which can be revealed by numerous, non-exhaustive facts, be they direct or indirect, as evaluated wisely by a judge.[62]

This approach is based on the following premises:

a) The COP is a financial status and not an event or a set of events or a breach of an obligation or a series of breaches. This status is based on an economic[63] and/or financial situation.

b) The COP usually pre-exists default, because if debtors fail to meet their payments it is precisely due to their economic and/or financial difficulties. This state is revealed by external events, among them, firstly, non-fulfilment of obligations along with debtors' actions revealing their inability to pay their debts or insolvency, such as express in court or out-of-court confession, requesting debt reduction or stay of payment, filing for bankruptcy or a reorganization procedure; implicit confession, as in the case of flight, concealment, closing of business offices or factories, etc.; the use of fictitious, deceptive or fraudulent means to obtain resources for the purpose of materially continuing payments, such as fake documents, selling goods below the market price or below cost, high-interest loans,

[62] See definition and arguments in Fernández, *La cesación..., cit.* p. 87-94.
[63] See specifically Bonelli, *Del fallimento*, 2nd ed. Milano, 1923, vol. I, no. 43.

creating new guarantees or refinancing previous ones, payments in kind, transfer of assets to relatives or third parties who are aware of debtors' economic and/or financial difficulties, etc.

c) This approach has a more scientific and practical perspective than the previously mentioned theories because it takes into account the economic and legal basis of bankruptcy as a defense against insolvency and features a preventive and reparative rather than a repressive nature, allowing preventive bankruptcy proceedings to prevent bankruptcy before the situation deteriorates irreparably.

d) It facilitates the implementation of a revocation scheme designed precisely to prevent debtors and some creditors acting in collusion with them from engaging in fraudulent actions to the detriment of other creditors, reducing assets or destroying the principle of creditor equality in the bankruptcy process.

e) It is a more systematic doctrine, avoiding self-contradictions and providing a basic concept of the COP, with its characteristics of permanence and generality, that preserves its unity: there is only one COP and not several simultaneously. And because the unity of criteria is preserved, it is not necessary to make artificial disquisitions, e.g. determining the start day of the COP e.g. to revoke the acts carried out by debtors to the detriment of creditors, or determining the relevance of other revealing facts, as is the case of the Italian theory of *equivalents*.

f) It avoids having to resort to an exhaustive list of *"acts of bankruptcy"* instances, which is always incomplete and insufficient, given that the COP can be determined by an infinite number of different facts that are impossible to anticipate or systematized.

g) It avoids turning to problems of normative interpretation —as does the thesis of *equivalents*—in an attempt to overcome legal constraints by acknowledging other revealing facts not expressly ruled in addition to breach.

h) The statement by advocates of the two previous theories in the sense that the court should apply a "broader" criterion upon determining the start date of the state of cessation proves applicable. Such criterion may include "other facts or acts" —other than a breach— that denote debtors' financial powerlessness, their economic decline, end of commercial activities, etc. Such facts are none other than those considered in the *broad theory* as revealing facts of the COP.[64]

[64] See Fernandez, *La Cesación ..., cit*. p. 86.

i) Undoubtedly, a breach is a revealing fact of the COP, but it is not the only one, nor perhaps the main one, since other revealing facts may exist in practice, as shown by the study of their historical evolution and their incorporation into modern statutory and Continental European positive law in Comparative Law.

j) All arguments against the materialistic and intermediate theories are applicable *a contrario sensu* in favor of the *broad theory*, and will be deemed hereby presented to avoid unnecessary repetitions.

This theory has been supported by many authors since the end of the 19th century and the beginning and middle of the 20th century in various countries, such as Italy[65] and France.[66] In Argentina, this approach has been adopted by Fernández and Yadarola, who have been joined by other authors after the period under consideration up to the present.

14. Definition of the Cessation of Payments / State of Default (COP).

As a result of the above perspectives on the different theories of the state of default and accepting the *broad thesis* as valid and true, it is possible to formulate the concept or definition of it in the following terms:

"The state of cessation of payments is the debtor's inability to pay his debts on a permanent and general basis, as evidenced by revealing non-exhaustive facts, which are conceptually different from the mere arithmetical imbalance between assets and liabilities, constitutes necessary and sufficient condition for declaring the debtor's bankruptcy or filing a petition for a reorganization procedure and must be assessed in each case prudently by the judge, after summoning the debtor. The crisis concept and consequences in Insolvency Law is included in this formulation.

15. General and Permanent Nature of the "State of Default" (COP)

Given that the cessation of payments is not a fact or a set of facts but a financial status, it is necessarily of a *general* nature, since it refers to the entire economic (and / or financial) situation of the debtor, whose net worth becomes powerless or insufficient to meet his debts, which are also considered in a general and potential manner, that is, not only those already due but those which may become due in the future.[67]

[65] See Bonelli, *op. cit.* I, Nos. 36, 38, 41, 43, 44, 46, 49 and 50 to 56.
[66] See Percerou, quoted by Fernández, *La cesación, ..., cit.* p. 86.
[67] See Fernandez, *La Cesación ..., cit.* pp. 104-109.

The *permanent* nature of the COP also derives from the *broad thesis* and indicates that failure to pay must extend for a considerable or relevant period of time.[68] With regard to this period of time, some economists speak of "current liabilities" and "current assets" —that is, a one-year term from its maturity or for its liquidation—as a temporary period of a company's reported economic activity in which *COP* may extend itself.[69] This is in opposition to transient, momentary, temporary or episodic[70] financial powerlessness, which may occur on numerous occasions, perhaps even intermittently or chronically. As is to be expected, the arguments of the so-called *materialistic* and *intermediate* theories reject this permanent nature of the COP.

16. Revealing Facts

According to the *broad thesis*, the COP is manifested in revealing facts, evidenced by the debtor and creditor's behavior. Enumerating them is an impossible task, since they vary infinitely, as can be deduced from the broad notion of the COP described above. Therefore, they must be assessed by the judge in each case, with full freedom of judgment, taking into account not only breach of obligations but also other revealing facts.

As for the classification of these facts, a large part of the Argentine doctrine of the first half of the 20th[71] century agrees in adopting Bonelli's systematic approach, considering it to be more in line with the economic, legal and historical reality, and avoiding enumeration.

In accordance with this doctrine, COP's revealing facts include:

1. *direct indicators* that require an explicit or implicit acknowledgement by the debtor of his inability to make payments:

Express confession:

[68] See, among others, Yadarola, *Revista Crítica de Jurisprudencia*, 1934, 436; Percerou, *op. cit.* I, No. 190.
[69] See Pablo van Nieuwenhove, *op. cit.*, pp. 564-565, who distinguishes between *crisis, state of default and insolvency*. According to this author, the COP is the inability, incapacity or powerlessness to meet binding commitments and it is tantamount to *working capital* quantitative or qualitative deficiency, reducing its definition to dangerous limits. *Crisis* will mean the overall decrease of assets, plus liabilities, plus working capital plus fixed capital, without prejudice to the fact that working capital be qualitatively and quantitatively in line with the new reality of the company which continues operating at a lower scale. Finally, *insolvency* will mean total cessation of the company's production activities with excess of liabilities (current and non-current) over assets (current and non-current). These notions, their formulation in economic terms and their expression in accounting terms need to be further developed, since they have not been analyzed, at least not by the Argentine doctrine.
[70] See Bonelli, *op. cit*. I, No. 44.
[71] For a more in-depth study of each of these revealing facts, see Fernández, *La cesación..., cit.* pp. 137-231.

a) Judicial: for example, filing for bankruptcy or seeking reorganization.

b) Extrajudicial: circular letters, letters, public acts, balance sheet publication, private summoning of creditors, execution of out-of-court reorganization agreements, prepackaged reorganization proceedings, etc.

Implicit confession:

a) Flight, concealment, or departure

b) Closing of business offices, factories or warehouses

c) Theft or concealment of goods or movable assets

d) Misappropriation, diversion or donation of assets

2º. *Indirect indicators*: they occur when debtors avoid showing insolvency and allow events to take their course, or simulate an artificial insolvency. They include:

a) Default

b) All means used by debtors to escape default and avoid bankruptcy, usually called fictitious, deceptive, or fraudulent means.

Part Three

Cessation of Payments (COP) in Argentine Legal Texts. Exegesis and Hermeneutics

Before addressing the 1902 and 1933, 1972, 1983 and 1994 Insolvency Laws, as amended, in Argentina, we will previously provide a brief outline of the 1862 and 1889 Commercial Codes.

17. The 1862 Commercial Code and its Doctrine

The 1862 Commercial Code regulated the cessation of payments in its articles 1511, 1512, 1522, 1527 and 1532. It can be said that the Code substantially subscribes to the *materialist thesis*, although it includes some of the characteristics of the *broad thesis*, since it imposes the obligation to confess the COP, provides for *ex officio* bankruptcy upon the request of the Public Prosecutor's Office in the event of flight, and sets the *period of suspicion* without mentioning non-compliance or default facts.

Moreno commented on these rules in 1883, endorsing the *materialist thesis*, based on legal texts[72] while Quesada[73] also seems to support the materialistic approach.

18. The 1889 Commercial Code and its Doctrine

The 1889 Commercial Code dealt with the COP in its articles 1379, 1380, 1389, 1392, 1394, 1396 and 1461. It can be reasonably inferred that this Code supports the materialistic theory: it distinguishes between commercial and non-commercial obligations, imposes the obligation to confess the COP, requires that debtors be summoned, provides for *ex officio* protective measures upon the request of the Public Prosecutor's Office or of any creditor, and requests that the bankruptcy order determines the date of cessation of payments while establishing the *suspicion period.*

Article 1584 of this Code allowed for moratoriums for merchants proving that their inability to pay resulted from "extraordinary, unforeseen or force majeure events" and whose assets were equal to or greater than their liabilities.

Segovia highlights the materialistic approach in article 1379, which identifies bankruptcy as a breach (even a single, isolated breach) and its contradiction with article 1380.[74] On the other hand, in his legal exegesis, Obarrio[75] also embraces the materialistic thesis.

19. The 1902 Insolvency Law Number 4156 and its Doctrine

The 1902 Argentine Insolvency Law uses different terminology to refer to different aspects of the COP: *"state of default*" (arts. 2 and 52), "cessation of payments" (arts. 3, 48, 78 and 79), "actual cessation of payments" (arts. 6, 43, 46 and 76),"date of cessation of payments" (arts. 8, 44 and 76) and "inability to meet trade obligations" (art. 6). Authors such as Fernández[76] interpret this Law as framed within the *broad thesis,* since, in the first place —following a correct exegesis of art. 6 and, especially, of art. 52— the judge has the power to determine, when deciding on a petition

[72] See José María Moreno, *Obras Jurídicas*, volume II, *Estudios sobre quiebras*, Buenos Aires, 1883, Nos. 1, 3 and 247.
[73] See Ernesto Quesada, *Estudios sobre quiebras*, Félix Lajouane Editor, Buenos Aires, 1882, nº 400, p. 281.
[74] See Lisandro Segovia, *Explicación y crítica del nuevo código de comercio: con el texto íntegro del mismo código*, F. Lajouane, Buenos Aires, 1892, Volume III, Nos. 4433, 4434, 4435 and 4437. This author seems to adhere to the intermediate thesis.
[75] See Obarrio, *Estudios sobre las quiebras*, Buenos Aires, 1895. There is a 1926 second edition issued in two volumes, annotated by Malagarriga and published in Buenos Aires. In vol. I, Nos. 1, 2, and 6, he discusses the COP.
[76] See Fernandez, *La Cesación ..., cit*., p. 263.

for bankruptcy by a creditor based on default, whether or not there is an actual situation of COP. Second, this Law allows for bankruptcy in the event of debtors' flight and concealment (arts. 52 and 1) and, third, art. 44 takes as the date of cessation of payments "the day of the filing of a petition by the debtor (requesting summoning of creditors, i.e., former term for "preventive bankruptcy proceeding", today more commonly known as "reorganization") when the actual cessation has occurred later".

On the other hand, it can be argued that Armengol[77] subscribes to the materialistic thesis, identifying the COP with non-compliance, even a single one. Later, Bunge Guerrico seems to support some aspects of the *broad thesis* and some aspects of the materialistic thesis while interpreting this Law as endorsing the materialistic thesis[78].

For Malagarriga, the 1902 Insolvency Law falls within the materialistic thesis; he comments on article 52 and disputes the practice of summoning the debtor to give explanations. He agrees with article 44 on setting the date of cessation of payments at the date of the filing of the petition for summoning of creditors, thus adhering to the *broad thesis*, at least in this respect.[79] Today, summoning the debtor to give explanations is a well-established defense practice in court. Martín y Herrera does not advocate the materialistic theory: he expressly states that even in the event of a single breach, it may not suffice to constitute bankruptcy.[80]

20. Case Law before 1933

Argentine case law prior to 1933 largely adheres to the materialistic thesis, even establishing that a single breach necessarily entails bankruptcy.[81] Exceptionally, other decisions favor either the intermediate or the broad theory. The former hold that COP can only be revealed by default, whereas flight, end of business operations or renewal of credit documents do not suffice for this purpose. Oftentimes, COP is identified with a mere arithmetical imbalance and, sometimes, commercial insolvency is identified with civil insolvency, hence applying civil insolvency

[77] See Manuel F. Armengol, *Fundamentos y crítica de la ley de quiebras*, 2nd ed., Buenos Aires, 1914, p. 8, 17, 106, 198, 199, 201, 238, 239, 247, 402.
[78] See Hugo Bunge Guerrico, *Interpretación de la ley de quiebras*, 2nd ed., Buenos Aires, undated, p. 7, 8, 39, 106, 107, 117.
[79] See Carlos C. Malagarriga, *Código de Comercio Comentado*, Vol. IX, 3rd ed., Buenos Aires, 1929, Nos. 12 and 200.
[80] See Félix Martín y Herrera, *La convocación de acreedores y la quiebra en el derecho argentino*, Buenos Aires, 1923, II, nos. 119, 186 y 187, pp. 280-283, and note 30.
[81] See a case in which the Commercial Court of Appeals rejected the debtor's flight or concealment as sufficient cause to declare bankruptcy due to the lack of defaults accredited by means of exchange protests. In this case, the Appeals Prosecutor favored the broad thesis: CNCom, April 12th, 1933, Gaceta del Foro 104, 30.

principles to bankruptcy. In certain instances, however, a distinction is made between COP and a mere arithmetical imbalance, which is referred to as insolvency.[82] Occasionally, the 1902 Law is considered to fall within the *broad theory*, which is all the more remarkable considering it was narrower than its 1933 counterpart.[83] The decision issued by the National Commercial Court of Appeals on August 22nd, 1911[84], accepting the *broad thesis*, constitutes a strong legal precedent for the 1933 Law. As is apparent, case law is varied and contradictory[85].

21. Critique of the Doctrine and Case Law before 1933

As already mentioned[86] in this paper, the most authoritative authors criticizes both the materialistic thesis — there is no COP without default and default necessarily leads to the debtor's bankruptcy— and the intermediate approach, and describe their negative impact on trade in general, both for debtors and creditors and the overall economy, and its particular detrimental effects on bankruptcy morality.

22. The 1933 Insolvency Law Number 11,719 and Case Law

The 1933 Argentine Insolvency Law No. 11,719 departed from the 1902 Law on the subject of the *state of cessation of payments* and readopted the technique of the 1862 and 1889 Codes, regulating with respect to the following: COP as a prerequisite for bankruptcy (art. 1), commercial or civil origin of the COP (art. 2); bankruptcy of a deceased person (art. 4); bankruptcy of a former merchant; (art. 5); compulsory reporting of the reasons for the cessation of payments and its date upon filing a petition for summoning of creditors (reorganization proceedings) (art 10); mandatory time limit for filing a petition for summoning of creditors and effects of filing as a conditional petition for bankruptcy (Art. 11); indirect bankruptcy due to rejection by creditors or failure to obtain judicial approval (Art. 41); setting of the same (initial) date of cessation of payments as date

[82] See CNCom, February 27, 1919, in *Gaceta del Foro*, 19, 45.
[83] See CNCom, 22nd August 1911, *"Arnalfitani y Carnevale"*, in *Revista de Legislación y Jurisprudencia*, 2, 1007. Also noteworthy is the opinion of the Appeals Prosecutor —which clearly took the broad position but was not followed by the court— in CNCom, October 11th, 1929, *Gaceta del Foro* 82, 334.
[84] Published in *Revista de Legislación y Jurisprudencia*, 2, 1007 and cited in Fernández, *La cesación de pagos..., cit.*, p. 193-194, n. 272. Also cited in Carlos Malagarriga, *Código de Comercio Comentado*, Buenos Aires, 3rd ed., 1929, vol. IX, p. 225-226. (this work by Malagarriga presents more judicial precedents regarding the COP, pp. 224-229). This Code establishes reasonable judicial discretion, allowing for the debtor's legitimate opposition to the obligation breached, and summoning of the debtor to give explanations.
[85] See judicial precedents from the end of the 19th century to 1935 cited by Fernández, *La cesación..., cit.* pp. 274-279.
[86] *Ibid*., p. 276.

of filing as a conditional petition for bankruptcy (Art. 41) unless it has occurred previously and a maximum period for a retroactive date of one year as of the date of filing (Art. 53); mandatory reporting of cessation of payments within 3 or 4 days of such cessation of payments (art. 55); proof of COP by the creditor requesting bankruptcy and summons of debtor (art. 56); appropriate preventive and protective measures to safeguard the interests of creditors against flight or concealment of the debtor (art. 56); preventive and protective actions to protect the interests of creditors in the event of debtor's flight or concealment (art. 58); setting of provisional date for cessation of payments (art. 59); trustee's opinion on the date of the cessation of payments (art. 60); challenging of the date of the cessation of payments (art. 64); effects of setting the date of cessation of payments (art. 65); nullity or voidability of debtor's actions after the date of the cessation of payments (art. 109).

The ambiguity of the topics addressed translate into a flawed wording of this Law which often identifies the COP with non-compliance. However, it has been pointed out that bad drafting does not allow for —as argued by several authors after its enactment—a literal and narrow interpretation that may lead to classify it under the materialistic theory. On the contrary, an accurate interpretation of these articles uncovers aspects and principles that are characteristic of the *broad thesis*, as highlighted by authors such as Fernández and Yadarola and discussed below.

Thus, following its enactment, several authors have concluded that the 1933 Law adheres to the materialistic thesis, a conclusion to which Fernández[87] has expressed his opposition. The great majority of these authors are supporters of the materialistic thesis, except for Fernández[88] , Yadarola[89], Satanowsky[90], Malagarriga[91] and Rivarola.[92] The number of proponents of the *broad thesis* seems to have increased over time, particularly in the second half of the 20th century,

[87] See Fernandez, *La Cesación ..., cit*., p. 283-297.
[88] See Fernández, *Tratado*..., cit..., *passim*.
[89] See Mauricio Yadarola, *Revista Crítica de jurisprudencia*, 1934, 433, chap. II. He asserts that equating COP with mere non-compliance is a mistake that must be disputed. At the 1940 Congress of Commercial Law, he set forth the broad thesis of the COP. See *above* in this paper.
[90] See Marcos Satanowsky, *Estudios de Derecho Comercial,* Tipográfica Editora Argentina, Buenos Aires, 1950, p. 206-207, who follows Yadarola on the broad thesis.
[91] See Carlos Malagarriga, *Tratado elemental de derecho comercial*, Tipográfica Editora Argentina, Buenos Aires, 1952, vol. IV, pp. 34-39. In his 1929 work he was apparently engaged in the materialistic thesis.
[92] See Mario A. Rivarola, *Tratado de derecho comercial argentino*, Compañía Argentina de Editores SRL, Buenos Aires, 1940, Volume V, pp. 59, 62-69 and 73-78.

including Roberto García Martínez and Fernandez Madrid[93], Cámara[94], Zavala Rodríguez[95] and others.

Undoubtedly, Article 11 of the Law has a decisive relevance in favor of supporting the *broad thesis,* allowing the same scope to summoning a creditors' meeting as to filing for bankruptcy or, in other words, a confession of financial powerlessness.[96]

As for post-1933 case law, authors such as Fernández state that the courts have rarely ruled on the COP and its notions, adopting, on such few occasions, the materialistic thesis as a general rule. During the first half of the 20th century, it can be argued that there is no constant, complete and precise case law interpretation of the COP, with the exception of a few isolated rulings, among them, two relevant 1930's[97] decisions and two other important rulings issued by the Buenos Aires Court of Appeals in commercial matters in 1946 and 1951 that clearly endorsed the *broad thesis.*[98] Other authors provide a broad overview of the prevailing case law on the matter from 1862 to 1953. This period features judicial decisions based on all three theories, with some rulings in line with the *broad thesis.*[99]

As maintained by Fernández, Law 11,719 does not conflict with the broad notion of cessation of payments, in accordance with a proper interpretation of the applicable laws. In this sense, it has been argued that the legal text establishes the *broad theory* in its articles 1, 11, 53 and 56; that article 2, paragraph 2, is not in contradiction with article 1; and that the flawed, confusing wording of articles 11, 53, 55, 60, 64, 65 and 109 does not hinder adoption of the *broad thesis.*[100]

[93] See García Martínez / Fernández Madrid, *op. cit*., pp. 218-245, especially p. 226.
[94] See Héctor Cámara, *El concurso preventivo y la quiebra, Comentario de la ley 19551*, Ed. Depalma, Buenos Aires, 1982, Vol. I, p. 239, notes 39 and 40 and pp. 241-247.
[95] See Zavala Rodriguez, Carlos *Código de Comercio y leyes complementarias, comentados y concordados*, Ed. Depalma, Buenos Aires, 1981, Vol. VII, ps. 108-110 and 117.
[96] See *Id*., p. 293. Case law prior to the 1933 Law occasionally adopted this criterion inherent to the broad theory, as can be seen, for example, in National Commercial Court of Appeals (CNCom), October 20th, 1922, in *Gaceta del Foro* 41, 194.
[97] See the decision issued by Judge Cermesoni on December 21st, 1938, published in La Ley, volume 15, p. 1195 and the Supreme Court decision of Santa Fe Province, Courtroom II, on December 20th, 1938, annotated by Fernández (the reference to the publication of this second decision, cited by Héctor Cámara, *El concurso preventivo y la quiebra, Comentario de la ley 19551*, Ed. Depalma, Buenos Aires, 1982, Vol. I, p. 238, n. 35, could not be found).
[98] See CNCom, June 24th, 1946, JA 1946, III, p. 646 and CNCom, August 13th, 1951, JA 1951, IV, 417.
[99] See García Martínez, *El concordato y la quiebra en el derecho argentino y comparado*, Zavalía, Buenos Aires, 2nd ed., 1953, pp. 82-89. This author, in this edition of his classic work, fully embraces the broad thesis: see Vol. I, pp. 69, 71, 75, 78 and 86.
[100] See Fernández's opinion, *La cesación..., cit*., pp. 298-311.

Given the broad terms of article 56 and the provisions of articles 11, 41, 52, 53 and 55 and the discussion held in the National Senate on the occasion of the passing of the 1933 Law, there is no doubt that it allows the declaration of bankruptcy for reasons other than actual breach of an obligation.

Finally, it is worth mentioning the adoption of the *broad thesis* by the 1950 National Bankruptcy Bill, whose message and articles 1 and 2 expressly legislate with respect to the revealing facts as studied and accepted by such thesis[101], an approach later emulated by articles 1, 78 and 79 of the 1972 Argentine Insolvency Law No. 19,551.

Part Four. Final Reflections and Conclusions

23. COP and Prevailing Notions in the 1901-1945 Period and at Present

The predominance of the materialistic thesis or —to a lesser extent—of the intermediate thesis over the broad thesis in Argentine doctrine, legislation and case law may be the result of the prevailing positivistic notions in the period considered (1862-1945). Indeed, setting as top priority strict and formal performance of obligations, primacy and adherence to legal texts in force and non-consideration of economic and ethical elements, among others, reflect to some extent the positivist nature underlying such preponderance.

In fact, the study of Argentine and European doctrines reveals the relevance of the materialistic thesis on the COP as compared to other approaches. Therefore, the opinions of certain authors as Fernández and Yadarola who, as we have seen, attempt to include economic reality and, to a certain extent, the ethical element among the relevant issues to be assessed with regard to the COP, prove to be remarkable and worthy of mention. This attempt was welcome in subsequent doctrine and case law and even in the express wording of the 1972 Argentine Insolvency Law No. 19,551, still in force today.

From my standpoint, the law goes beyond the mere analysis of the legal texts in force to include other elements which form an integral, inherent and relevant part of legal science, such as ethical and economic issues, intrinsically related to the COP. Therefore, I believe that considering economic and ethical aspects pertain to matters of justice, in terms of security, order, peace and the common good. These matters have already been dealt with, whereas the remaining aspects will be discussed in this part of the paper.

[101] A commentary and some critiques of this bill can be found in Carlos Malagarriga, *Tratado elemental de derecho comercial*, Tipográfica Editora Argentina, Buenos Aires, 1952, vol. IV, p. 37-39.

24. COP and Bankruptcy Ethics

COP raises ethical issues that need to be addressed and resolved. Commercial law doctrine does not usually tackle the ethical issue in bankruptcy. In this regard, I believe that COP cannot escape systematic or hermeneutical analysis beyond enacted law texts. This would certainly contribute to making them more reliable and legitimate.[102]

The study of ethical issues in Insolvency Law proves useful for resolving conflicts involving justice, and social peace inherent in the situation of insolvency, as well as facilitating access to effective practical solutions in insolvency cases.

Throughout this paper, *obiter dictum* reference has been made to some of the ethical problems arising from the perspective adopted vis-à-vis the true notion of COP. It is now time to systematize the problems and solutions we deem most important without attempting to cover them all. Specifically, the following ethical issues and their solutions, among others, are at stake:

1. Unjustly declaring bankruptcy of a legal entity that is not in economic COP, as may be the case pursuant to some Argentine positive bankruptcy rules and some foreign regulations like the French and Italian Insolvency Laws. The Insolvency Law currently in force in Argentina allows for four instances of extension of bankruptcy without prior COP: bankruptcy in the event of grouping (art. 67), out-of-court reorganization agreement (art. 69), bankruptcy by extension (arts. 160 and 161) and bankruptcy declared on the basis of a foreign judgement (art. 4, sub. 1). From the point of view of the broad thesis, these instances can be considered an unfair, disproportionate, automatic and an excessively strict sanction that must be replaced, appropietally, by specific civil liability systems, which may eventually lead to the bankruptcy of the liable party in COP.

2. Potential abuse of the bankruptcy process by debtors who are not in an actual COP and by creditors requesting bankruptcy of debtors who are not in COP raises the need to reaffirm the COP concept.

3. Inadequately requiring a purely arithmetical imbalance usually referred to as "insolvency" to declare bankruptcy, given its different meaning and notion with respect to the COP.

[102] I favor a systematic or complete analysis of the legal texts studied in order to supplement mere dogmatic-exegetical positions according to which the positive text is the main and practically the only element to be considered upon reflection. A critique of these positions by legal historians, such as Paolo Grossi, can be found in note 4 of this paper. We believe that analysis of legal texts in force should be complemented by analysis of ethical, economic, historical, sociological, political issues, etc., rules and conduct.

4. Arbitrarily declaring bankruptcy without having carried out, even *prima facie,* a reasonable judicial assessment of the debtor's economic and financial situation. This can constitute a usual judicial practice against which authors like Fernández have complained as early as the 1930s. It should be noted that grounds for a bankruptcy order can sometimes be merely formal and excessively abstract and generic, as well as narrowed down to default as single revealing fact of insolvency.

5. This issue is related to the so-called "pre-bankruptcy trial", a process whose justification, legitimacy and scope,[103] need to be assessed.

6. Drawing on the first breach of an obligation to determine the initial date of the *suspicions period*, disregarding the legal significance of other facts revealing the COP, which can backdate the effects of bankruptcy to earlier dates more appropriate to the protective purpose of the Insolvency Law.

7. Encouraging debtors' harmful behavior, such as fictitious, deceptive and fraudulent acts, by not taking them into account as facts that reveal a state of insolvency, in accordance with the materialistic thesis, and, therefore, excessively limiting bankruptcy revocability.

8. The disadvantage, both in theory and in practice, of regulating *"acts of bankruptcy"*, which can lead to many cases of injustice by excess or default. The flexibility of the broad thesis provides greater and better protection of stakeholders and the common good, thus resulting in more practical, fairer solutions.

9. We believe that the solution to these ethical problems lie in upholding the *broad thesis* as expressed in the views of authors such as Fernández and Yadarola, among others, who, albeit *obiter dicta*, have dealt with them more or less explicitly.

25. Significance of the Period Studied: Systematization, Historical Perspective and Comparative Law

The period of Argentine legal history hereby studied (from 1862 to the present day) has revealed itself as significant for the COP or *state of default* because it implied, in the first place, describing the *"status quaestionis*" of comparative legal sources (especially the Italian and French doctrine, legislation and case law) on the topic. The understanding of comparative law in foreign

[103] On the pre-bankruptcy trial and its procedural alternatives in Argentine law, see Osvaldo J. Maffía, *El juicio de antequiebra*, *Revista del Derecho Comercial y de las Obligaciones*, Ed. Depalma, Buenos Aires, 1983, pp. 361-374.

countries facilitated access to the notion of the COP, achieved through an organic and systematic investigation into foreign sources, mainly European.

Secondly, it should be emphasized that the early 20th century doctrine was responsible for systematizing all principles related to the COP. Thus it recognized a threefold classification, relying in historical, European and U.S. bankruptcy comparative laws in force at the time, going beyond the mere exegetical gloss of legal texts in effect and the prevailing case law.

Thirdly, this period was marked by adherence to the *broad thesis*, overcoming the contradictory elements in the other two theories.

And, finally, following an in-depth and thoughtful study, it laid the foundation for subsequent legislation, doctrine and case law, paving the way towards new principles and rules applicable to the issue of the COP, surmounting pitfalls and difficulties.[104]

This systematic study was a thorough master class on the limitations of legal studies based exclusively on linguistic and purely logical analysis of existing legal texts and national law, and detached from historical law, European comparative law and other issues such as economics and ethics. As a result, the analysis of the purposes of institutes and principles applicable in a systematic way and, using the historical and comparative law methods, adequate conclusions were drawn on the true notion of the *COP,* its distinction from other legal concepts and the legal consequences deriving from such definition.

This historical and comparative approach can serve as an example in the future for private and especially commercial legal scholars. Indeed, the Argentine Insolvency Law studies of the 1930s on the COP constitute an example of systematic, historical and comparative commercial law worthy of imitation. It should be noted that the commercial doctrine on this topic has drawn significantly from the history of law.

26. Economic Problems of the COP

Last, a study of the economic-financial principles conveying a real COP which would serve as a basis for the legal doctrine set out by some of the scholars cited in this paper remains to be done. This task has been undertaken, to some extent, during the 1980s, by the accountant Pablo van Nieuwenhove, among others.

[104] On the success of Fernández and Yadarola's discourse on the subsequent doctrine, legislation and case law in the 1930s, especially in Argentina, see, among others, Adolfo A. N. Rouillón, *Régimen de concursos y quiebras*, Astrea, Buenos Aires, 13th ed. 2004, p. 45 and 49. In Rouillón's view, both the 1972 Law 19,551 and the 1995 Law 24,522 support the *broad thesis*, with exception of Article 80 of the Argentine Insolvency Law.

"Working capital" and COP are closely related terms, in that the latter is the absence or virtual disappearance of the former. A detailed study of this issue and its meaning and conceptual expression with regard to Insolvency Law has yet to be done.

27. Fundamental Thesis

The fundamental thesis of this paper is to state the relevance and scientific legitimacy of the *broad thesis* on the COP and its consequences. Throughout this study, these consequences resulting from this *broad theory* —which are part of the principles applicable to this doctrine of the COP— have been highlighted in order to correctly interpret the legal texts *de lege lata* and *de lege ferenda* for several nations with European continental law systems, among them, Argentina. This theory adequately combines the legal, ethical and economic issues inherent in insolvency, supported by European and Latin-American Comparative Law as well as COP historical background. These analyses may prove useful for the doctrine in other nations, particularly within the scope of U.S. Insolvency Law.

28. De lege ferenda Proposal for Legal Texts

As a result of this research work, following the guidelines of the *broad thesis* developed by the doctrine in the first half of the 20th century in Argentina, we make the following *de lege ferenda* proposal to be used in future legal texts coming into force and, eventually, as *de lege lata* interpretative criterion for the law currently in force. This text summarizes everything discussed in this paper and the rationale behind the broad thesis on the COP.

The proposed text is as follows:

"The state of cessation of payments is the debtor's inability to pay his debts on a permanent and general basis, as evidenced by revealing non-exhaustive facts, which are conceptually different from the mere arithmetical imbalance between assets and liabilities and which must be assessed in each case prudently by the judge, after summoning the debtor.

The "crisis" concept and consequences in Insolvency Law is included in this formulation.

The following are facts revealing the debtor's state of default, among others: express confession —whether judicial or extrajudicial—, flight, concealment or departure without having left a representative, closure of business, offices, factories or warehouses, theft or concealment of goods or movable assets, misappropriation, diversion or donation of assets, one or more defaulted obligations, commercial or otherwise, and fictitious, deceptive or fraudulent acts.

The trustee will provide the initial date of the period of suspicion and the judge will set such initial date on the basis of the established facts, according to the circumstances of the case.

29. Key Findings

1. Although most Argentine authors of the late 19th and early 20th centuries —following the influence of a part of the French and Italian doctrine— embraced the materialistic theory, at least two authors —Fernandez and Yadarola— masterfully maintained the *broad thesis*, based on other European authors and case law of the time. The broad thesis is more rigorous than its counterparts.

2. Therefore, the broad theory has proven its success.

3. These authors' systematic, historical and comparative treatment of the COP may serve as a model for future research on other topics in the field of Commercial Law and, more specifically, Insolvency Law. These authors followed the models proposed by European sources *de lege lata* and *de lege ferenda* on the true notion of the COP in comparative bankruptcy legislation.

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