CENTRAL EUROPEAN UNIVERSITY

OUT-OF-COURT DEBT RESTRUCTURING VERSUS PRE-INSOLVENCY PROCEEDINGS: TWO SIDES OF THE SAME COIN?

A Comparative Analysis of the US and Croatian Solutions

by Ivona Vidović

LL.M. Short Thesis

Course: Bankruptcy Law

Supervisor: prof. Tibor Tajti

Central European University

1051 Budapest, Nador Utca 9

Hungary

ACKNOWLEDGEMENTS

First and foremost, I would like to thank my supervisor Professor Tibor Tajti, for inspiring me to pursue and deepen my interest in bankruptcy law on both sides of the Atlantic. Without his guidance, patience, and immeasurable knowledge this paper would still be just an idea in my head.

Furthermore, I would like to thank my family and friends for tolerating all those times I spent behind the computer screen and not with them: your support and faith in me has shaped me as a person and brought me to where I am today.

Finally, I would like to express my gratitude towards all those people accompanying me on my professional and academic life journey, professors and colleagues, advisors and mentors. Thank you for instilling the love of learning in me, watering it with your knowledge and expertise and enabling me to dream big and never cease chasing my goals.

ABSTRACT

When faced with a threat of bankruptcy, troubled debtors can decide to liquidate their companies or reorganize, giving their once viable business a second chance. A shift towards the latter approach has been very much welcomed in the wake of the global financial crisis, as it provides a second chance for companies with financial difficulties and thus helps achieve the economic recovery. States were faced with a choice whether to regulate such reorganization; if yes, how and to what degree should they interfere with the restructuring of the debtor?

This question has been answered differently in various jurisdictions. The United States is the leader in this field with the regulatory framework enabling debtors to reorganize both in and out-of-court, through formal bankruptcy Chapter 11 reorganization or informal workouts between the debtor and his creditors. The European perspective is slowly changing from liquidation to reorganization-oriented bankruptcy, introducing pre-insolvency proceedings as a sort of a counterpart to American workouts. Both types of debt restructuring tools serve the same purpose of keeping the entity alive, reorganizing its structure and enabling it to continue with its business activities.

Advantages and disadvantages of out-of-court reorganizations will be analyzed from the standpoint of US workouts, with the underlying rationale being to ascertain how can the Croatian insolvency law benefit from the lessons offered by this informal method of debt restructuring. Croatian legal framework will be examined from a comparative perspective, analyzing both current and previous acts containing provisions on pre-insolvency settlement procedure, as well as the placement of Croatian pre-insolvency proceedings in the wider EU environment. Upon reaching the conclusions on the analysis, a final standpoint will be provided on where does the Croatian pre-insolvency procedure stand and in which direction, if any, should it move forward.

TABLE OF CONTENTS

INTRODUCTION

Nothing lasts forever: there are hardly such things as everlasting businesses. However, the fact that all things must meet their end at some point does not entail that honest but unfortunate entrepreneurs should not be able to enter the second round of fight and revive their viable business plans. As strange as it may seem, bankruptcy law serves as their ally: modern day jurisdictions do not solely perceive bankruptcy as means of liquidating the company, but also as a tool for efficient reorganization of its viable business projects. With a growing number of types of reorganization proceedings, debtors and their creditors nowadays get to choose the way to restructure the debt, opting from formal bankruptcy reorganizations before courts to private, informal negotiations aiming to provide breathing space for the debtor's recovery.

The plurality of methods to reorganize is reflected in differences between restructuring regulatory schemes in various countries. The frontrunner of the race would be the US where, apart from reorganizing formally through various methods, debtors have the option to renegotiate their debt in a privately held workout with their creditors. The relative popularity of the informal workout avenue in the US inspires the question whether such solution could be successfully transposed to other legal systems, particularly civil law jurisdiction like Croatia. To answer it, this thesis delves into a critical assessment and comparison of workout features with those of formal bankruptcy reorganizations in the US, followed by an analysis of factors that would render them comparatively attractive and accessible to debtors and creditors restructuring in Croatia.

While the differences between workouts and formal reorganization proceedings in the US have been the topic of academic research, when it comes to comparing the US informal reorganization tools to the ones used in Europe, situation is a little bit different. The reason for this could be that,

while the US promotes completely informal out-of-court workout restructuring, European jurisdictions employ various types of pre-insolvency[1] reorganization proceedings that involve judicial intervention. This thesis will introduce the solutions offered by Croatian insolvency law, namely the pre-insolvency proceedings, as a sort of a counterpart to the US workout negotiations. The pre-insolvency proceedings in Croatia will be presented through a short reflection on their legal genesis, followed by their positioning in the wider EU context. Given that the relevant EU acts have been partially inspired by solutions found in the US reorganization and second chance practices, analyzing compatibility of Croatian pre-insolvency proceedings with the secondary EU legislation is of practical relevance: namely, it can serve as an intermediary ground in comparing Croatian solutions with US workout practices.

Finally, why Croatia? In the course of the last few years, the Croatian insolvency framework has undergone a significant reform: first, 2012 has witnessed introduction of the pre-insolvency settlement and second, 2015 brought a comprehensive reform of the entire system, altering the rules affecting pre-insolvency as well. While a lot has been changed, critiques show that there is still room for improvement. Therefore, the goal of the analysis and comparison of US out-of-court workouts and Croatian pre-insolvency proceedings is to determine valuable lessons that can be extracted from the informal restructuring practices and see whether they could and should be applied to still relatively stringent Croatian insolvency framework.

[1] The US legal terminology uses the term 'bankruptcy' to define all forms of statutory procedures typically triggered by insolvency, i.e. by debtor being in such a financial condition that the sum of its debts is greater than all of its property (Bankruptcy Code s 101(32)(A)). However, in Europe term 'insolvency' is of a broader meaning, encompassing both the type of the proceedings against the debtor and the trigger for their initiation. Given that the terminology varies among the different legal systems, this thesis will employ the term 'bankruptcy' when referring to the US definition of bankruptcy, while the term 'insolvency' will be used in the context of European (and Croatian) legislature and while designating the 'pre-insolvency proceedings'.

CHAPTER I.

OUT-OF-COURT DEBT RESTRUCTURING IN BANKRUPTCY LAW

Before delving into a detailed analysis of out-of-court restructuring methods, it is necessary to outline the origin of the reorganization proceedings and how they evolved to become rather informal measures. After elaborating on their genesis, the focus will shift to laying out the basic similarities and differences between types of reorganizations compared, namely workouts and pre-insolvency proceedings.

1.1. Development of Informal Restructuring Methods

1.1.1. Dichotomy of Bankruptcy Avenues: Liquidation or Reorganization?

Bankruptcy law is typically characterized by a dichotomy of scenarios to be unfolded upon the distressed company: financial burdens and operational difficulties may force the debtor[2] to either liquidate its firm, selling it as a piecemeal or as a going-concern,[3] or to take the reorganization avenue, seeking to restructure the debts and reorganize the entity in order to keep the business going. The choice between the two will depend on several factors: going-concern value of the firm, existing debt-equity ratio, position of the business on the relevant market, indicators of potential growth or failure of the business activity in a certain sector and creditors' willingness to participate in the restructuring efforts. Debtor's dilemma on choosing one of the two options will also be

[2] It is often not only the debtor who has the power to initiate liquidation or reorganization proceedings, but also the creditors who do not see the expected returns on their investment (this is particularly the case with countries where debtors are hesitant to initiate the proceedings because of the high level of bankruptcy stigma and/or uncertainty of bankruptcy legal framework). However, given that the debtor is the one primarily responsible for conducting and monitoring the financial flow of its business, it is logical that he should be the one to react in a timely manner and initiate the proceedings when necessary.

[3] Certain authors hold the going-concern sale to be the third option, apart from the liquidation and reorganization. In such a scenario, the distressed company is liquidated in a sense that it is sold to a new owner who might change its form, but is not broken into pieces and continues to operate as a business. Therefore, the going-concern sale would lie in between liquidation and restructuring procedure, combining features of both. *See* Richard Squire, *Corporate Bankruptcy and Financial Reorganization* (Wolters Kluwer 2016) 491.

influenced by the bankruptcy law framework, which may provide incentives for either reorganization or liquidation of insolvent businesses.

No two legal systems are the same, and this applies also to bankruptcy law. The difference in approaches is maybe most visible when juxtaposing the two sides of the Atlantic, namely the US and European civil law jurisdictions. Even though the roots of bankruptcy practice can be traced to medieval European markets,[4] they lived to see their blossoming in the western part of the New World. Driven by the development of corporations and overall capital flows, the US bankruptcy law has witnessed a paradigm shift from traditional bankruptcy law towards a second chance philosophy, far better suited to deal with market failures. What differentiates the US from the rest of the world, and especially most European countries, is the lenient approach to business failure, known as the second chance or fresh start approach. The bankrupt businesses are not perceived as weak links of the entrepreneurship idea; it has been recognized that businesses may fail for other reasons than only bad management (such as, for example, extremely volatile market conditions). Consequently, the American bankruptcy system encourages the idea of giving a *second chance* to bankrupt, but economically viable debtors by introducing reorganization options supported by debt discharges.[5] Today, the framework for the formal reorganization process is laid out in Chapter 11 of the US Bankruptcy Code, which is often juxtaposed with Chapter 7 liquidation process.[6] Furthermore, American bankruptcy framework is generally considered more comprehensive and

[4] The root of the word 'bankruptcy' lies in the Italian term *bancarotta*, translated as 'broken bench'. This is due to a practice developed in the medieval trade markets, where tradesmen indicated their bankruptcy by breaking the trading table. *See* Maurizio Pontani, 'Pre-Bankruptcy Crimes and Entrepreneurial Behavior. Some Insights from American and Italian Bankruptcy Laws' (2004) German Working Papers in Law and Economics, Working Paper No. 14, abstract.
[5] Niall Ferguson, *The Ascent of Money: A Financial History of the World* (Penguin Books 2009) 60-62.
[6] Title 11 (Bankruptcy) of the U.S. Code; Chapter 7 (Liquidation), ss 701-784, Chapter 11 (Reorganization) ss 1101-1174, available at https://www.law.cornell.edu/uscode/text/11.

'debtor-friendly' than respective European jurisdictions.[7] The Bankruptcy Code provisions on stay of proceedings, debtor-in-possession management [hereinafter: DIP], access to new financing and cramming down of impaired dissenting creditors under certain conditions all work on encouraging the debtor to engage in reorganization before turning to liquidation proceedings. Conversely, the German example involves company law provisions holding the managing partner of the company personally liable for not commencing the insolvency proceedings in three weeks after becoming insolvent,[8] thus giving little incentive for management to give reorganization a try.

However, the restructuring-stimulating regulatory background is not the sole key to success of the US reorganization procedures. For example, the German Insolvency Code (*Insolvenzordnung*) also contains provisions enabling the debtor and it creditors to file for both liquidation and reorganization proceedings, while the bankruptcy system has recently been updated with a special law on reorganizations;[9] nevertheless, Germany still lags behind the US in use of reorganization procedure.[10] This is often brought up in connection with the general public's opinion on bankrupt companies. While bankruptcy in the US is not perceived as a reason to necessarily cease trading with the debtor, bankruptcy of a business in Germany most likely entails a dead-end for the entrepreneur. Due to the high level of bankruptcy stigma, ex-clients and suppliers tend to turn their

[7] Martin R. Gudeon, Shirish A. Joshi, 'The restructuring and workout environment in Europe' in Ben Larkin (ed), *Restructuring and Workouts: Strategies for Maximizing Value* (2nd edn, Globe Business Publishing 2013) 7-13. For a challenge of this characterization, *see* Gerard McCormack, 'Apples and Oranges? Corporate Rescue and Functional Convergence in the US and UK' (2009) 18 Int. Ins. Rev. 109-134.

[8] German Insolvency Code 1994, as last amended by Article 19 of the Act of 20 December 2011 s15a. In addition, German law criminalizes excessive risk taking, which is a further disincentive to enter reorganization proceedings.

[9] Act on Simplification of Corporate Restructuring (*Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen* - ESUG), entering into force on March 1 2012.

[10] Statistical data for year 2003 shows that out of 33,579 bankruptcies in Germany, 99% were liquidation proceedings, as compared to only 70% in the US *See* John Carreyrou, Matthew Karnitschni, 'Paris Looks to U.S. – on Bankruptcy' (2003) WSJE. The same trend for the US is seen in the number of business bankruptcy filings for 2016, where 29% are Chapter 11 filings. *Source:* US Bankruptcy Courts – Business and Nonbusiness Cases Filed, by Chapter of the Bankruptcy Code <http://www.uscourts.gov/sites/default/files/data_tables/bf_f2_1231.2016.pdf> accessed 14 January 2017.

backs on the bankrupt debtor, thus leaving it with no incentive to reorganize and rise from the ashes. Such phoenix-like action is unlikely to occur in Germany and, while the regulatory framework might be changing,[11] it will take a lot more to eradicate the stigma. The difference in US and German position is perhaps best illustrated by professor Reinhard Bork, a bankruptcy law expert from University of Hamburg. When commenting on the German approach to bankruptcy, prof. Bork stated that 'insolvency is still viewed as a failure and the filing of an insolvency application as an admission of one's own failure – regardless of the actual cause.'[12] On the other hand, the US bankrupt debtors will be welcomed with open arms in the US where the general presumption is that bankruptcy brings experience, making an entrepreneur 'better and wiser for having failed'.[13]

1.1.2. Paradigm Shift Towards Reorganization and Introducing Out-of-Court Restructurings

The global economic crisis of 2008 and the following recession stressed the importance of reorganization of financially troubled debtors to preserve jobs, encourage entrepreneurship, create added value, help in repayment of debts and stabilize the overall vulnerable economic situation. This caused a paradigm shift in countries with traditional view of bankruptcy law, resulting in promotion of reorganization proceedings *in lieu* of standard liquidation, providing better incentives for failed businesses and their creditors to negotiate a reorganization plan instead of pulling the trigger of liquidation.

[11] The insolvency framework in Germany underwent certain changes in 2011, when the Insolvency Code was amended to be more reorganization-friendly; 2012 witnessed entering into force of special Act on Simplification of Corporate Restructuring (ESUG). For more information on changes in the European approach to business failure *see infra*, s 3.3.1.

[12] Reinhard Bork, *Rescuing Companies in England and Germany* (Oxford University Press 2012) 24-25.

[13] Thomas L. Friedman, *The Lexus and the Olive Tree* (Anchor Books 2000), citing successful Silicon Valley entrepreneur Harry Saal.

While the US system already acknowledged the economic benefits of reorganization proceedings, the movement towards a reorganization-friendly framework in Europe started with the amendments to existing and enactment of new bankruptcy laws,[14] promoting restructuring of debts and creation of reorganization plans both in and outside formal court proceedings. On the EU level, the European Commission [hereinafter: EC] issued a Recommendation on a new approach to business failure and insolvency[15] [hereinafter: Recommendation] aimed at harmonizing the laws of EU Member States in order to first, enable the debtors to prevent insolvency by restructuring at an early stage and second, give honest bankrupt entrepreneurs across the Union a second chance to conduct their businesses.[16] Alongside the movement towards corporate rescue culture legislation, European jurisdictions introduced or enhanced existing pre-insolvency procedures.[17] Such movement was further endorsed in the 2015 recast Regulation on insolvency proceedings[18] [hereinafter: Recast Regulation], which expanded its scope to include pre-insolvency proceedings, thus rendering them automatically recognizable when the debtors have center of main interest within the European Union territory.[19]

The turnabout in European insolvency law framework was mostly motivated by the global crisis and desire to find more appropriate solutions for coping with business failures. One of the crucial

[14] Introducing reformed reorganization proceedings in Germany; conciliation, *mandate ad* hoc and safeguard (*sauvegarde*) debtor-in-possession proceedings in France; company voluntary agreements (CVA) on top of schemes of arrangement in the UK. *See* Alexandra Kastrinou, 'Comparative Analysis of the Informal Pre-Insolvency Procedures of the UK and France', (2016) 25 Int. Ins. Rev. 99.
[15] EC Recommendation of 12 March 2014 on a new approach to business failure and insolvency, OJ L 74/65.
[16] Preamble of the Recommendation.
[17] Some examples are French *sauvegarde* proceedings and UK company voluntary agreements.
[18] Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (Recast) OJ L 141/19, which replaced the Council Regulation (EC) 1346/2000 of 29 May 2000 on insolvency proceedings.
[19] On a more general level, changes in countries' legislation enhancing reorganizations proceedings were noted and positively assessed by the 2016 World Bank *Doing Business* Study 101-107. Available at: < http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB16-Full-Report.pdf)>

points for the European policy-making is the encouragement of out-of-court debt restructurings, known as contractual workout procedures in the US legal system. Recognizing that out-of-court business reorganizations yield certain benefits for both the debtor and the creditors, legislators in Europe regulated a special kind of pre-insolvency procedures, aimed at preventing insolvency by stabilizing a debtor's business through debt renegotiations. Notwithstanding the similarities between the two proceedings, differences between US style workouts and European pre-insolvency procedures mandate further explanation on why is it useful to take a comparative approach in assessing the strengths and weaknesses of out-of-court debt restructurings in both jurisdictions.

1.2. European Pre-insolvency Proceedings and US Workouts: Comparing Apples and Oranges?

1.2.1. European Context: Pre-Insolvency Proceedings Across the EU

Pre-insolvency proceedings are defined differently in various jurisdictions of the EU Member States. In the recently enacted Recast Regulation, the scope of which includes 'pre-insolvency', this term is defined as:

> 'public collective proceedings, including interim proceedings, which are based on laws relating to insolvency and in which, for the purpose of rescue, adjustment of debt, reorganization or liquidation, […] (c) a temporary stay of individual enforcement proceedings is granted by a court or by operation of law, in order *to allow for negotiations between the debtor and its creditors*, provided that the proceedings in which the stay is granted provide for suitable measures to protect the general body of creditors, and, where

no agreement is reached, are preliminary to one of the proceedings referred to in point (a) or (b).'[20] (Emphasis added.)

Therefore, pre-insolvency proceedings in the Recast Regulation are those that aim for negotiations between the parties and thus require prevention of individual enforcement actions during the renegotiation period. It is further provided in Article 1 of the Regulation that, in cases where these proceedings may be commenced in situations involving only a likelihood of insolvency,[21] their purpose shall be to avoid the debtor's insolvency or the cessation of the debtor's business activities. The fact that the Recast Regulation encompasses pre-insolvency proceedings stems from the general agenda of the EC to encourage the development of corporate recue culture, by backing the harmonization of rules in Member States providing debt-troubled, but economically viable businesses with a chance for reorganization.[22]

Pre-insolvency proceedings are first of all collective proceedings, including all or a significant part of a debtor's creditors, provided that, in the latter case, the proceedings do not affect the claims of creditors not taking part in them.[23] The Annex A of the Regulation, which defines types of insolvency proceedings governed by the Recast Regulation in different jurisdictions, does not give the explicit answer on what are the characteristics of pre-insolvency proceedings existing in various European jurisdiction. However, the enumeration of different types of insolvency

[20] Recast Regulation (n 18) art 1. Points (a) and (b) referred to in the art 1(c) include proceedings where (a) a debtor is totally or partially divested of its assets and an insolvency practitioner is appointed, and (b) the assets and affairs of a debtor are subject to control of supervision by a court.

[21] The Recast Regulation only uses the term 'insolvency proceedings', which are those that are enumerated in the Annex A to the Regulation and conform the general definition contained in art 1. The term 'insolvency' in the meaning of the trigger for initiation of the proceedings is not defined, leaving it up to the Member States to structure the test of insolvency themselves (typically 'cash-flow' or 'balance-sheet' test).

[22] Richard Tett, Katharina Crinson, 'The recast EC Regulation on Insolvency Proceedings: a welcome revision' Freshfields Bruckhaus Deringer Corporate Rescue and Insolvency' (April 2015) FBD CRI <http://www.freshfields.com/uploadedFiles/SiteWide/Campaigns/R_and_I/Content/The%20recast%20EC%20Regulation%20on%20Insolvency%20Proceedings%20a%20welcome%20revision.pdf > accessed 14 January 2017. The importance of inclusion of pre-insolvency proceedings in the Regulation stems from the fact that they are now automatically recognized on the EU level.

[23] Recast Regulation (n 18) art 2(1).

proceedings in Annex A provides basic grounds for comparison of different kinds of pre-insolvency proceedings in different Member States (including voluntary arrangements under insolvency legislation in the UK, *procedimiento de acuerdoes extrajudiciales de pago* (mediated settlement agreement proceedings) in Spain, *sauveguarde* rescue proceedings in France or *postopek preventivnega prestruktiriranja* (preventive restructuring procedure) in Slovenia). This is further evidenced by one of the commentaries of the Recast Regulation, in which it is stated that besides the traditional insolvency proceedings, the Regulation applies also to rescue and reconstruction proceedings where only a threat of danger suffice for commencing the proceeding.[24]

The above-mentioned pre-insolvency proceedings share a few characteristics. Firstly, they are available only for the debtor which has not yet become insolvent. The French *sauveguarde* proceedings are a type of voluntary proceedings aiming at reorganization at an early stage, provided for the still solvent debtors that wish to restructure under court protection, but outside standard insolvency proceedings.[25] The same principle applies to the Croatian pre-insolvency proceedings, which render the proceedings accessible only to the debtor who is faced with the imminent threat of insolvency (*prijeteca nesposobnost za placanje*), but is not already insolvent.[26]

Secondly, instead of liquidation, they aim at restructuring and continuation of the debtor's business. Various pre-insolvency and out-of-court restructuring mechanisms serve as means of preventing or as alternative to simple liquidation of the debtor. An example could be English law company voluntary arrangements which, by way of redefining the debtor's contractual obligations

[24] Gabriel Moos, Ian F. Fletcher, Stuart Isaacs, *Moos, Fletcher and Isaacs on The EU Regulation on Insolvency Proceedings* (3rd edn, Oxford University Press 2016) 281.
[25] *See* chapter on France in Larkin (n 7) 141-158.
[26] Croatian Insolvency Act OG NN 71/15 art 4. The same principle applies to the Slovenian preventive restructuring procedure (*see* Igor Pirc, 'Preventivno prestrukturiranje po ZFPPIPP-F <http://korporacijsko-pravo.si/preventivno-prestrukturiranje-zfppipp> accessed 14 January 2017.

through a compromise or a moratorium approved by the creditors, serve primarily as an alternative avenue to liquidation.[27] If there is a reasonable opportunity for the debtor to reorganize and continue its business anew, either by means of debt restructuring or simply implementing a revised business scheme, policy reasons mandate offering opportunity for the debtor to use simplified, out-of-court avenues for achieving such goals.

Thirdly, even though some jurisdictions mandate that the courts should affirm the final result of the proceedings, pre-insolvency procedures are usually construed with minimal role of the courts. This feature of pre-insolvency proceedings is still not harmonized among the Member States, as level of court intervention varies greatly among different countries. The Croatian pre-insolvency proceedings are still partially administered by the administrative body (the Financial Agency – FINA) and partially by the competent commercial courts.[28] The role of the court consists of confirmation of the creditors' claims after they have been submitted to the Agency and, if the restructuring plan is agreed upon by the required majority of creditors, affirmation of the pre-insolvency agreement which is then binding upon all creditors.[29] Therefore, the level of the judicial interference in the pre-insolvency proceedings is as almost as high as in the formal insolvency procedure under the Croatian law.

Notwithstanding that Annex A to the Recast Regulation may not expressly place Croatian pre-insolvency agreement (*predstecajni sporazum*) on the list of the European pre-insolvency procedures, all types of proceedings share the same basic characteristics of aiming for efficient,

[27] Christopher Mallon, Shai Y. Waisman (eds), *The Law and the Practice of Restructuring in the UK and the US* (Oxford University Press 2011) 167.
[28] Croatian Insolvency Act (n 21) arts 36-45. For more details on the role of the courts in Croatian proceedings, *see infra* s 3.3.1.
[29] ibid arts 50-65.

mostly out-of-court reorganization and restructuring of debtor's obligations, as means of preventing or avoiding liquidation of the debtor and its withdrawal from the market.

1.2.2. American Context: Out-of-Court Workouts and Pre-Packaged Bankruptcy

The United States represent the other side of the spectrum as a legal system pioneering the world of bankruptcy law and going the farthest in exploring restructuring options outside formal bankruptcy. The importance of bankruptcy law in the US is reflected in the vast amount of case law and scholarly work on the topic.[30] However, even the country with such a highly-developed niche of bankruptcy law, a long tradition of dealing with insolvent debtors in court proceedings and a low level of bankruptcy stigma has not stayed immune to the alternatives to formal bankruptcy proceedings. The rise in use of informal out-of-court bankruptcy remedies can be attributed to downsides of judicial bankruptcy proceedings, such as the high administrative costs of proceedings. Furthermore, the advantage of informal bankruptcy proceedings lays in the possibility of effectively avoiding bankruptcy through restructuring the debts without the costly supervision of the court.

When looking for alternatives to potentially costly and lengthy bankruptcy proceedings, American legal practitioners established two possible solutions: a completely informal workout or a semi-informal pre-packaged bankruptcy. The difference between the two is in their position on the scale

[30] For example, bankruptcy is the center or an important field of research in 12 American law journals, including American Bankruptcy Institute Law Review, The American Bankruptcy Law Journal, Harvard Business Law Review and other. To put it in perspective, articles concerning European insolvency law practice are published under the auspices of INSOL, in its specialized journals like Eurofenix, but are nowhere close in number to vast American literature and academic work on the issues of bankruptcy law. As for the case law, in the US 352 authorized bankruptcy judges decide up to 800,000 cases per year in average, making it a case load of 2,273 cases per judge annually (on the basis of data for years 2015 and 2016, available at
< http://www.uscourts.gov/sites/default/files/data_tables/bf_f_1231.2016.pdf > accessed 14 January 2017.

of procedural formality: while pre-packaged proceedings involve court proceedings in a later stage of the process, workouts are exercised in complete independence from court.

Workout is defined as an agreement between the debtor and its creditors, negotiated out of court, in order to reduce or discharge the debt.[31] A workout agreement may take the form of a composition, whereby the creditor agrees to accept partial payment in full satisfaction of all claims, or an extension, whereby the creditor agrees to receive the full payment, but over a prolonged period of time.[32] Of course, given that the workout agreement rests on contractual grounds, parties always have the opportunity to combine elements of both compositions and extensions and add special contractual provisions responding to their needs. Such contractual freedom, alongside the informality and secrecy of the proceedings, renders workouts appealing to those debtors wishing to avoid formal bankruptcy proceedings. However, what is a blessing can also be a curse. While the participants of workout negotiations applaud the lack of high administrative expenses connected to court proceedings, the other side of the spectrum is the absence of protections provided by the law or afforded by court, otherwise available in formal court bankruptcy proceedings. One of the biggest drawbacks in that sense is the lack of means for imposing the workout agreement on non-assenting creditors, which is comparable to a court's power to exercise cramdown on dissenting creditors in case of Chapter 11 reorganization,[33] nor is there a possibility to prevent the creditors seeking individual enforcement of their rights, like it would be the case with automatic stay under the Bankruptcy Code. For these reasons, American bankruptcy law offers another less formal restructuring avenue: the pre-packaged bankruptcy proceedings.

[31] *Black's Law Dictionary* (9th edn, West Thomson Reuters 2009) 1745.
[32] David G. Epstein, Bruce A. Markell, Steve H. Nickles, Lawrence Ponoroff, *Bankruptcy: Dealing with Financial Failure for Individuals and Businesses* (4th edn, West Academic Publishing 2015) 12.
[33] ibid 351.

In the pre-packaged bankruptcy, the informal negotiations between the debtor and its creditors precede the commencement of Chapter 11 reorganization proceedings. The debtor and the creditors work and vote on the reorganization plan outside the court proceedings, and then the agreed-upon plan is simply filed to the bankruptcy court upon the initiation of the proceedings.[34] The only thing left for the court to do is to check whether the solicitation of the votes given prior to the commencement of formal proceedings was in compliance with 'any applicable non-bankruptcy law, rule or regulation governing the adequacy of disclosure in connection to such solicitation.'[35] The drawback of the proceedings is that the time savings are only an ostensible advantage: while the court proceedings take shorter to complete after petition filing, it should be noted that the preceding negotiations may last up to several times the duration of court proceedings.[36] Nevertheless, it could hardly be denied that obtaining the creditors' consent to the reorganization plan prior to any formal procedure results in certain cost savings.[37]

1.2.3. Comparison and Terminology Caveats

Notwithstanding the differing terminology of pre-insolvency proceedings, out-of-court proceedings or informal proceedings, all of them serve the same purpose of effectively reorganizing the debtor while trying to prevent or avoid liquidation proceedings. The American legal practice went the farthest in developing the informal bankruptcy remedies, as it could rely on its comprehensive Bankruptcy Code and settled business practices. In comparison to the US system, European civil law jurisdictions are still missing the mind shift to allow the parties of traditional bankruptcy proceedings to negotiate in complete freedom, without any interference of

[34] Epstein et al (n 32) 355-356.
[35] Bankruptcy Code s 1126.
[36] Mark J. Roe, *Corporate Reorganization and Bankruptcy* (Foundation Press 2000) 430-431.
[37] Jay Lawrence Westbrook (ed), Charles D. Booth, Christoph G. Paulus, Harry Rajak, *A Global View of Business Insolvency Systems* (The World Bank 2010) 180. *See* more on pre-packaged bankruptcies *infra*, s 2.4.

the state courts. This does not imply that the above-mentioned countries are not heading in the same direction: to the contrary, the introduction of pre-insolvency proceedings demonstrates their willingness to allow for different *modus operandi*, all in order to grasp the right formula for the efficient debtor reorganization.

Following that line of thinking, this thesis does not present US workouts as a complete antipode to the Croatian pre-insolvency proceedings, but rather as an interesting mechanism of informal debt restructuring that may or may not be introduced in Croatian legal framework. Consequently, the emphasis will not lay that much on what differentiates the two methods of reorganization, but more on what can the Croatian legislation learn from the American workout practices.

CHAPTER II.

US OUT-OF-COURT WORKOUTS AS AN ALTERNATIVE TO FORMAL CHAPTER 11 BANKRUPTCY

In order to lay out the arguments for and against the out-of-court workouts, they have to be compared with the alternative reorganization proceedings, namely the formal court bankruptcy reorganization. The following chapter will give an overview of (dis)advantages of workouts compared to formal Chapter 11 proceedings, as well as provide potential solutions for certain drawbacks of this informal restructuring method.

2.1. Differentiating Formal from Informal Reorganization Proceedings

Notwithstanding the highly-developed bankruptcy framework in the US, the financially distressed debtor would still, before delving into Chapter 7 or 11 filing applications, mostly do everything it can to save the company outside the formal court proceedings. Such a way of thinking is reasonable, as no entrepreneur wants to face its own failure and let alone publicize it by announcing to the world that it has gone bankrupt. It is not only the debtor who might consider the informal ways of saving the business: creditors are usually also aware of the risks associated with formal bankruptcy court proceedings, including the low debt return ratio, high costs of formal proceedings, tiresome and potentially long lasting procedures which might drain and diminish the value of the bankruptcy estate, thus leaving less for the creditors to collect from. It has been recognized that, under certain conditions, careful negotiations and debt restructuring can help avoid bankruptcy.[38] However, does this mean that bankruptcy, especially the reorganization proceedings, should be avoided at all costs? How should the practitioners distinguish between

[38] Renegotiating the contractual covenants and changing the type of financing can go a long way in preventing bankruptcy. *See* hypothetical case study in Fred G. Hathaway, Jr., 'Workouts: Early Restructuring Could Have Prevented Bankruptcy' (1992-1993) 8 Com. Lending Rev. 70, 70-74.

viable candidates for restructuring and the firms that are simply going down the drain? When should the parties choose informal restructuring over formal Chapter 11 process? Answers to those questions will be analyzed in the following sections.

2.1.1. Advantages of Workouts (or: Why Workouts?)

Even though workouts are not explicitly regulated in the US Bankruptcy Code, examples of incentives to out-of-court restructuring avenues are enshrined in its text. One such provision was outlined in *In re Timbers*[39], according to which the court has the power to dismiss the case or suspend the proceedings if the interests of the creditors and the debtor would mandate such dismissal or suspension,[40] e.g. if they would be better off in an out-of-court workout. The same policy considerations are visible in provisions that enable continuation of prepetition creditors' committees[41] and enumerate procedures for acceptance of the reorganization plan, including the prepetition solicitation of plan approval.[42] While the state encourages workouts to take the pressure off the courts, the parties to a workout find various advantages to promote their own interests.

Workouts are creatures of contractual law. They provide greater flexibility for the parties, allowing them to construe a specific solution for every individual debtor. The means of resolving financial

[39] *United Savings Association v. Timbers of Inwood Forest Association*, 793 F.2d 1380 (5th Cir. 1986), aff'd, 484 U.S. 365 (1988). In *Re Colonial Ford, Inc.*, 24 B.R. 1014, 1015-17 (Bankr. D. Utah 1982), the court stated that 'Congress designed the [Bankruptcy] Code, in large measure, to encourage workouts in the first instance, with refuge in bankruptcy as a last resort.' Cited in Squire (n 1) 487.

[40] Bankruptcy Code s 305(a): 'The court, after notice and hearing, may dismiss a case under this title, or may suspend all proceedings in a case under this title, at any time if – (1) the interests of creditors and the debtor would be better served by such dismissal or suspension.'

[41] Bankruptcy Code s 1102(b)(1): 'A committee appointed (...) shall ordinarily consist of persons, willing to serve, that hold the seven largest claims against the debtor of the kinds represented on such committee, *or the members of the committee organized by creditors before the commencement of the case under this chapter*, if such committee was fairly chosen and is representative of the different kinds of claims to be represented.' (Emphasis added.)

[42] Bankruptcy Code s 1126(b): 'For the purposes of subsections (...), a holder of a claim or interest that has accepted or rejected the plan before the commencement of the case under this title is deemed to have accepted or rejected such plan, as may the case be, if – (1) the solicitation of such acceptance or rejection was in compliance with any applicable nonbankruptcy law, rule, or regulation governing the adequacy of disclosure in connection with such solicitation; or (2) if there is no any such law, rule, or regulation, such acceptance or rejection was solicited after disclosure to such holder of adequate information (...).' (Emphasis added.)

and operational problems in the debtor company vary from using extensions agreements, waivers of interest to full or partial discharge of debt.[43] While contractual provisions of workout depend primarily on parties' willingness to agree on renegotiation of their rights and obligations, some changes might not be operable under the formal bankruptcy law. For example, placement of creditors in different classes which do not correspond to the absolute priority rule would be contrary to provisions governing Chapter 11 proceedings.[44] The workout process is not restricted by legislation on fraudulent conveyances, meaning that the debtor is generally free to arrange beneficial treatment of creditors as consideration for their concessions in the workout agreement. The flexibility of out-of-court reorganizations might be particularly beneficial for proceedings involving cross-border group of companies, as the complexity of official proceedings could push the participants towards less formal avenues.[45] Furthermore, workouts are generally easier to negotiate, as they are conducted in informal surroundings, with less confrontations and lighter procedural rules.[46]

Another important advantage of workouts is their confidentiality.[47] Engaging in a workout helps keeping the financial troubles of the company from the public eye, thus preventing or at least mitigating damage to reputation.[48] Furthermore, the absence of appearance before a court renders

[43] For other methods of out-of-court debt restructuring, *see infra* s 2.2.
[44] Jose M. Garrido, *Out-of-Court Debt Restructuring* (World Bank study, Washington D.C.: World Bank 2012) 15.
[45] Conference report from the IBA's 16th Annual Global Insolvency and Restructuring Conference– Cleaning up the mess: restructuring and insolvency approaches worldwide (Hamburg, Germany, May 2010) < http://heinonline.org/HOL/Page?handle=hein.journals/iri4&div=28&g_sent=1&collection=journals > accessed 14 January 2017, 4.
[46] Garrido (n 44) 15. However, the opposing argument might be that workout could not be particularly easy to renegotiate considering the differing interests of various classes of creditors. For more disadvantages, *see infra* s 2.1.2.
[47] Even though generally considered as a feature of workouts, confidentiality is only of partial reach in publicly listed companies, who have duties of disclosing certain information. *See* fn. 7 in Garrido (n 44) 15.
[48] Annemarie Franczyk, 'Workouts keep the debt out of the court, public eye' (*Buffalo Law Journal*, 9 November 2009) <http://www.bizjournals.com/buffalo/blog/buffalo-law-journal/2009/11/workouts-keep-debts-out-of-court-public-eye.html> accessed 25 January 2017. Even with diminishment of the level of bankruptcy stigma in the US, private reorganization still helps to uphold the value of company's goodwill.

workouts speedier, contributing to time efficiency which is of an essence when trying to avoid liquidation. Given that workouts are typically shorter than formal bankruptcy proceedings[49], they help preserve the value of the company as a going-concern, which benefits both the debtor and the creditors.

Shorter duration of the proceedings is one of the elements contributing to lower costs of out-of-court debt restructuring in comparison with formal Chapter 11 proceedings. When assessing the costs of reorganization procedures, scholars distinguish direct costs from indirect costs.[50] Direct costs are the ones in direct connection to the proceedings, such as administrative expenses, court costs and legal fees for attorneys and other personnel working on the case. Indirect costs are the ones attributed to adverse impact of reorganization on investors' and clients' decisions to work with the company and buy its products.[51] They can also be defined as 'foregone profits', i.e. the loss in profits caused by the debtor's management being unable to devote time to conscious business management or by the debtor having to pass on some profitable investment opportunities because of the difficulties in raising funds during reorganization proceedings.[52] Engaging in a workout is not free, but the costs are still lower compared to the costs of formal bankruptcy proceedings. According to one study, Chapter 11 direct costs can only amount to 1 to 7 percent of the debtor's assets (with smaller debtors usually having larger costs ratios),[53] leaving indirect costs aside. The reason for this might be high court and attorneys' fees associated with formal

[49] Garrido (n 44) 15.
[50] Squire (n 3) 36.; Stuart Gilson, 'Coming through a Crisis: How Chapter 11 and the Debt Restructuring Industry Are Helping to Revive the U.S. Economy' (fall 2012) 4 J. Appl. Corp. Finance 22, 26.
[51] Gilson (n 50) 26.
[52] Squire (n 3) 36.
[53] Arturo Bris, Ivo Welch and Ning Zhu, 'The Costs of Bankruptcy: Chapter 7 Liquidation Versus Chapter 11 Reorganization' (2006) 61 J. Fin, 1253, 1280, as cited by Squire (n 1) 36.

bankruptcy filing, which could sometimes double those of a workout.[54] On the other hand, direct workout costs will typically include the negotiated fees for attorneys and experts, but will not contain various court and administrative fees. As for the indirect costs, the confidentiality of the out-of-court proceedings will help maintain damage caused by omnipresent society stigma to at least a reasonable level.

Aside from the debtor company benefiting from the less disruption to its business operations, another potential advantage of workout is the absence of change in company's management, which is particularly appealing in systems where management is routinely displaced in the wake of bankruptcy threat.[55] However, it should be noted that such debtor-in-possession type of management is available in Chapter 11 reorganization as well. When comparing the two types of proceedings, the power of management to continue running the company's affairs appears two-sided. On the one side, management in Chapter 11 scenario, backed by rules on automatic stay and super-priority on post-petition financing, enjoys greater bargaining power vis-à-vis the creditors.[56] On the other side, the fact that workouts do not have the power to interfere with the rights of creditors on enforcing their security may encourage them to participate, knowing that they can exercise control over their claims at any given moment. Creditors might also be keen on taking the out-of-court avenue considering that the workout structure does not prevent them from asserting their set-off rights,[57] which is not the case with some bankruptcy law statutes.[58]

[54] According to Raymond Fink, a Harter Secrest & Emergy LLP partner in Buffalo quoted in Franczyk (n 48), in 2009 typical attorney and court fees payable for bankruptcy filing in western New York could average between $50,000 and $250,000 for a company with revenues ranging from $5 million to $30 million, not including the quarterly fees to be paid to the U.S. Trustee's Office.
[55] Garrido (n 44) 15.
[56] Michelle J. White, 'Corporate Bankruptcy as a Filtering Device: Chapter 11 Reorganizations and Out-of-Court Debt Restructurings' (1994) 10/2 J.L. 268, 287.
[57] Garrido (n 44) 15.
[58] Even though it does not completely prohibit set-off, s 553 of the US Bankruptcy Code enumerates various limitations to such right: the claim has to be allowed, it has to be transferred to the creditor after the commencement of the case

2.1.2. Disadvantages of Workouts (or: Why Chapter 11 Proceedings?)

Notwithstanding the benefits of workouts, their growing popularity has not eliminated the need for formal court reorganization proceedings. As per some authors, workouts can be perceived as only a part, potentially a starting point of the debt restructuring continuum.[59] If the workout turns out successful, there will be no need to take additional steps. If this is not the case, the state should provide back up court proceedings to enable the parties to finally determine their positions in the wake of debtor's financial difficulties.

Another point is that the parties might simply decide to go with formal Chapter 11 reorganization from the start, as they perceive the strengths of a workout being outweighed by the potential weaknesses. In order to have a fruitful workout, parties must live up to a very high level of cooperation. A debtor has to be honest with its creditors, presenting the situation in its reality instead of the manner of wishful thinking. The creditors might fear that the debtor will not frankly report on the company's condition, thereby putting them in position of being asked to restructure the business for which they are not sure whether it is at all viable. The law cannot mend a bad business model, so it will be up to them to distinguish a company that has chance of recovering from a case of a terminally sick borrower.[60] As the creditors would lack means to formally check

or after 90 days before the filing of the petition and while the debtor is insolvent (again with certain exceptions) etc. Furthermore, to be put in the position to exercise the set-off, creditor has to receive a relief from the automatic stay of individual enforcement. Croatian Insolvency Act also allows set-off to a certain extent in formal insolvency proceedings, with limitations similar to those contained in the US Bankruptcy Code (Insolvency Act arts 174-176).

[59] According to the scheme presented by Garrido in the World Bank study, the continuum for treatment of debtor's financial problems would look like: 1) completely informal out-of-court restructuring, potentially in form of a workout; 2) enhanced restructuring, which is a workout supported by certain norms or principles; 3) hybrid procedure, in which case workout is supported by the intervention of the court; 4) formal reorganization, including reorganization plan under Chapter 11; and 5) formal insolvency under Chapter 7. The author notes that, for a successful debt restructuring, it is not necessary to go through all the above-mentioned stages; to the contrary, a well-structured reorganization plan should never lead to liquidation stage. The sequences only elaborate on the increase in formality and complexity of proceedings with the change in circumstances surrounding the debtor-creditor relationship. *See* Garrido (n 44) 5.

[60] Adam Michelin, 'Can Bankruptcy Be Avoided?' (March 2002) 17 Comm. Lending Rev. 41.

the information coming from the debtor, they might be hesitant on entering into workout arrangements. In that sense, court-administered bankruptcy proceedings will more suitably meet their needs for verified information on the debtor.[61]

Another disadvantage of a workout is the absence of automatic stay on enforcement proceedings. The strength of a workout lies in contractual agreement of the creditors not to pursue individual enforcement of their claims, but there is no strict provision prohibiting them from doing so. To the contrary, debtor in court proceedings automatically benefits from the stay from the moment of filing the petition for Chapter 11 case.[62] Automatic stay provides greater freedom to the remaining management of the company, enabling it to continue businesses of the debtor during the reorganization proceedings. Moreover, official Chapter 11 proceedings provide a chance for the debtor to get out of burdensome contracts with its creditors.[63] However, it should be noted that the rejection of contracts implies contractual liability for non-performance, which could have significant impact on the balance sheet of the debtor.[64]

Keeping the creditors out of the court-enforcement zone is particularly challenging when the debtor has to deal with a large number of creditors who may pursue different interest and ideas on how to collect on their claims. For example, long-term loan providers like financial institutions might wish to restructure the debt in a way which would enable future business and potentially yield higher return in the later phase of the debt repayment, while trade creditors could be

[61] Garrido (n 44) 16.
[62] Bankruptcy Code s 363.
[63] According to Bankruptcy Code s 365(1), the trustee has the power to either assume or reject any executory contract or unexpired lease of the debtor.
[64] For example, rejecting a generally too expensive labor contract might be good for the continuation of the debtor's business, but could also imply liability for labor claims coming from various ancillary obligations to the collective bargaining agreement. One such situation was illustrated in Maury B. Poscover (ed), 'The Business in Trouble – A Workout Without Bankruptcy' (1984) 39/3 Bus. Law., where pulling out of the collective labor agreement included withdrawal from a multiemployer pension fund, bringing along the withdrawal liability up to $4 million.

interested in the highest possible debt return ratio in the near future, as their own business typically depends on the proceeds from contracts concluded with the debtor. Some creditors could even be interested in the failure of negotiations, as such an event could potentially trigger debt acceleration or other types of obligation favorable to individual creditor's interests.[65] The multiplicity of creditors' interests can therefore cause the so-called aggregation and coordination problems[66] in the negotiations process, which could result in higher transactions costs and generally losing the time and cost efficient traits of workouts.

The importance of harmonizing the creditors' interests lies in the fact that, due to the contractual nature of workouts, unanimous consent of all creditors is usually required for the plan to be deemed accepted.[67] Even though workouts do not have to include all the creditors, the aim will typically be to encompass as many of them as possible in order to conduct constructive reorganization. Chapter 11 proceedings deal with this issue by abolishing the requirement of absolute unanimity for reorganization plan to be passed.[68] In order to tackle the unanimity requirement in workout, debtor could deliberately exclude certain classes of creditors from negotiations.[69] However, if part of the creditors who are left out would be substantial enough to put pressure on participating

[65] Garrido (n 44) 68.
[66] As defined by Garrido, aggregation problem is caused by disparate legal positions of various classes of creditors, which then causes coordination problem in situations where many creditors participate in a workout. *See* Garrido (n 44) 13.a.
[67] Gilson (n 50) 30. Creditors may change the unanimity requirement by opting for a majority vote that would bind all the participants, but there is no formal body to perform cramdown on the dissenting creditors.
[68] According to Bankruptcy Code s 1126(c), (d) and (f), reorganization plan will be deemed accepted by a voting class if it has been accepted by creditors holding at least two-thirds in amount and more than one-half in number of the allowed claims of such class, while a class of interests will be deemed to have accepted the plan if it has been accepted by holders of at least two-thirds in the amount of the allowed interests of such class. Furthermore, the classes of creditors which have not been impaired by the plan are deemed to have voted in favor of the plan.
[69] For example, if the majority of the creditors are financial institutions, debtor might wish to exclude minor trade creditors from the debt restructuring negotiations. Disparity of creditors' interests will necessarily cause high transaction costs and potentially endanger the outcome of the negotiations, and the big financial creditors might be interested to have trade creditors fully paid out first, thus eliminating the threat of them commencing the unfavorable liquidation proceedings. *See* Garrido (n 44) 69.

creditors not to accept the plan, the workout could still fail.[70] Another issue related to the unanimity requirement is the situation in which creditors, instead of participating, decide to free ride on the collective efforts of those who renegotiate their claims. Such a holdout situation is a classic example of the so-called 'prisoner's dilemma', whereby a collective action yields better results for the parties taken together, but an individual can be better off by not participating in the action which takes place.[71] The means of preventing such free riders from benefiting of the haircuts endured by other creditors will be addressed *infra* in this thesis,[72] but for the time being it should be stated that holdouts represent a significant deterring factor for creditors to engage in workouts.

One of the ways to ensure unanimity and tackle holdouts is to provide certain advantages to the dissenting creditors, e.g. priority status, additional insurance or higher interest rates. However, if the case eventually ends up in Chapter 11 court, the trustee's avoidance powers may cause problems for the gifted creditors. This is because such acts of preference could be considered fraudulent conveyances under the provisions of the Bankruptcy Code and thus trigger avoidance actions on the side of the trustee.[73] On the other hand, the threat of Chapter 11 proceedings could help the debtor in convincing the creditors to take on the workout plan, as the potential benefits they could receive under it would be unlikely to survive formal bankruptcy proceedings.

Finally, an important consideration potentially working against workouts is the ease of obtaining financing in the restructuring phase. A troubled debtor will typically need 'fresh money' to repay creditors and continue business during the negotiations, but traditional sources of financing like

[70] Garrido (n 44) 68.
[71] Rick Antonoff, 'Out-of-Court Debt Restructuring and the Problem of Holdouts and Free Riders' (*Metropolitan Corporate Counsel*, October 2013) < http://www.metrocorpcounsel.com/articles/25455/out-court-debt-restructuring-and-problem-holdouts-and-free-riders > accessed 15 February 2017.
[72] *See infra* s 2.3.
[73] Bankruptcy Code s 548.

banks and other financial institutions will be reluctant to provide the funds to a failing business. Existing shareholders might also refuse to provide loans to the company, as they risk the loans being considered equity contributions and thus hardly repayable in potential bankruptcy.[74] Formal Chapter 11 proceedings deal with such creditors' fears by providing that post-petition financing gets the status of administrative expense claims and consequently ensures super-priority of lender's claim.[75] The provisions enabling such debtor-in-possession financing are one of the biggest advantages of formal reorganization proceedings. Similar results could be achieved out-of-court, but only if the highly-ranked major creditors would agree to enter inter-creditor agreement subordinating their claims to the providers of fresh funds, again on purely voluntary, contractual basis.[76]

2.1.3. On the Crossroads Between Workout and Chapter 11: Which Way to Go?

The given analysis makes it clear that both out-of-court debt restructuring methods like workouts and official Chapter 11 reorganization proceedings bear certain advantages and disadvantages for the debtor and creditors involved in the process. While the workout may, and often does, chronologically come before Chapter 11, it is not a precondition to be fulfilled by the debtor before turning to court administered proceedings. Before deciding on what type of procedure to take, debtor's management should duly screen the company's position and examine the factors which may determine the outcome of reorganization proceedings.

[74] According to the absolute priority rule, reflected in s 1129(b) of the Bankruptcy Code, equity holders will be the last in line to be repaid and thus risk getting no payment at all.
[75] Bankruptcy Code s 364. Under certain conditions, both unsecured and secured post-petition creditors are eligible to hold super-priority claims, thus providing the trustee with efficient means in obtaining new lines of credit.
[76] Another way to attract financing would be by creating a security interest over unencumbered assets or over collateral with the value higher than the claims it already secures, if there is any. *See* Garrido (n 44) 61.

A significant volume of research has been conducted on the question of factors indicating the possibility of a successful workout. The first and most basic one is the number of creditors and the way they participate in the company's capital structure: if there is a large number of creditors, especially if they are spread over various jurisdictions or hold minor claims but with substantial share in the overall debt, workout will hardly be a viable option.[77] On the other hand, a debtor would be better off without formal reorganization when faced with high indirect financial distress costs, e.g. in situations where company holds relatively more intangible assets. Since asset sale may be a viable way to avoid formal bankruptcy, companies that sell large portions of their assets have higher chances to successfully restructure their debts.[78] Firms with high percentage of intangible assets will be interested to sell those assets outside bankruptcy, as their value is more likely to deteriorate due to decrease in customer demand during the lengthy bankruptcy proceedings.[79]

Furthermore, workout stands a greater chance of being successful if the majority of the company's long-term debt is held by banks, as creditors who are typically more experienced and better equipped to renegotiate the debt in a speedy and economically efficient manner.[80] Another important factor is the share of publicly held debt in the overall indebtedness of the company, which will typically be restructured through exchange offers, exchanging the distressed debt for either new debt or equity.[81] Studies have shown that bank lenders are more willing to restructure

[77] Gilson (n 50) 33. Author provided a case study on the Chapter 11 bankruptcy of LyondellBasell Industries, whose $23.2 billion debt was owed to almost 25,000 creditors spread among borrowing entities in both US and Europe, making it impossible to conduct a feasible workout.

[78] According to Asquith, Gertner and Scharfstein (1994), in a research based on pattern of 21 companies engaging in out-of-court debt restructuring, 49% of the firms with no or small assets subsequently filed for bankruptcy, while only 14% of the companies that sold over 20% of their assets did the same. Cited in Edith S. Hotchkiss, John Kose, Robert M. Mooradian, Karin S. Thorburn, 'Bankruptcy and the Resolution of Financial Distress' (January 2008) < https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1086942 > accessed 25 January 2017, 13.

[79] According to Gilson, John and Lang (1990), cited in Hotchkiss et al (n 78) 16.

[80] ibid.

[81] The so-called debt-to-debt and debt-to-equity swaps. *See* more *infra*, s 2.2. As cited in Hotchkiss et al. (n 78) 15.

their claims by forgiving the principal and taking equity in exchange when a relatively low fraction of debt is held by public debt holders who also agree to undergo a debt restructuring process.[82] On the other hand, if the debtor company's debt structure involves a high portion of public debt and secured private debt, the more feasible option for restructuring would be Chapter 11 formal proceedings,[83] as private renegotiation of complex debt structures could result in longer and more costly negotiations with higher potential for holdouts. Certain empirical data indicates that, after the initial announcement of an out-of-court restructuring attempt, distressed firms with less secured debt and higher leverage see a more favorable return on shares then the ones filing for formal bankruptcy.[84]

To summarize, the debtor companies that are more likely to succeed in an out-of-court workout restructuring are the ones that, besides a high going-concern value, have more intangible assets and fewer creditors. The chances of successful negotiations will further increase if the debt is owed mostly to financial institutions, if the firm has relatively strong operating performance and if the creditors show a greater level of internal cooperation.[85] When the debtor company is highly leveraged, owes primarily publicly held debt and experiences coordination problem among creditors, there is a greater chance of the out-of-court debt restructuring attempt eventually ending up in formal Chapter 11 proceedings.[86]

[82] According to James (1995, 1996), as cited in Hotchkiss et al. (n 78) 17.
[83] According to Asquith, Gertner and Scharfstein (1994), as cited in Hotchkiss et al. (n 78) 17.
[84] Philipp Jostarndt, Zacharius Sautner, 'Out-of-Court Restructurings versus Formal Bankruptcy in a Non-Interventionist Bankruptcy Setting' (2010) 14 Rev Financ 623, 664. After having compared the data of 116 workout attempts in Germany taking place between 1997 and 2004, the authors have found that after the announcement of a workout, firm value appreciates by up to 11%, while the announcement of a bankruptcy filing leads to a loss in value of shares up to 56%.
[85] Garrido (n 44) 59, fn 35.
[86] ibid. *See* also Hotchkiss et al. (n 78) 17.

2.2. Methods of Out-of-Court Restructuring

As emphasized earlier, workouts are primarily creatures of contract. The notion behind this implies that the methods used in workouts will typically involve renegotiation of contractual terms producing obligations for the debtor. Dealing with distressed company's obligations will usually include restructuring on two levels, one related to the debtor's business and other to the debtor's finances, i.e. debt-restructuring *stricto sensu*.[87]

With regards to restructuring the debtor's business scheme, the management may decide to restructure through the partial sale of assets in order to increase cash levels necessary for doing business, or to cut off the assets or units which cause losses to the company.[88] In another scenario, the debtor may decide to go with the sale of the company as a going-concern to a single buyer, achieving a higher price than what would be the case with a piecemeal liquidation.[89] The practice of going-concern sales is widely recognized, as it can imply sale to a person connected to the company[90] or sale to a newly created company, which takes over assets and operations free of antecedent liabilities (the so-called 'hive-down').[91] The latter method of saving the debtor caught the attention of the broader legal community when used to save the American companies General Motors and Chrysler in 2009. The scheme was effectuated by the distressed (Old) Chrysler selling

[87] Garrido (n 44) 75, 76.
[88] ibid 75.
[89] Stephan Madaus, 'Reconsidering the Shareholder's Role in Corporate Reorganizations under Insolvency Law' (2013) 22 Int. Ins. Rev. 106, 107; Garrido (n 44) 75; Squire (n 3) 491-492.
[90] This is often the case with the UK pre-packaged administration, in which an arrangement for the sale of business or assets is negotiated with a purchaser prior to the appointment of an administrator, who then effects the sale immediately. *See* Mark Wellard, Peter Walton, 'A Comparative Analysis of Anglo-Australian Pre-packs: Can the Means Be Made to Justify the Ends?' (2012) 21 Int. Ins. Rev. 143, 145. It is important to note that UK administered pre-packs differ from US style pre-packs; latter include restructuring negotiations with creditors prior to commencement of formal bankruptcy proceedings, which do not necessarily end up in partial or total sale of debtor's assets. *See* more on pre-packaged solutions *infra*, s 2.4.
[91] Madaus (n 89): Garrido (n 44) 75.

its assets as a going-concern[92] to the New Chrysler company free of almost all claims, while the Old Chrysler kept the liabilities alongside filing for Chapter 11 bankruptcy.[93] Curiously, while the American company decided to take the going concern sale approach, the Canadian subsidiary of General Motors Ltd. underwent a completely out-of-court restructuring in order to minimize the reorganization costs.[94] It is useful to mention the analysis of both cases here, as it clearly shows that neither a going-concern sale nor a completely informal workout can be perceived as a perfect solution for distressed firms; it will take a careful case-by-case due diligence approach to weigh on the estimated costs and risks associated with both proceedings.[95]

When it comes to restructuring of debtor's financial obligations, typical contractual arrangements include compositions, i.e. renegotiating the liabilities contained in debts instruments and extensions, i.e. standby agreements on extension of debt maturity.[96] The mechanisms used in these arrangements may differ, with some of them including change of maturity dates without change in the interest rate, forgiving past or future interest, change of interest rates in order to increase the chances of full repayment on the principal, conversion of the currency on which the debt is owed, change in contractual covenants or exclusion of penalties for minor contractual violations.[97]

[92] The sale was perpetuated under Bankruptcy Code s 363, dealing with administrative powers of the trustee to use, sell or lease the property of the estate.
[93] IBA Conference report (n 45) 28.; Squire (n 3) 511-516. The court in *In Re Chrysler LLC*, 576 F.3d 108 (2nd Cir. 2009), vacated by 130 S. Ct. 1015, as cited by Squire, upheld the s363(b) sale as a going-concern because of its efficiency, speed of the process and maximization of the asset value.
[94] Robert Harlang, Mitch Vininsky, '*C*anadian Court Rules in Favor of GM Canada over Dealers' (*American Bankruptcy Institute Journal*, November 2015) < http://www.ksvadvisory.com/articles/ >, accessed 14 January 2017. The case, *Trillium Motor World Ltd. v. General Motors of Canada Ltd., 2015* ONSC 3824 (CanLII), is available at: < canlii.ca/t/gk0p7>.
[95] ibid. In the respective cases, while the Canadian GM subsidiary underwent informal reorganization to cut the costs, the following distributors' class-action had a substantial impact on the final price of the reorganization. On the other hand, the going-concern sale of GM to New GM did not exclude the New GM taking over liability claims concerning pre-restructuring cars, which also increased the overall costs of rescuing the company.
[96] Poscover (n 64), where the creditors contemplate which type of workout agreement to use in the given situation. *See* also Garrido (n 44) 78.
[97] Garrido (n 44) 78.

However, creditors will typically tend to reduce the number of such alterations since 'too much freedom is as bad as too many restrictive covenants.'[98]

Other important means of restructuring of the debtor's balance sheet include debt for equity, debt for debt and equity for equity swaps.[99] All these transactions share the common goal of exchanging the existing debt instruments for new, less burdensome ones. If possible, the debtor could offer to create new security interests in exchange for creditors' concessions on the debt repayment; the same instrument may be used to attract new financing, which would then be provided priority through inter-creditor agreements. [100] In addition, the rising interest of private equity firms and hedge funds in investing in financially distressed firms provides another opportunity for the debtor company to acquire fresh funds.[101] The consequential change in shareholder structure of the company is not necessarily a bad thing, as such 'vulture funds' generally consists of well-equipped professionals who might help discipline the debtor's management and get the company back on track.[102] Finally, the financial debt restructuring could simply be done by creditors agreeing to partial or total write-offs or 'haircuts' of their claims; however, considering the debtor's interest in good cooperation with creditors in workout negotiations, such option should only be used as a final resort.[103]

[98] Hathaway (n 38) 74.
[99] Garrido (n 44) 78. Debt for equity swaps imply transactions whereby the debts of the company are exchanged for something of value, i.e. equity in the company. If the company is held publicly, debt for equity swaps will typically be based on an exchange offer for the exchange of bonds for existing of newly issued shares. Source: investopedia.com.
[100] Garrido (n 44) 61, fn 70.
[101] Gilson (n 50) 24. Hedging themselves with the knowledge and skills to deal with a company in crisis, private equity firms and hedge funds are more keen on investing in financially distressed firms despite the potential risks. The distressed firm is typically acquired through a leveraged buyout, whereby the private equity firm, in order to obtain control, acquires most or all of the outstanding stock of the company. Once the private equity firm repackages the company, it puts its shares back on the market to sell it at an initial public offering. Source: investopedia.com.
[102] Garrido (n 44) 72.
[103] ibid 78.

2.3. How to Make Out-of-Court Workouts Binding?

No matter the contractual method used to negotiate an out-of-court debt restructuring, there is always a chance of a debtor experiencing resistance of certain creditors to take part in the workout. Since there are no statutory means to bind the dissenting creditors by the workout plan,[104] the debtor will have to think of alternative ways to prevent or minimize the damage that might arise out of such holdout situations.

The absence of statutory solutions to the holdout problem forced lawyers to use their creativity when protecting the clients from such situations. One of the first moves was to insert the so-called majority clauses in public debt securities and syndicated loans.[105] The example would be a contractual clause in the bond indenture providing that the modifications and extensions of bonds' maturity date, agreed upon among majority bondholders and the debtor, would affect all the bondholders alike. The dissenting bondholders would thus be bound by the modifications of the indenture regardless of their opposition.[106] Notwithstanding this solution being significantly limited in the US by provisions of the Trust Indenture Act,[107] the idea could still be applied elsewhere in cases where creditors are all parties to the same contract, e.g. in cases of the same series of bonds or shares and if the regulations do not provide otherwise.

[104] As opposed to Chapter 11 cramdown option, whereby the court can impose the plan on dissenting classes of creditors if certain conditions are met. *See* Bankruptcy Code s 1129.
[105] Garrido (n 44) 77.
[106] As cited by Squire (n 3) 39-43, such an approach was taken up in *Aladdin Hotel Co. v. Bloom* 200 F.2d 627 (8th Cir. 1953) case, where the dissenting bondholders sued on the basis that of a change in the terms of debenture not being valid because it was not made in good faith, despite the contractual provision binding all bondholders alike. The court held that the modification was effected in compliance with the provisions of the contract, which are to be respected as the expression of common will of the parties.
[107] According to the 1939 Trust Indenture Act, dissenting bondholders are exempt from indenture amendments concerning change in the amount or the maturity date of the bonds. The only remaining exception is the case of the postponement of interest payments to up to three years, under condition that at least 75% of the bonds consent to it. *See* Squire (n 3) 463-464.

Another method of tackling holdouts involves using coercive tactics in negotiating the exchange offers.[108] When the creditors agree on replacing a current debt with a newly issued more senior debt, softening financial covenants by providing for longer maturity or requiring lower payment, the holdouts could be left with only junior claims, notwithstanding more favorable terms.[109]

Finally, the holdout problem could be dealt with by using the so-called 'exit consents.'[110] When an exchange offer is made in a workout, the holders of senior bonds might be offered to exchange their bonds for common stock and/or zero-coupon bonds,[111] which do not pay interest but are redeemed at the maturity date for their full face value.[112] The proposed exchange offer could be conditioned by bondholders' consent to strip the financial covenants from the indenture governing the bonds they are holding.[113] Since the participating bondholders will no longer be subject to the indenture due to exchange of debt securities, the cost of the transaction would be borne only by the holdout bondholders. Therefore, the use of such exit clauses in bond indentures could motivate the holdouts to participate, as their free ride would not bring them too many benefits.[114]

In case of creditors who are not necessarily holders of debt securities, e.g. financial creditors, a possible way of avoiding holdout situations is by abandoning the requirement of unanimity for the workout to produce binding effects. Financial creditors can opt for the use of various non-binding protocols when negotiating their claims with the debtors, such as the INSOL Principles 2000[115],

[108] Hotchkiss et al. (n 78) 19.
[109] ibid. Authors cite Chatterjee, Dhillon and Ramirez (1995) report that notes the higher completion rates and a higher proportion of bonds tendered or exchanged in cases of coercive exchange offers, leading to higher rate of successfully conducted workouts.
[110] Squire (n 3) 463-465.
[111] ibid.
[112] Source: investpedia.com.
[113] Squire (n 3) 463-465.
[114] ibid.
[115] INSOL Principles 2000: Statement of Principles for a Global Approach to Multi-Creditor Workouts, consisting of eight recommended principles for out-of-court debt restructuring.

London Approach[116] or other country-specific policy approaches.[117] By agreeing to adhere to a certain protocol, creditors can rely on various quotas required for rendering decisions related to future workouts, such as 75 to 90% for full restructuring or 66% for credit draws and asset sales.[118] Such *ex ante* agreements among creditors could effectively eradicate the holdout problem by opting out from the typical unanimity requirement for a workout to be binding.

2.4. Pre-Packaged Bankruptcy as the Middle Grounds Solution

Notwithstanding the efforts to remove or reduce the downsides of workouts, it is still possible that the plan reached through workout negotiations will not prove to be a viable one. With the lack of the plan's binding effect on dissenting creditors being the largest issue, the legislators decided to tackle it by developing hybrid solutions for informal debt restructurings in forms of 'pre-packaged' bankruptcy proceedings.[119] Pre-packaged bankruptcies combine advantages of both formal and informal debt restructuring: the reorganization plan is negotiated privately, in a form of a workout, but is also submitted to the court for confirmation in order to become binding on all creditors.[120]

The voting rules tailored to prevent holdout situations and providing certain beneficial tax treatment, alongside less burdensome costs than those of the Chapter 11 proceedings, turned pre-

[116] London Approach, a policy approach developed in early 1990s, as a 'non-statutory and informal framework introduced by the Bank of England for dealing with temporary support operations mounted by banks and other lenders to a company or group in financial difficulties, pending a possible restructuring.'
[117] E.g. Istanbul Approach, Jakarta Initiative, Corporate Debt Restructuring Committees in Republic of Korea, Malaysia, Thailand etc. *See* Garrido (n 44) 89.
[118] As proposed in the Istanbul Approach.
[119] Gilson (n 50) 24. The author differs 'pre-packaged bankruptcies', where creditors' votes are formally solicited prior to filing for bankruptcy and 'prenegotiated bankruptcies', where key creditors only sign up a 'lock-up' agreement in which they promise to vote for the plan once the debtor initiates Chapter 11 bankruptcy. Some jurisdictions define pre-packaged bankruptcies as 'pre-packaged sales', namely already arranged sale of the business as a going concern before the formal bankruptcy proceeding is opened. The most prominent country to use such definition is the UK; *see* Wellard, Walton (n 90) and Garrido (n 44) 99.
[120] Garrido (n 44) 94-96.

packaged bankruptcies into a desirable option for the US debtors.[121] European jurisdictions have as well recognized the advantages of pre-packaged solutions: French law includes pre-packaged agreements as a part of the safeguard procedure,[122] while German companies found pre-packaged plans to be quite useful, especially in combination with elements of DIP governance of the company.[123]

Pre-packaged bankruptcies with a limited involvement of the court, often called 'hybrid procedures',[124] still have certain drawbacks. In the US Chapter 11 scenario, the court confirming the plan will require proof of the debtor disclosing adequate level of information to creditors during negotiations, namely the same amount it would have been required to disclose in Chapter 11 proceedings.[125] In the absence of a prospectus associated with publicly traded securities, debtor will have hard time proving that all the creditors, including holders of non-publicly traded debt, have been adequately informed on the reorganization process and its consequences. Furthermore, pre-packaged bankruptcies typically lack the additional level of protection provided by formal bankruptcy: for example, avoidance of fraudulent transfers will hardly be applicable to benefits granted in the plan and confirmed by the court.[126] In addition, pre-packaged proceedings might not be suitable for handling the inter-creditor disputes concerning the existence of the claims.[127] However, these problems only come into picture when comparing pre-packaged bankruptcies to

[121] Baird and Rasmussen (2003), as cited by Hotchkiss et al (n 78) 16, estimate that 25% of 93 large-firm Chapter 11 bankruptcies in 2002 very pre-packaged bankruptcies; Gilson (n 50) 31 notes that pre-packaged bankruptcies in 2009 alone accounted for $124 billion corporate assets filing for Chapter 11.
[122] Kastrinou (n 14) 102-103.
[123] Annerose Tashiro, 'Prepacked Plans in Germany' available at <https://www.iiiglobal.org/sites/default/files/annerosetashiro.pdf> accessed 25 January 2017.
[124] Garrido exemplifies hybrid procedures as those where court appoints a mediator to assist in the plan negotiations, where there is a stay on creditor actions or where the court validates an agreement among creditors (prepackaged bankruptcy). *See* Garrido (n 44) 94-96.
[125] Gilson (n 50) 30.
[126] Garrido (n 44) 102.
[127] ibid.

formal bankruptcy reorganizations; when put in comparison with workouts, pre-packaged bankruptcies could efficiently tackle holdouts and still keep the costs of reorganization at a reasonable level. It is mostly for this reason that their use is on the rise in the US and in Europe; the last chapter of this thesis will analyze whether they can compete with Croatian pre-insolvency proceedings and potential introduction of completely informal workouts.

CHAPTER III.

CROATIAN PRE-INSOLVENCY PROCEEDINGS

While workouts have proved to be a rather useful restructuring tool in the US, it cannot automatically be stated that the same scheme would yield similar results in other jurisdictions. In order to see whether American informal reorganization experiences can be transposed to the Croatian legal system, it is necessary to firstly introduce the current Croatian bankruptcy framework, alongside its most important changes. In addition, given that the recent EU insolvency law reforms partially drew inspiration from the US reorganization and second chance policies, examining whether Croatian pre-insolvency proceedings meet the goals of the secondary EU legislation helps in comparing the level of compatibility of Croatian and US debt restructuring methods.

3.1. The Legal Genesis of the Croatian Pre-Insolvency Proceedings

Pre-insolvency settlement proceedings were first introduced to the Croatian insolvency system in 2012, when the Croatian Parliament enacted the Financial Operations and Pre-Insolvency Settlement Act (*Zakon o financijskom poslovanju i predstečajnoj nagodbi*) [hereinafter: FOPSA].[128] The insolvency system underwent a major reform in 2015, resulting in provisions on pre-insolvency proceedings being integrated into the new Insolvency Act.[129] The rationale behind introducing and later amending the pre-insolvency framework in Croatia consists of a myriad of legal and financial reasons.

[128] Financial Operations and Pre-Insolvency Settlement Act, *Official Gazette*, NN 108/12, 144/12, 81/13, 112/13, 71/15, 78/15.
[129] Chapter II of the Croatian Insolvency Act.

Croatia is a Central European country of roughly 4,2 million inhabitants, with 185 297 registered and active business legal entities in 2016.[130] Being a small-scale economy with a transitional background, the country was severely hit by the 2008 financial crisis, resulting in many business entities ceasing to function. In its report to the Croatian Parliament, the Croatian Ministry of Finance stated that on the 30 September 2012, the number of inactive business entities amounted to 73 583, with 44 580 billion HRK (approximately 5,959,020,704.86 EUR[131]) on the blocked accounts and 63 023 workers employed in those entities.[132] The existing insolvency system was not yielding adequate results in terms of efficiently reorganizing or liquidating the debtor, due to overly lengthy insolvency procedures[133], high costs of administering the proceedings[134], unsuccessful attempts of reorganization and a very low rate of collected claims of the State in bankruptcy.[135] In the eyes of the legislator, the insolvency law has failed in one of its key missions: to keep the failed business entities, who are unable to meet their own obligations, away from the market. Acknowledging that the system needs an alternative to the formal insolvency proceedings, the legislator introduced the option of debt restructuring for entities with continuing business potential, thus both preserving existing work places and preventing the actors who cannot successfully cope with the market from making any further harm to the economy.

[130] The data is provided in the Croatian Bureau of Statistics' annual Release on the number and structure of business entities (December 2015) available at <http://www.dzs.hr/Hrv_Eng/publication/2015/11-01-01_04_2015.htm> accessed 14 January 2017.
[131] Calculated on the basis of the Croatian National Bank's middle rate exchange rate on the day of 23 November 2011, available at <http://old.hnb.hr/tecajn/etecajn.htm>.
[132] Report of the Ministry of Finance of the Croatian Parliament on the implementation of pre-insolvency settlement proceedings on the basis of Financial Operations and Pre-Insolvency Settlement Act in the period from 01 October 2012 till 31 December 2014 (Zagreb, March 2015) 1.
[133] Lasting up to 5 years, and in extreme cases up to 15 years (e.g. insolvency of department store NAMA, which is in the ongoing insolvency proceedings since the year 2000).
[134] The costs go up to average of 15% of value of the claims, while at the same time in the time span of 2005/2015 creditors received payment of only 10,4% value of their claims.
[135] Only 10,46% of value of the claims in the time span of 2001-2013.

The first pre-insolvency settlement proceedings introduced by FOPSA consisted of out-of-court proceedings administered by the Croatian Financial Agency (FINA). The parties to the proceedings were the debtor and the creditors who filed their claims (i.e. not necessarily all the creditors of a certain debtor). Once the competent commercial court, determined according to the registered seat of the debtor, rendered a decision on the opening of the proceedings, FINA would publicize the court's decision on its website, alongside the call to the creditors to report their claims to FINA within 30 days.[136] In the course of each proceeding, two administrative bodies were to be established: the settlement committee (*Nagodbeno vijece*) and the settlement trustee (*povjerenik*).[137] If the debtor and the creditors involved would reach an agreement on the restructuring plan (involving redefining debtor's obligations under the claims, alongside writing off the rest of the claim), the pre-insolvency settlement would be concluded before the competent commercial court.[138] The costs of the restructuring proceedings were to be borne by the debtor, including settlement trustee's fees, administrative fees and court taxes, which could, depending on the value of the debtor's debts, amount up to approximately 2,000 EUR.[139]

3.2. Criticism of the Regulatory Framework and Implementation of the Proceedings

3.2.1. Era of the Financial Operations and Pre-Insolvency Settlement Act

From the time of its enactment in 2012, FOPSA was subject to various types of criticism on two levels: the faulty drafting of the provisions concerning the pre-insolvency settlement and the bad implementation of the proceedings in practice.

[136] 2012 FOPSA art 51.
[137] ibid art 32.
[138] ibid art 66.
[139] Anita Krizmanic, Ivana Manovelo, Jelena Zjacic of Macesic & Partners, 'How to Restructure in Croatia' (*International Financial Law Review*, 21 February 2013)
< http://www.iflr.com/Article/3158630/How-to-restructure-in-Croatia.html>, accessed 14 January 2017.

The first major problem arising out of the FOPSA provisions was the fact that pre-insolvency settlement proceedings were imposed as mandatory; a debtor facing an inability to pay its debts or having its liabilities exceed the value of its assets was obliged to initiate pre-insolvency settlement proceedings.[140] Given that this 'cash-flow' and 'balance sheet' tests were also preconditions for commencement of formal bankruptcy proceedings, the debtor was effectively precluded from initiating formal bankruptcy before first trying to reorganize by using the pre-insolvency settlement. Even though the underlying reasoning was to enable each debtor to avoid costly and stigmatized bankruptcy, forcing the debtor to firstly go through pre-insolvency did not yield the expected results. One of the reasons for this failure was that the Act did not differentiate between debtors who had the potential to reorganize and those who were ripe for liquidation, forcing the latter ones to lose time and resources trying to reorganize a non-viable business model.

Furthermore, when setting up the legal framework for pre-insolvency settlement proceedings, the Croatian legislation failed to address some important practical issues. One of the questions overlooked by the drafters was who may dispute the claims filed by creditors: is it only the prerogative of the debtor or could the other creditors object to the filing of potentially unfounded claims as well? In addition, once a claim is disputed, can the holder of such a claim continue to participate in the pre-insolvency settlement proceedings or should he exercise his rights through individual court enforcement?[141] Another legal gap in the Act was the issue of the status of creditors who did not file their claims and therefore did not take part in the proceedings. Since the Act did not mention whether they are free to litigate their claims or are estopped because of an ongoing pre-insolvency proceeding, some creditors held that they were not in any way affected by

[140] 2012 FOPSA art 39(1).
[141] Krizmanic et al. (n 139).

the settlement. The same ambiguity existed in cases of creditors whose debt was being litigated during the pre-insolvency settlement stage; the Act did not define whether if their litigation would be successful, they could enforce on the judgement after and in spite of the conclusion of the pre-insolvency settlement.[142]

The legal concerns over the pre-insolvency settlements were soon joined by the criticism of their application. Apart from the general complaints of the creditors on too high percentage of the debt being wiped out and favoring certain creditors' claims on a political basis,[143] a practical problem occurred in the form of misuse of the pre-insolvency settlement proceedings by holding or related companies. According to the Act, creditors were requested to vote on the proposed restructuring plan, but could always oppose it and thus block the pre-insolvency proceedings.[144] As the Act did not include specific provisions regarding voting rights of creditors like holding companies and other debtor-affiliated companies, these entities could have had an immense effect on the outcome of the voting on the restructuring plan. Given the high number and value of claims held by the companies related to the debtor company, they could effectively vote for a settlement which would discriminate other creditors.[145] As there was no mechanism to check the claims reported by these

[142] Suzana Varosanec, 'Vjerovnici bi mogli minirati predstecajne nagodbe' [The Creditors Could Mine the Pre-Insolvency Settlements] (*Poslovni dnevnik*, 5 December 2012) < http://www.poslovni.hr/hrvatska/vjerovnici-bi-mogli-minirati-predstecajne-nagodbe-223633> accessed at 14 January 2017.

[143] Ivica Kristovic, 'Uspjesan model ili kriminal: Kako popraviti predstecajne nagodbe?' [A successful model or a crime: How to fix the pre-insolvency settlements?] (*Vecernji list*, 27 February 2014) < http://www.vecernji.hr/hrvatska/uspjesan-model-ili-kriminal-kako-popraviti-predstecajne-nagodbe-923352 >, accessed 14 January 2017.

[144] 2012 FOPSA art 64 (1).

[145] Vladimir Mamic, Nikola Kokot, Branimir Zarkovic, Nera Popovic, 'Croatian Pre-Insolvency Settlement Saves Companies which are 'Too Big to Fail'' in Rodrigo Olivares-Caminal, *Expedited Corporate Debt Restructuring in the EU* (Oxford University Press 2015) 109.

companies, they would file their fictitious ('sham') claims in order to ensure the required threshold of votes necessary to obstruct or push further the one version of the plan which suits them.[146]

As reports on the misuse and problems arising out of legal gaps in FOPSA continued to grow, there was pressure from both legal practitioners and academia to amend the provisions concerning the pre-insolvency settlement proceedings. After passing the amendments to FOPSA in 2012 and 2013, the once again amended provisions on pre-insolvency settlements were included in the new Insolvency Act (*Stečajni zakon*), enacted by the Croatian Parliament in September 2015.

3.2.2. Remarks on the Changed Pre-Insolvency Proceedings in the 2015 Insolvency Act

The integration of pre-insolvency settlement in the 2015 Insolvency Act brought great changes to the procedure. The first significant change is the name of the end product of the pre-insolvency proceedings, which is no longer titled 'pre-insolvency settlement' (*predstečajna nagodba*) but 'pre-insolvency agreement' (*predstečajni sporazum*) confirmed by the competent commercial court.[147] Another important amendment struck to the very nature of the proceedings: the new Insolvency Act abandoned the obligation of the debtor to initiate pre-insolvency proceeding before filing for formal insolvency proceedings; in other words, the pre-insolvency stage is no longer mandatory. [148] The debtor now has the choice to either commence pre-insolvency proceeding while he is facing only an imminent threat of becoming insolvent or to slip into insolvency and initiate

[146] ibid. The example of such case was the pre-insolvency settlement reached in 2014 *Dalekovod* pre-insolvency procedure. The proposed settlement was heavily criticized by the Zagreb Commercial Court, partially because of the difference in amounts of the claims reported by the debtor, the amount confirmed by the auditors and the amount reported by the creditors. This raised an issue of filing sham claims, as various affiliates of the debtor filed suspicious claims with no means for the court to examine their authenticity. The Commercial Court refused to confirm the settlement, but court of higher instance overturned on the grounds that Commercial Court was not authorized by law to make a substantive review of the settlement. The case caused quite a stir in Croatian business and political circles, leading to subsequent legislative changes on giving more power to the courts in reviewing and confirming the pre-insolvency settlements. For further details on the role of the courts, *see infra* s 3.3.2.6 and 3.3.2.7.

[147] Insolvency Act arts 61 and 62.

[148] Ante Vukovic, Dejan Bodul 'Novi Stečajni zakon' [New Insolvency Act] <http://www.iusinfo.hr/Article/Content.aspx?SOPI=CLN20V01D2015B848> accessed 1 March 2017.

formal insolvency liquidation procedure, saving both time and resources by not trying to save a bad business model.

The newly amended proceedings brought certain changes to the bodies entrusted with governing the procedure: the previous settlement committee and administrative body are replaced by the strengthened court and insolvency administrator (*povjerenik*). The FINA administrative agency is still somewhat present, but only as an administrative body assisting the court in the proceedings. Such shift in power from administrative institutions to regular commercial courts is partially due to the scholarly criticism of FINA being bestowed with powers that should not have been given to an administrative body, namely ruling on and confirming the rights and obligations of the parties to pre-insolvency proceedings. The argument was that Article 6 of the European Convention on Human Rights and Fundamental Freedoms applies to insolvency proceedings, therefore mandating the stronger role of the court in pre-insolvency matters as well. [149] Therefore, the legislation bestowed the powers of adjudicating in pre-insolvency issues upon the competent commercial courts deemed equipped for the task, reducing the role of FINA to only a supporting agency to the judicial operations.

Another generally welcomed change includes the newly envisioned right of both the insolvency administrator and the creditors to contest the claims filed by other creditors.[150] As that right was previously accorded to the debtor only, he could manipulate the proceedings by acknowledging the validity of non-existing claims (typically for certain consideration on creditor's part) and/or contesting the validly existing claims. In that way, given that the right to vote was accorded only

[149] Art 6(1) of the European Convention on Human Rights and Fundamental Freedoms provides that '[...] everyone is entitled to a fair and public hearing by an independent and impartial *tribunal* established by law' (Emphasis added.); the critics argued that 'tribunal' within the practice of ECtHR implies 'court' and not an administrative body. *See* Vukovic, Bodul (n 148).
[150] Insolvency Act arts 41 and 42.

to the creditors whose claims were determined (i.e. not contested), the debtor could significantly affect the voting structure and possibly the outcome of the vote on the restructuring plan.[151] Creditors can now have more control over the proceedings by contesting other creditors' claims of doubtful origins, which can be determinative for the outcome of the entire pre-insolvency proceedings.[152]

3.3. Placement of Croatian Pre-Insolvency in the European Legal Framework

The latest amendments to Croatian insolvency law cannot be insulated from the wider European approach to pre-insolvency procedures. Revising the insolvency framework in Croatia coincided with the European Union reconsidering its own approach to (pre)insolvency proceedings, resulting in the 2014 Recommendation on a new approach to business failure and insolvency. Considering Croatia's status as an EU Member State at the time EC issued the Recommendation, the Croatian legislator could have drawn inspiration from its provisions concerning early filing of restructuring plans in order to avoid formal insolvency proceedings. As the Commission's working group included references to the US second chance reorganization model,[153] in order to effectively compare Croatian situation to American solutions, it is necessary to first place Croatian pre-insolvency proceedings on the EU legal map.

[151] Vukovic, Bodul (n 148).

[152] For instance, Insolvency Act art 64 (1) (2, 3) provides that the pre-insolvency proceedings will be suspended in cases where the amount of determined claims is 10% higher than the amount of overall obligations as stated by the debtor or where the value of the contested claims amounts to more than 25% of the claims filed. Before the changes in the legislature, creditors could report fictitious claims to retain the necessary ratio of filed and contested claims, thus forcing the continuation of pre-insolvency proceedings.

[153] Gerard McCormack, Andrew Keay, Sarah Brown, Judith Dahlgreen, European Commission 'Study on a new approach to business failure and insolvency: Comparative legal analysis of the Member States' relevant provisions and practices', Tender No. JUST/2014/JCOO/PR/CIVI/0075 (European Commission, University of Leeds, January 2016)
<http://ec.europa.eu/justice/civil/files/insolvency/insolvency_study_2016_final_en.pdf> accessed 14 January 2017, 221.

3.3.1. The 2014 European Commission Recommendation on a New Approach to Business Failure and Insolvency

The 2014 Recommendation, even though not binding, represents a significant step towards highlighting the advantages of second chance policy and early restructuring of economically viable businesses. Member States' compliance with the Recommendation could significantly contribute to leveling the playing field within the Union by eliminating the need for 'restructuring migration', i.e. situations where companies move their center of main interests to jurisdictions with more favorable reorganization frameworks.[154] The goal of the Recommendation is to encourage Member States to ensure a 'preventive restructuring framework' for 'efficient restructuring of viable enterprises in financial difficulty',[155] or in other words to establish an EU-wide framework that would enable businesses to get a second chance by restructuring, while at the same time yielding higher returns for the creditor, preserving jobs and improving the overall economy.[156] The importance of the aforementioned restructuring policies is clearly seen in the EC's November 2016 decision to elevate the goals of the Recommendation to a directive level, introducing a proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase efficiency of restructuring, insolvency and discharge procedures.[157]

In order to promote harmonization on an equal footing among all Member States, the Recommendation sets out non-binding 'minimum standards' that should be observed when

[154] Horst Eidenmüller, Kristin van Zwieten, 'Restructuring the European Business Enterprise: the European's Commission Recommendation on a New Approach to Business Failure and Insolvency' (2016) 16 Eur Bus Org Law Rev 625, 626. In the case of EU, United Kingdom (England) is the most desirable jurisdiction for reorganization due to its relatively flexible regime and variety of restructuring tools (e.g. company voluntary arrangements or schemes of arrangement).

[155] Recommendation 1.

[156] Michael Thierhoff, Renate Müller, 'A new approach to business failure and restructuring: pre-insolvency restructuring v. early filing in Germany' (2014) Thomson Reuters Practical Law < http://uk.practicallaw.com/1-573-5547> accessed 15 February 2017.

[157] Emmanuelle Inacio, 'The European Commission's Directive Proposal for common principles and rules on preventive restructuring frameworks, insolvency and second chance' (Winter 2016/2017) Eurofenix 66, 12-13.

revising one state's insolvency framework. These minimum standards consist of seven elements necessary to ensure the efficiency of preventive restructuring procedures throughout the Union, concerning namely the time the procedure can take place, position of the debtor, stay of individual enforcement actions, adoption of a restructuring plan, encouraging new financing, promoting out-of-court negotiations and having the plan confirmed by a court.[158]

3.3.2. Conformity of Pre-Insolvency Proceedings with the Goals of the Recommendation

While reforming the insolvency law system, the Croatian legislation had the option to take into account the minimum standards set out in the Recommendation. The following sections explore whether the drafters of the new Insolvency Act conformed to any of the recommendations and if the answer is positive, how they were implemented in the existing framework.

3.3.2.1. Initiation Stage of the Restructuring Proceedings

The first minimum standard set out in the Recommendation concerns the stage at which the debtors can initiate early restructuring proceedings. The Recommendation provides that the debtor should be given the power to decide to initiate early restructuring in order to prevent insolvency from happening,[159] thus implying that the restructuring avenue should be available as soon as there is 'likelihood of insolvency'.[160] The rationale behind early restructuring lies in the fact that the longer the debtor postpones the commencement of proceedings, the higher the costs of restructuring and the lower the management powers and success rate of reorganization.[161] The same reasoning

[158] EC Study (n 153) 219-266.
[159] Recommendation 6(a).
[160] EC Study (n 153) 224.
[161] NACIIL Workshop EC Recommendation on new approach to business failure and insolvency 4 June 2014, materials available at < http://www.naciil.org/uploads/files/Presentations_NACIIL_Workshop_4_June_2014.pdf> accessed 25 January 2017.

applies to early restructuring through US workouts, where the debtor should react in a timely manner to be able to reorganize efficiently.

In this respect, Croatian insolvency framework corresponds to the Recommendation's requirements. Insolvency Act provides that early restructuring can be carried out within the boundaries of the pre-insolvency proceedings, initiated either by the debtor, as recommended by the EC, or by the creditor with the debtor's consent.[162] Vesting only the debtor with the power[163] to initiate pre-insolvency proceedings is in line with the Recommendation's view of the debtor as the one best acquainted with the state of affairs within the company and best suited to react at the proper point in time, i.e. when the risk of imminent insolvency occurs.[164] The Croatian Insolvency Act identifies the risk of imminent insolvency as a situation in which the debtor is likely to become unable to pay its debts. If the debtor would already be unable to pay the debts or if its liabilities would overcome the value of its assets, Insolvency Act mandates that the debtor or its creditors open formal insolvency proceedings, and not pre-insolvency ones.[165]

Another Recommendation standard implies that, in order to diminish the costs and procedural formalities, the debtor should be able to initiate early restructuring without having to formally turn to the courts.[166] Notwithstanding the reasonableness of such standpoint, many Member States decided not to adopt this standard.[167] The same is true for Croatia, where pre-insolvency

[162] Insolvency Act art 25(1).
[163] And no longer an obligation, as it was set out in FOPSA. *See supra*, s 3.2.2.
[164] It is recognized in the Recommendation that this point in time differs from jurisdiction to jurisdiction, varying from 'cash-flow' tests to 'balance-sheet' tests or a combination of both. *See* EC Study (n 153) 224.
[165] Insolvency Act pt. 4-5.
[166] Recommendation 7, where it is stated that 'The restructuring procedure should not be lengthy and costly and should be flexible so that more steps can be taken out-of-court. The involvement of the court should be limited to where it is necessary and proportionate with a view to safeguarding the rights of creditors and other interested parties affected by the restructuring plan.'
[167] EC Study (n 153) 227.

proceedings, notwithstanding their flexibility, can only be opened by court decision declaring the existence of debtor's likely inability to pay debts.[168]

3.3.2.2. The Position of the Debtor

Looking up to the US Chapter 11 model, the Recommendation suggests that the debtor should be allowed to retain control over day-to-day business operations during the restructuring process.[169] Such an approach implies that the appointment of an insolvency practitioner, be it in a form of mediator, supervisor or a trustee, should only be optional and carried out in cases where considered appropriate.[170] Not removing the existing management could incentivize the debtor to initiate restructuring at an early stage, therefore retaining control and bearing less disruption to the regular course of business.[171]

The Croatian approach implies that the court will, if it deems necessary, appoint an insolvency administrator (*povjerenik*) to supervise the business activities of the debtor.[172] The debtor generally remains in possession of his assets, but when exercising day-to-day operations he can only make payments necessary for the ordinary course of business.[173] Any sale or encumbrance on the assets would require prior approval by the administrator or, if he is not appointed, by the court.[174] What follows is that Insolvency Act does recognize the DIP framework, but only to a certain extent and without leaving the complete freedom to the debtor in the course of pre-insolvency proceedings.[175]

[168] Insolvency Act art 4(1).
[169] Recommendation 6(b).
[170] EC Study (n 153) 228. An example would be court appointment of a supervisor who would overlook the course of debtor's business, but would not displace the existing management.
[171] EC Study (n 153) 228-229.
[172] Insolvency Act art 33(2).
[173] Insolvency Act art 67.
[174] ibid, in connection with art 29(3).
[175] However, Croatian insolvency law does recognize and regulate in more detail the DIP system within the formal insolvency proceedings. An entire chapter (VIII) of Insolvency Act is devoted to DIP (*osobna uprava*), but there is no indication that such system might be used in the context of pre-insolvency proceedings.

3.3.2.3. Stay of Individual Enforcement Actions

Another important minimum standard embodied in the Recommendation involves the debtor being able to request the court to grant a temporary stay of individual enforcement actions during restructuring proceedings.[176] Without such a stay, the debtor could hardly have any 'breathing space' in order to restructure its obligations and would have no means to tackle holdouts in reorganization proceedings. Stay on individual enforcement is not only a prominent feature of the US Chapter 11,[177] but is also recognized by the UNCITRAL Legislative Guide on Insolvency which emphasizes the importance of stay as means of protecting the going-concern value of the restructuring business.[178] Staying individual executions benefits both the estate and the interests of all creditors; this is why the Recommendation does not differ the ways stay affects general unsecured and secured creditors. However, granting of stay should preserve a fair balance between debtor's and creditors' interests and should not exceed reasonable duration determined on the basis of complexity of the restructuring. Recommendation provides for the stay to be granted for up to four months, with possible renewal not exceeding an overall period of 12 months.[179] The UNCITRAL Legislative Guide on Insolvency goes further in protecting interests of different creditors, as it provides the secured creditors with additional leeway of requesting for relief from stay if the encumbered asset is not necessary to the prospective restructuring of the debtor's business.[180]

[176] Recommendation 6(c).
[177] The US goes as far as to grant *automatic* stay on enforcement (*see* Bankruptcy Code s 362), while the Recommendation proposed the standard or *requested* stay on enforcement.
[178] UNCITRAL Legislative Guide on Insolvency (2005) < https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf > Recommendations 39-51.
[179] Recommendation 13. Renewal would be possible only if the Member State provided for in its insolvency law.
[180] In addition, if the relief from stay would not be granted, secured creditor is entitled to protection of the value of the encumbered asset. *See* Recommendations 50-51.

Croatian law recognizes the benefits of stay on individual enforcement, but with some specifications. The Insolvency Act provides that lawsuits and individual enforcement of claims is stayed from the moment of opening to the moment of closure of the pre-insolvency proceedings.[181] However, considering the great impact of this moratorium on creditors, the law specifies certain categories of creditors exempted from the stay: these are secured creditors and employees in connection to claims arising from current or previous employment relationship.[182] Furthermore, the duration of the stay is limited to the duration of the pre-insolvency proceedings, which is 120 days[183] and is thus falling within the Recommendation's four months limitation. Consequently, even though it is aiming for the same type of debtor protection, Croatian stay on enforcement still does not operate as Chapter 11 automatic stay, which functions as an injunction. Nevertheless, Croatian version does provide a higher level of protection than US workouts, where no stay is employed unless specifically contracted for.

3.3.2.4. Adoption of the Restructuring Plan

The keystone of every successful pre-insolvency proceeding lies in construing a restructuring plan that will be accepted and internalized by the all the relevant creditors. The importance of a feasible restructuring plan is reflected in a substantial part of the Recommendation devoted to questions relating to content, adoption and confirmation of the restructuring plan.[184] In order for the debtor to come up with a viable plan, the Recommendation sets out that Member States' laws should separate creditor classes according to their interests, aiming primarily at the distinction between

[181] Insolvency Act art 68(1).
[182] Insolvency Act art 66. Pre-insolvency proceedings also bear no effect on security measures within criminal proceedings nor tax procedures relating to establishing abuse of law.
[183] Insolvency Act art 63. The proceedings could be extended for up to 90 more days.
[184] Recommendations 15-29.

secured and unsecured creditors, and enable them to vote on the plan separately.[185] Furthermore, even though the Recommendation does not prescribe the exact majorities needed for a creditor class to be deemed to have accepted the plan, it does set out the principle that non-affected creditors should not have the option of blocking the plan, as they have no interest in it.[186] Having creditors divided into different classes and excluding non-affected creditors from voting simplifies the adopting of the restructuring plan by removing any potential hindrance due to differing interest of various types of creditors.[187]

The Recommendation proceeds by stating minimum standards regarding voting requirements. In order for the court to confirm a restructuring plan, the plan has to ensure the protection of legitimate interest of creditors, has to be notified to all creditors likely to be affected by it, must not reduce the rights of dissenting creditors below what they would reasonably be expected to receive in the absence of restructuring and must ensure that the potential new financing foreseen in the plan is necessary for the plan implementation and does not unfairly prejudice the interests of dissenting creditors.[188] The text of the Recommendation does not define the majorities necessary to deem the plan accepted by certain classes of creditors, leaving the issue at the discretion of Member States. This solution has resulted in a variety of different majorities required in various Member States,[189] but what they all more or less have in common is that the plan has to meet certain criteria on top of the majority requirement in order to be confirmed by the court.[190]

[185] Recommendation 18.
[186] Recommendations 16 and 20. This approach resembles the US Chapter 11 structure, as Bankruptcy Code s 1124 provides that creditors whose rights are not impaired by the plan are deemed to have accepted the plan, effectively neutralizing their position in the voting process.
[187] The differentiation can go beyond just separating secured from unsecured creditors. In its plan, debtor could propose to separate trade creditors, typically interested in getting short-term cash, from unsecured financial lenders, who more often opt for repayment over longer period of time, but with higher interest. *See* EC Study (n 144) 236.
[188] Recommendation 22. For further information on the new financing standard, *see infra* s 3.3.2.5.
[189] EC Study (n 153) 239.
[190] For more information on the court confirmation standard, *see infra* s 3.3.2.7.

The Croatian Insolvency Act requires the debtor making the pre-insolvency restructuring plan to categorize the creditors into specific groups in accordance with the level of their rights. The Act differentiates between secured creditors, unsecured creditors and workers as creditors.[191] If the debtor would like to distinguish more types of creditors within a particular class, it may do so if all the creditors of a particular type share the same economic interest, supported by objective reasons.[192] Therefore, the debtor is not allowed to make arbitrary differentiations among creditors, especially since all creditors within a particular class or type have to be treated equally.[193] As for the secured creditors' participation in the plan, they will not be involved in the process if the plan does not impair their right to separate satisfaction,[194] which is in line with the Recommendation's input on non-affected creditors.

As for the voting requirements, once the creditors' voting rights are established, each class of creditors will vote separately on approval of the plan. The plan is deemed to be accepted if a majority of all creditors voted in favor and if, within each class of creditors, the total value of claims in favor amounts to two-thirds of the value of all voting creditors' claims.[195] This model of majority voting replaced the previous simple majority, non-cumulative model, according to which the plan was deemed accepted if it is voted on by creditors accounting for more than 50% of value in a particular class *or* if voted on by creditors accounting to more than two-thirds of value of all claims, notwithstanding the class division.[196] Even though the new, cumulative requirement to deem the restructuring plan accepted by the creditors seems to impose more difficulties on the

[191] Insolvency Act art 308(1) in conjunction with art 27(8).
[192] Insolvency Act art 308(2).
[193] Insolvency Act art 312(1).
[194] Insolvency Act art 38(4).
[195] Insolvency Act art 59(2).
[196] 2012 FOPSA art 63(2).

debtor, it does help in pushing the plan through the rest of the procedure and the enforcement stage by effectively diminishing the value/number of the dissenting creditors.[197]

3.3.2.5. Encouraging New Financing

One of the strongest tools a debtor can use in its restructuring plan involves obtaining new cash influx through additional financing avenues. In order to do that, the financially troubled debtor will typically have to provide some special benefits for the financiers willing to take the risk and provide funding for the company.[198] The drafters of the Recommendation recognized the danger that might fall on the additional benefits for the new financiers; namely, that Member Sates' insolvency regimes may treat them as transactions subject to fraudulent transfer laws and consequently block their enforcement. In order to prevent such an outcome, the Recommendation sets out that new financing forms, contained in the restructuring plan and confirmed by the court, should be exempted from civil and criminal liability and not be rendered invalid as an act detrimental to the general body of creditors.[199] The rationale behind such an approach is that, even though such new financing methods could harm the interests of other creditors, they will generally profit more from giving priority to providers of new financing than from retaining the existing priority order and incurring losses on their return rates.

The Croatian Insolvency Act contains provisions on avoiding fraudulent transfers pertaining to the formal insolvency proceedings,[200] but remains silent on the issue of such transfers in the context

[197] Furthermore, under current version of Insolvency Act, the dissenting creditors will have to abide by the plan if they do not manage to prove that other conditions for the court approval of the plan have not been met. *See infra* on the new cramdown power of the court in s 3.3.2.7.
[198] The debtor will usually grant the providers of new loans security in all or substantial amount of unencumbered assets, if any such assets exist. If this is not the case, the debtor will try to renegotiate the existing priority scheme with the existing creditors to provide more beneficial treatment for the new financiers' claims.
[199] Recommendations 27 and 28.
[200] Insolvency Act c 4 s 3.

of the pre-insolvency procedure. It would be advisable for the legislator to include an express provision shielding the new financing in the restructuring plan from avoidance actions, thus encouraging the lenders to invest their money into restructuring companies. As for the potential special treatment of new financiers provided by law, Croatian legal framework still does not allocate any benefits to the lenders, e.g. in the form of higher priority of claims. However, the absence of special provisions does not prevent the new creditors from requesting special benefits from the debtor in the negotiations phase, provided that other creditors would agree to subordinate their claims and the transaction would remain out of the reach of fraudulent transfer law.

3.3.2.6. Encouraging Out-of-Court Negotiations: Minimal Involvement of the Court

In line with the promotion of efficient restructuring proceedings, the Recommendation provides that court involvement in the process should be confined to minimal interference.[201] This implies courts should interfere only where it is necessary to protect the rights of the parties, e.g. when there is a need to protect the debtor's estate by staying individual enforcement actions or where the court should protect dissenting creditors' interests by checking the plan in the confirmation stage.[202] According to the drafters of the Recommendation, any other involvement of the court[203] in the process would be counterintuitive to the purpose behind early restructuring, as it would increase the costs of overall proceedings and cause a certain time delay.

The involvement of courts in pre-insolvency restructuring is a point of controversy in the Croatian insolvency system.[204] While the first version of early restructuring process, namely the FOPSA

[201] EC Study (n 153) 243.
[202] Recommendation 21.
[203] For example, creditors' meetings and voting on the plan, which can be organized outside the court procedure.
[204] Croatian lawmakers thus follow the European debate on the role of the courts in early restructurings. Most of the EU countries require the courts to confirm the restructuring plan and interfere where necessary to protect the rights of the parties; the only partial exception to this norm is the UK company voluntary arrangement that requires court

pre-insolvency settlement proceedings, provided for an important role of the FINA administrative body in carrying out the proceedings,[205] legislative amendments brought changes in the sense of diminishing the role of FINA and transferring the power of administrating and overseeing the proceedings to the courts.[206] This effectively means that the competent commercial court in pre-insolvency proceedings now has the power to formally open the proceedings, appoint an insolvency administrator where it deems necessary to do so, supervise the work of FINA, formally determine the existence of filed and contested claims, organize the hearing on restructuring plan, decide on termination of the proceedings and confirm the plan if it meets all the legislative criteria.[207] This change in Croatian legislative approach to pre-insolvency proceedings clearly indicates that the system is still not ready to leave the restructuring solely in the hands of the parties, despite the Recommendation's proposition that high level of court involvement actually diminishes the proceedings' efficiency and contrary to the complete informality of the US workout practices.

3.3.2.7. Court Confirmation of the Restructuring Plan

One of the areas where the Recommendation does bestow an important role on the courts is their final confirmation of the restructuring plan by a formal court decision. The Recommendation provides that, in the interest of legal certainty and for the sake of preserving the rights of the dissenting creditors, pre-insolvency restructuring plans that affect the interests of dissenting creditors or contain provisions on new financing should be confirmed by a court in order to become

approval only if the creditors would challenge the arrangement on procedural grounds or on grounds of unfair prejudice (English Insolvency Act 1986 s 6). *See* EC Study (n 153) 243.

[205] *See supra* s 3.1.

[206] For the discussion on the changes, *see supra* s 3.2.2.

[207] Insolvency Act arts 22, 55, 61. In addition, under the general provision of art 22(6), the court has the power to decide any other question relating to pre-insolvency proceedings if such question is not within the competence of FINA or the insolvency administrator.

binding.[208] The reasons for this are twofold: the first is that the court's decision includes a final review of whether all the legal requirements for the plan to become binding are met and second is that, if all the requirements are met, certain laws empower the court to exercise 'creditor cramdown' in order to make the plan binding on all creditors, including the dissenting ones.

It is important to note that, unlike in the US workout scenario, not all Member States require pre-insolvency restructuring plans to be adopted by unanimity of affected creditors.[209] To the contrary, many states require only a majority of creditors in either the total number of creditors, classes of creditors or both to support the plan for it to become binding. In latter cases, the law typically requires the debtor to bring the plan forth to the court for confirmation in order to ensure that, considering that not all the creditors have agreed to the plan, the rights of dissenting ones are not too adversely affected. According to the Recommendation and many Member States' laws, the role of the court in this stage of the proceedings is to verify that all the general requirements for the plan to become binding have been met; if not, the court will reject the confirmation of the plan. The Recommendation defines these general requirements by providing that the court should confirm the plan only if it has been adopted in conditions ensuring the protection of legitimate interests of creditors; if all the affected creditors or the ones likely to be affected have been notified on the content of the plan; if the plan does not reduce the rights of dissenting creditors below what they would reasonably expect to receive in the absence of restructuring and if any new financing provided by the plan is necessary to implement the plan and does not unfairly prejudice the interests of dissenting creditors.[210] On top of that, the Recommendation provides that the court should also take into account feasibility of the restructuring plan, i.e. whether it has prospects of

[208] Recommendation 21.
[209] Examples in this group are France and UK, where all classes of affected creditors have to support a plan for it to be approved by the court. *See* EC Study (n 153) 246.
[210] Recommendation 22.

actually preventing the insolvency of the debtor and ensuring viability of its business; if not, the court should reject the plan.[211] Therefore, the court's task is to ensure that the creditors who did not support the plan, but still may be affected by it, do not suffer greater consequences than the ones they would endure if the plan was not accepted.

The fact that the courts have the power to review and confirm the proposed pre-insolvency restructuring plan entails an important consequence: if general requirements for confirming the plan are met, such powers effectively allow the courts to exercise cramdown on dissenting creditors. In one of its most prominent points, the Recommendation provides that the restructuring plans confirmed by a court (and thus subject to the court scrutiny) should be binding upon each creditor affected by and identified in the plan,[212] notwithstanding the lack of its consent to it. Many Member States recognized the importance of such powerful tool for the courts to have,[213] especially given that such power may reduce the problem of creditors' holdout due to their personal interests in an otherwise feasible restructuring plan, which is often encountered in US workout restructuring.

Croatia is not an exception in this regard. According to the Insolvency Act, a competent commercial court will confirm the proposed restructuring plan and thus confirm the pre-insolvency agreement if it meets the positive requirement of being adopted by the required majority of creditors[214] and if it does not meet the negative requirements regarding its effect on creditors' rights. The most important negative precondition concerns the rights of dissenting creditors: the

[211] Recommendation 23. However, it is worth noting that this recommendation is not without criticism: it has been argued that judges do not possess adequate skills for conducting a financial feasibility review, meaning that the court will mostly rely on the financial propositions undertaken by the parties to the proceedings. *See* EC Study (n 144) 245.
[212] Recommendation 26.
[213] EC Study (n 153) 245-247.
[214] As mentioned *supra* s 3.3.2.4., the restructuring plan will be deemed adopted if it is accepted cumulatively by the majority of all creditors and by two-thirds of value of creditors' claims within each class.

court will not confirm the restructuring plan if a creditor proves it to be likely that the plan diminishes its rights below the level it could reasonably expect absent the restructuring.[215] Therefore, Croatian courts do have the power to override dissenting creditors and make the plan binding on them if the required majority of creditors adopts the plan and if dissenting creditors receive at least what they would have received outside the restructuring process.[216] The remedy left to the dissenting creditors is to oppose the confirmation on the basis of non-fulfillment of the statutory conditions, which will typically imply them trying to prove that they would receive higher returns in liquidation proceedings.

In conclusion, Croatian pre-insolvency framework mostly corresponds to the Recommendation's proposals on rules and characteristics attributable to early debt restructuring aiming to prevent formal insolvency proceedings. In the same sense, some aspects of Croatian pre-insolvency proceedings like encouraging early initiation are similar to US workout practices, but some go as far as to completely contradict them, which is the case of ignoring the recommendation on minimal or non-existing role of the court. With the new EC Directive Proposal on preventive restructuring frameworks, Croatian legislator will potentially have to revisit solutions of the Insolvency Act contrary to the Recommendations' provisions. When doing so, it will also have the chance to reflect on the potential advantages of informal workout practices and examine whether to include them in the revised insolvency framework.

[215] Insolvency Act art 61 (1). In addition to this requirement, the court will not confirm the restructuring plan if it is not likely that the implementation of the plan will increase debtor's ability to make payments and if the plan would not be in conformity with certain provisions of the Companies Act.
[216] In Croatian case, the relevant benchmark will typically consist of the amounts dissenting creditors would get in liquidation proceedings.

CHAPTER IV.

ADVANTAGES OF THE US APPROACH:

ARE THERE ANY AND WHAT CAN CROATIA LEARN?

After elaborating on the arguments for and against the use of workouts as means of out-of-court debt restructuring and examining the EU expectations from Croatian pre-insolvency proceedings, it is time to see whether the two approaches, both aiming to save the debtor prior to filing for bankruptcy, reconcile or go in their separate ways. It cannot be denied that the workout approach would yield some benefits for the Croatian debtors and creditors, but the current legislation still includes a high level of court involvement in the pre-insolvency reorganization proceedings. The question remains: what can Croatia, deeply rooted in the EU settlement, learn from the US and should it follow the workout path?

4.1. Workout Lessons for Croatian Pre-Insolvency Proceedings

Even though the US workouts and Croatian pre-insolvency proceedings may not seem to be cut entirely from the same cloth, they do bear certain resemblances. Apart from sharing a common purpose of saving viable business schemes, they operate on similar grounds by providing a platform for the creditors to file and renegotiate their claims, while at the same time enabling restructuring and continuation of the debtor's business operations.

However, this is where their differences come into play. While the US workout renegotiation process is effectuated in an entirely informal environment with no involvement of court or administrative bodies, Croatian pre-insolvency proceedings are partially administered under the auspices of the competent commercial courts. Even though the absence of court intervention can be seen as a positive side to workout procedure because it diminishes the overall costs and duration of negotiations, Croatian legislation decided to put more emphasis on the Chapter 11 function of

the court as a body confirming feasibility and fairness of the proposed pre-insolvency reorganization plan. In other words, while from the standpoint of pre-insolvency proceedings court involvement represents useful scrutiny, workout practitioners see it as an unnecessary burden. Considering the current state of affairs and the recent change in legal framework bestowing more power on the courts in the context of pre-insolvency proceedings, it is not very likely that the Croatian legislature will encourage court-free workouts in the near future. Workouts imply almost absolute contractual freedom, leaving it up to the parties to construe their future relationship in the wake of debtor's financial difficulties: the current business and legal framework in Croatia is presumably still too fragile to rely solely on the good will and abilities of the parties to restructure the debt without any formal supervision. However, the US practices regarding completely informal workouts could serve as a role model for forward-looking practitioners and parties to debt renegotiations, encouraging them to give a try to informal negotiations outside and prior to the initiation of pre-insolvency procedures.[217]

Another factor to be taken into account is that workouts can be rather successful or complicated, depending on the debtor's financing structure and methods of restructuring used. In the event of such structure involving a lot of mezzanine debts, hedge fund creditors, collateralized debt obligations and other more complex financing mechanisms, informal negotiations without clearly established rules on creditor rankings might pose significant challenges for the debtor to renegotiate the restructuring plan with its creditors, calling for more stable reorganization rules and court supervision. On the other hand, if Croatian debtors would engage in more traditional loan debt financing,[218] workouts could serve as an efficient means of restructuring the debt in

[217] Since pre-insolvency proceedings are no longer mandatory for the debtor facing the threat of imminent insolvency.
[218] This could be the case, since Croatian capital and financing markets are still not as developed as their US counterparts, thus encountering less complex financing instruments.

accordance with the interests of short and long term creditors. Effective informal pre-insolvency reorganizations could particularly be achieved through simple compositions and standby agreements, as the first step towards delaying further financial deterioration, which might be arranged faster through workout than through current pre-insolvency framework.

The relative ease of restructuring in a workout is connected to their flexibility. The contractual nature of a workout allows the parties to exercise set-offs, engage in special arrangements and acquire benefits without the need for a formal confirmation, as long as the required majority of creditors is on board. However, while the flexibility of workouts might encourage Croatian practitioners to use them, the holdout problem is still a significant drawback pushing them back towards pre-insolvency proceedings with an option of cramming down the dissenting creditors. As long as workouts practices do not bring forward effective solution for battling holdouts, Croatian practitioners will be more inclined to engage in pre-insolvency proceedings.

Another benefit of workouts is their confidential nature: confidentiality of workout negotiations, alongside debtor not waiting for too long to reorganize, is of crucial importance for saving the financially troubled debtor. This is in contrast with Croatian public pre-insolvency proceedings, which do not shield the information on the financial troubles of the debtor from the market. Holding such information private can go a long way, as destabilization rumors can affect significantly the stock and general value of the business, thus working against its successful restructuring.[219] Therefore, lesson for the Croatian practitioners could be to advocate for pre-

[219] Most recent example of such situation is the financial downfall of one of Croatia's leading food companies, Agrokor Group. Facing imminent inability to repay debts and after publicizing the information on potential restructuring of the operational and financial structure, the stock price of companies within the Group fell considerably. Such price drop had an immediate spillover effect to the restructuring options, as one of them was also a going-concern sale of one of the financially viable companies to increase the cash flow necessary to service its financial obligations. Whether Agrokor Group will opt for private negotiations with its creditors or a formal pre-insolvency proceedings only remains to be seen. *See* UK Reuters article 'Croatia wants to shield economy from Agrokor's problems' < http://uk.reuters.com/article/croatia-agrokor-idUKL5N1GS59U> accessed 25 March 2015.

insolvency proceedings to become confidential, in order to postpone the public announcement of debtor's business troubles.

Furthermore, contractual freedom embedded in workouts enables creditors to acknowledge the importance of 'fresh money' by contractually subordinating their claims to the providers of the new financing. Inspired by both contractual options used in US workouts and the EC Recommendation, the Croatian pre-insolvency framework could be enhanced by providing priority position for new financiers in the Insolvency Act provisions, alongside making their claims less susceptible to the avoidances of fraudulent transfers.

Finally, informal workouts are comparatively less expensive than court-administered restructurings, be it in the form of pre-insolvency or formal insolvency proceedings. As elaborated earlier, these costs include not only direct costs of court fees, but also indirect costs associated with the publicity of pre-insolvency proceedings measured in lost profits of the business. Cost and time efficiency aspects of workouts could render them attractive to Croatian practitioners, especially considering that one of the underlying reasons for the reform of the pre-insolvency framework was to make the proceedings more accessible to both small and big-scale troubled businesses through diminishing the costs associated with their administration.

On the other side, important positive features found in the Croatian pre-insolvency framework and lacking in US workouts are provisions on sorting creditors into separate classes, required majorities for the restructuring plan to be deemed accepted and potential for making the restructuring plan binding on the dissenting creditors. Such provisions indirectly work on ensuring fairness of the restructuring plan towards all groups of creditors, including the dissenting ones, and facilitate the voting procedure by giving up on the unanimity requirement typically associated with

workout restructurings.[220] In contrast, workouts typically do not have such strict rules on creditor grouping or voting, which makes them more prone to holdouts of dissenting creditors effectively blocking the restructuring plan. Consequently, as long as debt restructuring in the form of a workout does not find a proper solution to the holdout issue, parties in Croatia might be more inclined towards pre-insolvency proceedings for the sake of their predictability and safety, even in spite of potentially higher costs and longer duration.

4.2. Future in a Pre-Pack?

While the drafters of the Croatian pre-insolvency framework can take some notes from the American workout practices, it does not necessarily follow that the Croatian practitioners will internalize the method just because it became available. The absence of court involvement in workouts shifts a significant task of safeguarding the creditors' interests onto practitioners, who may or may not be ready to handle such work. The role of the court in the Croatian system, being in line with the EC Recommendation, is to protect the rights of the creditors by confirming the plan only if it acknowledges the interests of different parties and stands a fair chance in saving the debtor company. Abandoning such court scrutiny in favor of giving the absolute freedom to the parties is possible only in systems with business culture built upon a certain degree of mutual trust between the debtor and its creditors, which is still not the case with Croatia. The Croatian legislation has not only recognized, but also strengthened the position of courts in pre-insolvency proceedings thinking of it to be the best way to safeguard the interests of all parties to the proceedings. For this reason, out-of-court debt restructuring in form of a US workout can be seen

[220] It is true that the parties to a workout could employ e.g. soft law instruments like abovementioned INSOL Principles (n 115) to diminish the threshold for the reorganization plan to be deemed accepted, but they would first have to agree on which instrument to use and how to determine the threshold.

as a point to strive to in the development of informal and semi-formal reorganization tools that will be embraced only when Croatian legislator and practitioners feel ready for it.

However, what could serve as an intermediary between the current pre-insolvency framework and completely informal workouts is the pre-packaged bankruptcy model. The idea of introducing pre-packaged bankruptcies, as a sort of a compromise between the formal bankruptcy reorganization plan and pre-insolvency agreement, is not unknown to Croatian academics and practitioners; when analyzing the comparative solutions of the US and European jurisdictions, the advantage of diminishing costs and saving time by filing an already negotiated plan with the court appeared as a welcomed step forward in the Croatian insolvency system.[221] In that sense, while the current pre-insolvency framework corresponds to the Recommendation's input on the existence of court involvement, pre-insolvency proceedings could still be further reformed by having the filing of the claims and negotiation process take place privately among the parties, and not before the court or any other administrative body. By reforming the pre-insolvency proceedings to look more like the pre-packaged bankruptcy model, Croatian legal framework would achieve an even higher level of correspondence to the Recommendation's instruction on *minimal* court interference, while at the same time saving time and costs in the early restructuring process.

In conclusion, pre-insolvency proceedings in Croatia are not exactly in line with informal workouts, but have a good standing compared to costly US Chapter 11 proceedings and are relatively in line with the EC Recommendation. However, is this enough? The pre-insolvency

[221] Ivana Tomas Živković, Dejan Bodul, Saša Živković, 'Novosti i problemi u provedbi stečajnog zakonodavstva u Republici Hrvatskoj' [Novelties and problems in bankruptcy law implementation in Croatia] (2014) Ekonomski pregled 65(4) 345-346.

settlement proceedings introduced in 2012 did not yield the expected results because of the flaws in the system, which have now been more or less removed.

Should Croatia go one step further and consider introducing completely out-of-court workouts, as a presumably less formal, faster and cheaper means of debt restructuring? Yes.

Would they be used as widely and frequently as in the US? No.

Croatian legislation should take a step-by-step approach, learning from the good practices coming from the West, particularly the US. Considering that the current trust level between the parties sitting at the opposite sides of the renegotiation table is not at an all times high, but with formal insolvency still being costly and shielded with bankruptcy stigma, Croatia should consider introducing a hybrid procedure like pre-packaged bankruptcy. This middle ground solution, offering the best from both formal insolvency reorganizations and informal workouts, could be a good choice for practitioners to try out and see how markets react to such a tool, i.e. whether it would incentivize the parties to explore further ways of restructuring out of court. If the pre-packaged solution would be well accepted in the Croatian market and among insolvency practitioners, there is no reason why the doors to completely informal workouts should not remain open.

CONCLUSION

While it is true that bankruptcy nowadays forms an omnipresent part of the business world, it is still far from being unavoidable. This is particularly true for the traditional liquidation bankruptcy proceedings, which have slowly started in some jurisdictions to give way to reorganization endeavors aimed at saving the debtor's viable business schemes. Once the reorganization avenue has been given a try, debtor can decide to either restructure informally and out-of-court or with the court assistance in formal or semi-formal proceedings. Both options have their strengths and weaknesses, but what is maybe most striking is the use of completely private workout debt restructurings in the US, envisioned to replace the formal reorganizations by simply relying on contractual covenants and good faith of the parties. The relative simplicity of such solution sounds tempting, but could it be applied in all situations? Could it be transposed to another, more traditional European jurisdiction like Croatia, or should the European means of debt restructuring remain unchanged?

Conclusions following from the comparative analysis of debt restructuring methods on both sides of the Atlantic tell us that there is no universal, 'one size fits all' answer to the reorganization challenges. While EU promotes early restructuring and certain degree of judicial supervision, the US workouts operate in business environment where parties are free to arrange their contractual relationship outside the court's reach. Until the EC Recommendation turns into a binding directive, Croatia has a choice on how to structure its pre-insolvency legal framework, namely whether to encourage court proceedings or out-of-court reorganization of debtor's business. Even though it can be said that Croatia does follow the path towards more informal debt restructuring and preventing the formal insolvency proceedings, there is still a long way to go. With lending and business culture not being on the level where court scrutiny in reorganization proceedings would

become superfluous, completely informal workouts might still represent too much of a grasp for the Croatian insolvency framework. However, middle ground solutions like pre-packaged bankruptcies, with minimal court involvement and private debt renegotiations, could serve as an efficient intermediary step on the road to completely informal proceedings.

Finally, even in the absence of the direct legislative action, methods of out-of-court or at least semi-formal debt restructuring should be encouraged and promoted among Croatian insolvency practitioners. The business environment is evolving rapidly and any chance to deal with financial difficulties in a relatively short period, with low(er) costs and far from public eye is more than welcomed, making informal reorganization comparatively more attractive then formal court proceedings. On the other hand, when deciding on how to restructure, practitioners are expected to weigh the risks of both options and find the proper balance between the debtor's and creditors' interests, which is even more important in informal proceedings lacking the final confirmation of the court. Put in the words of the ingenious innovator Alexander Graham Bell, 'the only difference between success and failure is the ability to take action.' Or, when transposed to saving the debtor through reorganization, the ability to take action at *the appropriate time* and *by appropriate restructuring means*, be it pre-insolvency proceedings, pre-packaged bankruptcy, workouts or formal insolvency reorganization. While making the right choice will typically be a formidable task, saving an honest debtor's viable business from unnecessary liquidation makes it worth the effort.

BIBLIOGRAPHY

TABLE OF LEGISLATION

Croatia

- Financial Operations and Pre-Insolvency Settlement Act 2012, *Official Gazette*, NN 108/12, 144/12, 81/13, 112/13, 71/15, 78/15
- Insolvency Act 2015, *Official Gazette*, NN 71/15

Germany

- Insolvency Code 1994, *Federal Law Gazette* I p. 2866, as last amended by Article 19 of the Act of 20 December 2011, *Federal Law Gazette* I p. 2854
- Act on Simplification of Corporate Restructuring 2011 (ESUG), *Federal Law Gazette* I p. 2588

United States

- US Code: Title 11 – Bankruptcy (Bankruptcy Code), *Pub. L.* 114-38
- Trust Indenture Act of 1939

European Union

- European Commission's Recommendation of 12 March 2014 on a new approach to business failure and insolvency, *Official Journal of European Union*, L 74/65 (2014/135/EU)
- Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, *Official Journal of the European Union*, L 141/19

BOOKS

- Black's Law Dictionary (9th edn, West Thomson Reuters, 2009)
- R. Bork, *Rescuing Companies in England and Germany* (Oxford University Press, 2012)

- D. G. Epstein, B. A. Markell, S. H. Nickles, L. Ponoroff, *Bankruptcy: Dealing with Financial Failure for Individuals and Businesses* (4th edn, West Academic Publishing, 2015)
- N. Ferguson, *The Ascent of Money: A Financial History of the World* (Penguin Books, 2009)
- T. L. Friedman, *The Lexus and the Olive Tree* (Anchor Books, 2000)
- J. M. Garrido, *Out-of-Court Debt Restructuring*, World Bank study (Washington D.C.: World Bank, 2012)
- B. Larkin (editor), *Restructuring and Workouts: Strategies for Maximizing Value*, (2nd edn, Globe Business Publishing, 2013)
- C. Mallon, S.Y. Waisman (editors), *The Law and the Practice of Restructuring in the UK and the US* (Oxford University Press, 2011)
- G. Moos, I. F. Fletcher, S. Isaacs (editors), *Moos, Fletcher and Isaacs on The EU Regulation on Insolvency Proceedings* (3rd edn, Oxford University Press, 2016)
- R. Olivares-Caminal, *Expedited Corporate Debt Restructuring in the EU* (Oxford University Press, 2015)
- M. J. Roe, *Corporate Reorganization and Bankruptcy* (Foundation Press, 2000)
- R. Squire, *Corporate Bankruptcy and Financial Reorganization* (Wolters Kluwer, 2016)
- J. L. Westbrook (editor), C. D. Booth, C. G. Paulus, H. Rajak, *A Global View of Business Insolvency Systems* (Washington D.C.: World Bank, 2010)

JOURNAL ARTICLES AND PAPERS

- Adam Michelin, 'Can Bankruptcy Be Avoided?' [March 2002] 17/2 Commercial Lending Review 41-43
- Alexandra Kastrinou, 'Comparative Analysis of the Informal Pre-Insolvency Procedures of the UK and France' [2016] 25 International Insolvency Review 99-118
- Edith S. Hotchkiss, John Kose, Robert M. Mooradian, Karin S. Thorburn, 'Bankruptcy and the Resolution of Financial Distress' [January 2008] <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1086942> accessed 25 January 2017

- Emmanuelle Inacio, 'The European Commission's Directive Proposal for common principles and rules on preventive restructuring frameworks, insolvency and second chance' [Winter 2016/2017] Eurofenix 66, 12-13
- Fred G. Hathaway, Jr., 'Workouts: Early Restructuring Could Have Prevented Bankruptcy' [spring 1993] 2 Commercial Lending Review 70-74
- Gerard McCormack, 'Apples and Oranges? Corporate Rescue and Functional Convergence in the US and UK' [2009] 18 International Insolvency Review 109-134
- Horst Eidenmüller, Kristin van Zwieten, 'Restructuring the European Business Enterprise: the European's Commission Recommendation on a New Approach to Business Failure and Insolvency' [2016] 16/4 European Business Organization Law Review 625-667
- Ivana Tomas Živković, Dejan Bodul, Saša Živković, 'Novosti i problemi u provedbi stečajnog zakonodavstva u Republici Hrvatskoj' [Novelties and problems in bankruptcy law implementation in Croatia] [2014] Ekonomski pregled 65(4) 318-351
- John Carreyrou, Matthew Karnitschni, 'Paris Looks to U.S. – on Bankruptcy' The Wall Street Journal Europe [25 September 2003]
- Mark Wellard, Peter Walton, 'A Comparative Analysis of Anglo-Australian Pre-packs: Can the Means Be Made to Justify the Ends?' [2012] 21 International Insolvency Review 143-181
- Maurizio Pontani, 'Pre-Bankruptcy Crimes and Entrepreneurial Behavior. Some Insights from American and Italian Bankruptcy Laws' German Working Papers in Law and Economics [2004], paper 14
- Maury B. Poscover (ed), 'The Business in Trouble – A Workout Without Bankruptcy' Business Lawyer [May 1984] 39/3 1041-1087
- Michelle J. White, 'Corporate Bankruptcy as a Filtering Device: Chapter 11 Reorganizations and Out-of-Court Debt Restructurings' [1994] 10/2 Journal of Law, Economics and Organization 268-295
- Philipp Jostarndt, Zacharius Sautner, 'Out-of-Court Restructurings versus Formal Bankruptcy in a Non-Interventionist Bankruptcy Setting' [2010] 14 Review of Finance 623-668
- Stephan Madaus, 'Reconsidering the Shareholder's Role in Corporate Reorganizations under Insolvency Law' [2013] 22 International Insolvency Review 106-117

- Stuart Gilson, 'Coming through a Crisis: How Chapter 11 and the Debt Restructuring Industry Are Helping to Revive the U.S. Economy' [fall 2012] 24/4 Journal of Applied Corporate Finance 23-35

ONLINE ARTICLES

- Annerose Tashiro, 'Prepacked Plans in Germany' <https://www.iiiglobal.org/sites/default/files/annerosetashiro.pdf> accessed 25 January 2017
- Annemarie Franczyk, 'Workouts keep the debt out of the court, public eye' (Buffalo Law Journal, 9 November 2009) <http://www.bizjournals.com/buffalo/blog/buffalo-law-journal/2009/11/workouts-keep-debts-out-of-court-public-eye.html> accessed 25 January 2017
- Anita Krizmanic, Ivana Manovelo, Jelena Zjacic of Macesic & Partners, 'How to Restructure in Croatia' (International Financial Law Review, 21 February 2013) <http://www.iflr.com/Article/3158630/How-to-restructure-in-Croatia.html> accessed 14 January 2017
- Ante Vukovic, Dejan Bodul 'Novi Stečajni zakon' [New Insolvency Act] <http://www.iusinfo.hr/Article/Content.aspx?SOPI=CLN20V01D2015B848> accessed 1 March 2017
- Igor Ilic, 'Croatia wants to shield economy from Agrokor's problems' <http://uk.reuters.com/article/croatia-agrokor-idUKL5N1GS59U> accessed 25 March 2017
- Igor Pirc, Preventivno prestrukturiranje po ZFPPIPP-F [Preventive restructuring under ZFPPIPP-F] [Korporacijsko pravo, 9 December 2013] <http://korporacijsko-pravo.si/preventivno-prestrukturiranje-zfppipp> accessed 14 January 2017
- Ivica Kristovic, 'Uspjesan model ili kriminal: Kako popraviti predstecajne nagodbe?' [A successful model or a crime: How to fix the pre-insolvency settlements?] [Vecernji list, 27 February 2014]

<http://www.vecernji.hr/hrvatska/uspjesan-model-ili-kriminal-kako-popraviti-predstecajne-nagodbe-923352> accessed 14 January 2017

- Michael Thierhoff, Renate Müller, 'A new approach to business failure and restructuring: pre-insolvency restructuring v. early filing in Germany' [2014] Thomson Reuters Practical Law
  < http://uk.practicallaw.com/1-573-5547> accessed 15 February 2017
- Rick Antonoff, 'Out-of-Court Debt Restructuring and the Problem of Holdouts and Free Riders' [The Metropolitan Corporate Counsel, October 2013]
  <http://www.metrocorpcounsel.com/articles/25455/out-court-debt-restructuring-and-problem-holdouts-and-free-riders> accessed 15 February 2017.
- Richard Tett, Katharina Crinson, 'The recast EC Regulation on Insolvency Proceedings: a welcome revision' [Freshfields Bruckhaus Deringer Corporate Rescue and Insolvency, April 2015]
  <http://www.freshfields.com/uploadedFiles/SiteWide/Campaigns/R_and_I/Content/The%20recast%20EC%20Regulation%20on%20Insolvency%20Proceedings%20a%20welcome%20revision.pdf> accessed 14 January 2017
- Robert Harlang, Mitch Vininsky, '*C*anadian Court Rules in Favor of GM Canada over Dealers' [American Bankruptcy Institute Journal, November 2015]
  < http://www.ksvadvisory.com/articles/ > accessed 14 January 2017
- Suzana Varosanec, 'Vjerovnici bi mogli minirati predstecajne nagodbe' [The Creditors Could Mine the Pre-Insolvency Settlements] [Poslovni dnevnik, 5 December 2012] <http://www.poslovni.hr/hrvatska/vjerovnici-bi-mogli-minirati-predstecajne-nagodbe-223633> accessed 14 January 2017

PUBLICATIONS

- Conference report from the IBA's 16th Annual Global Insolvency and Restructuring Conference– Cleaning up the mess: restructuring and insolvency approaches worldwide [Hamburg, Germany, May 2010]
  <http://heinonline.org/HOL/Page?handle=hein.journals/iri4&div=28&g_sent=1&collection=journals> accessed 14 January 2017

- Croatian Bureau of Statistics, Release on the number and structure of business entities (annual basis) [December 2015]
  <http://www.dzs.hr/Hrv_Eng/publication/2015/11-01-01_04_2015.htm> accessed 14 January 2017
- Croatian Ministry of Finance, Report to the Croatian Parliament on the implementation of pre-insolvency settlement proceedings on the basis of Financial Operations and Pre-Insolvency Settlement Act in the period form 1 October 2012 till 31 December 2014 (March 2015)
- INSOL Principles 2000: Statement of Principles for a Global Approach to Multi-Creditor Workouts
  <https://www.insol.org/pdf/Lenders.pdf>
- Gerard McCormack, Andrew Keay, Sarah Brown, Judith Dahlgreen, European Commission 'Study on a new approach to business failure and insolvency: Comparative legal analysis of the Member States' relevant provisions and practices', Tender No. JUST/2014/JCOO/PR/CIVI/0075 [European Commission, University of Leeds, January 2016]
  < http://ec.europa.eu/justice/civil/files/insolvency/insolvency_study_2016_final_en.pdf > accessed 14 January 2017
- London Approach
  <http://www.bankofengland.co.uk/archive/Documents/historicpubs/qb/1993/qb93q1110115.pdf>
- NACIIL Workshop EC Recommendation on new approach to business failure and insolvency 4 June 2014, materials available at
  <http://www.naciil.org/uploads/files/Presentations_NACIIL_Workshop_4_June_2014.pdf> accessed 25 January 2017
- UNCITRAL Legislative Guide on Insolvency [2005]
  < https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf >
- US Bankruptcy Courts – Business and Nonbusiness Cases Filed, by Chapter of the Bankruptcy Code
  <http://www.uscourts.gov/sites/default/files/data_tables/bf_f2_1231.2016.pdf> accessed 14 January 2017

- World Bank *Doing Business* Study 2016 <http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB16-Full-Report.pdf>

CASE LAW

- *Aladdin Hotel Co. v. Bloom*, 200 F.2d 627 [8th Cir. 1953]
- *Dalekovod* pre-insolvency settlement, FINA 'Minutes from Hearing on Pre-Insolvency Settlement for Dalekovod d.d., Zagreb [29 January 2014]
- *In Re Colonial Ford, Inc.*, 24 B.R. 1014, 1015-17 [Bankr. D. Utah 1982]
- *In Re Chrysler LLC*, 576 F.3d 108 [(2nd Cir. 2009], vacated by 130 S. Ct. 1015
- *United Savings Association v. Timbers of Inwood Forest Association*, 793 F.2d 1380 [5th Cir. 1986], aff'd, 484 US 365 [1988]
- *Trillium Motor World Ltd. v. General Motors of Canada Ltd*., [2015] ONSC 3824 (CanLII)