Debt Restructuring and Bankruptcy in Bosnia and Herzegovina, Croatia and the United States: Comparative Study

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LL.M SHORT THESIS

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Abstract

As a large number of business bankruptcies end with liquidation, the number of business entities deleted from registries in Bosnia and Herzegovina is not only an alarming economic but also a social and legal problem. Namely, liquidations resulted in thousands of employees left jobless, assets accumulated over many years being sold off for a fraction of their former value and, for owners, a permanent loss of credibility and business reputation. Such loss of credibility and reputation ultimately stems from the impact of a so-called 'bankruptcy stigma,' in Bosnia and Herzegovina, where it is common to equate insolvency proceedings and debt restructuring with liquidation, it is viewed as the end of for a business, rather than an opportunity for a second chance. The thesis will include some proposals on how a business culture favoring out-of-court workouts and pre-bankruptcy reorganization plans could be domesticated. With this agenda in mind, on the one hand, the focus will be on the nature, typology and identification of key legal problems corollary to out-of-court workout agreements. Taking a comparative legal approach, some possibilities, potential challenges and benefits of the introduction of out-of-court workouts and pre-bankruptcy reorganization plans into B&H bankruptcy law will be analyzed. The United States' experience is of particular interest in this regard, because of its long and tested history of out-of-court workouts. Furthermore, the Republic of Croatia is also of interest in this context, having previously introduced pre-bankruptcy procedures as a form of fast-tracked restructuring, which may provide insight for current attempts at bankruptcy reform in Bosnia and Herzegovina.

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Introduction

I. Context

The process of privatization is a ubiquitous feature of states in transition and is commonly fraught with a variety of issues which are often systemic in nature. These issues stem from a number of socio-economic factors, but they often also stem from poorly-devised bankruptcy laws. Such a state of affairs can be the result of a poor or absent entrepreneurship culture: governments in transition countries are unlikely to step in to rescue a private business from liquidation. However, by contrast, they will keep a public[1] company from liquidating, even if doing so would be economically inefficient. This behavior is connected with certain prejudiced attitudes and opinions about debt and insolvency in transition economies, perhaps especially evident in former socialist countries, where bankruptcy was connected with capitalism and worker exploitation. For example, one common belief is that a business will become insolvent as a result of some measure of incompetence or dishonesty on the debtor's part, or even outright criminal behavior such as fraud. However, it is more likely that many insolvencies are the result of bad luck and may have even been avoided in the first place, had a 'rescue plan' existed. This problem is becoming more apparent in the Western Balkans among those states aspiring to future EU accession. One such country is Bosnia and Herzegovina (BiH), where a second wave of privatization and business consolidation, including various mergers and acquisitions, is gaining steam each year. For policy makers, it is important to pay attention to the regulatory framework and procedures overseeing such high-value operations, to prevent or at least decrease the socially and economically negative effects of privatization. However, with regard to business bankruptcy in Bosnia and Herzegovina, so far the majority of cases before bankruptcy courts tended to end in business liquidation. Until

[1] Not referring to publicly-listed companies; in Bosnia and Herzegovina and other Yugoslav successor states, state-owned companies are colloquially referred to as 'public' companies, in contrast to privately-owned companies.

fairly recently, preserving the healthy parts of an existing company and continuing to operate as a going concern existed only within the BiH bankruptcy proceedings, as part of a reorganization plan. As part of a plan of reorganization, a debtor may partially avoid the stigma associated with liquidation by founding a new entity, several new entities, or merging into a new entity unencumbered by debt. However, examples of successful reorganizations for private businesses have been few and far between until very recently. This was mostly the result of late bankruptcy filings which tend to leave the debtor too financially distressed to be rescued by reorganization proceedings. Consequently, as a large number of business bankruptcies end with liquidation, thousands of employees are left jobless and assets accumulated over many years are being sold off for a fraction of their former value. For debtors, such a scenario will result in a permanent loss of credibility and business reputation. Such a loss of credibility in the eyes of the public ultimately stems from the impact of a so-called 'bankruptcy stigma,' which is essentially a negative perception of debtors who file for bankruptcy, both within the business environment and society in general. There are a number of alternatives to formal bankruptcy proceedings, and one which is becoming increasingly popular is out-of-court restructuring (OOCR). While present in one form or another in neighboring countries, OOCR has been absent from Bosnian-Herzegovinian Bankruptcy Laws, until recent reforms partially introduced a variant of debt restructuring in the pre-bankruptcy procedure, specifically as an alternative to bankruptcy proceedings.

II. Research Aim

In accordance with its Constitution, the area of bankruptcy in BiH is regulated by the country's constitutive entities; the Federation of Bosnia and Herzegovina (FBiH), Republika Srpska (RS), and the self-governing Brčko District (BD). This thesis will focus on analyzing the Bankruptcy Laws in the two entities, since the District of Brčko only covers a very small area of the country. In Bosnia and Herzegovina, where it is common to equate insolvency proceedings and debt restructuring with liquidation, declaring insolvency is viewed as the end of a business, rather than an opportunity for a fresh start. The thesis comes forward with some concrete proposals on how a

business culture favoring alternative solutions such as OOCR and prepackaged reorganization plans could be domesticated in Bosnia and Herzegovina. With this agenda in mind, this thesis focuses on the nature, typology and identification of key legal problems corollary to ad hoc workout agreements. In addition to workouts and formal bankruptcy proceedings, pre-packaged reorganization plans, considered to be a type of 'hybrid' between the two, will be examined as well. Little has been written about the bankruptcy laws in Bosnia and Herzegovina, save for a few studies conducted either by independent experts and international law firms on behalf of foreign clients, or commissioned by international financial organizations such as the World Bank and the IMF. Since studies dealing with the implementation of new bankruptcy laws in this country are currently unavailable to a broader English-speaking public, one of the goals of this thesis is to fill this gap in international scholarship. In addition to that, a secondary aim of the thesis is to contribute to the interdisciplinary discourse on how a 'second-chance' culture could be introduced into an emerging country with a significant level of bankruptcy stigma and a complicated legal and political system. By the means of taking a comparative legal approach, the key aim is to analyze the possibilities, potential challenges and benefits of the introduction of a domesticated form of OOCR or prepackaged reorganization plans into the Bosnian-Herzegovinian insolvency procedure. The United States' experience is of particular interest in this regard because of its long and tested history of out-of-court workouts[2]. Croatia is also interesting in this context, having previously introduced pre-insolvency proceedings as a statutory requirement for voluntary bankruptcies in its Pre-Insolvency Act. Croatia further introduced fast-tracked restructuring procedures, which may also provide valuable insight for any future attempts at bankruptcy reform in Bosnia and Herzegovina.

III. Thesis Structure

[2] Extra-judicial agreements of the insolvent business debtor and its creditors.

The first part of the thesis, titled 'Overview of Bankruptcy Proceedings is dedicated to an overview of the current state of the court-based bankruptcy framework in Bosnia and Herzegovina, Croatia and the US. The first subchapter introduces the reader to the bankruptcy laws of the entities of Bosnia and Herzegovina, the Federation of Bosnia and Herzegovina and Republika Srpska, respectively. Additionally, it helps lay a groundwork for the following chapters dealing with alternative debt restructuring methods and bankruptcy reform, as well as to identify individual advantages and common deficiencies present in both bankruptcy laws. Bosnia and Herzegovina's neighboring country and EU member state since 2013, Croatia recently overhauled its bankruptcy procedure by introducing a new bankruptcy law in 2015 which introduced a number of innovations into its bankruptcy system. The following subchapter therefore gives an overview of the bankruptcy law in Croatia, including both alternatives such as restructuring and the introduction of so-called fast-track procedures and mandatory pre-bankruptcy procedures into the bankruptcy framework. The effects and outcome of the most recent bankruptcy reform in Croatia will be examined, and recent bankruptcy-related issues connected with the reform will also be broached, in order to compare and obtain insight on these issues with regard to Bosnia and Herzegovina's bankruptcy procedures. The last subchapter of the overview goes over the United States' experience with bankruptcy-related procedures and the Chapter 11 bankruptcy reorganization, the concept of debtor-in-possession and related bankruptcy institutes. The next chapter deals with alternatives to debt restructuring found in formal bankruptcy proceedings in the US and Croatia. The reason for leaving out BiH in this comparison was due to the novelty of the new law in Republika Srpska providing for such an option, and because one has not yet been passed in FBiH. The subchapter on the US will specifically focus on out-of-court restructurings, also known as corporate workouts, a popular alternative to standard Chapter 11 bankruptcy procedure. The pros and cons of workouts will be laid out and compared with the potential benefits and downsides of Chapter 11 proceedings. The subchapter will also deal with prepackaged bankruptcies as another form of popular alternative to formal bankruptcy proceedings. In addition, the popularity of these

alternatives will be discussed and why the introduction of OOCR culture in Bosnia and Herzegovina, could improve business and the state of the bankruptcy framework. The concluding part of the thesis will present several opinions on how to resolve the systemic problem of frequent liquidation in Bosnia and Herzegovina. By applying the insight obtained from the experiences with alternatives and shortcuts in bankruptcy procedures presented in the previous two chapters, as well as proposed to solutions to the issues present in the current bankruptcy laws. This part also serves as an overview of the underlying socio-economic issues affecting bankruptcy, including the influence of the so-called bankruptcy stigma on bankruptcy law and proceedings, with the aim of identifying the underlying problem and how to solve it without going into the particular causes The effect of socially prevalent bankruptcy stigma and how such stigma may be lessened or avoided will be presented in a comparative analysis with the problems faced by neighboring Croatia, which presents a better subject of comparison than the US, due to its proximity, common history and similarities in language, culture and legal traditions.

IV. Methodological Challenges

The judiciary on the state-level in Bosnia and Herzegovina recently created a comprehensive registry which collects data from both entities and Brčko District relating to the status of registered businesses. While the statistics on insolvencies and liquidations exist and are publicly available, there are no official studies analyzing the available data. However, a cursory search is enough to discover that there exists a distinct lack of scholarly literature on the subject of alternatives to existing bankruptcy procedures in Bosnia and Herzegovina. This applies regardless of whether sources are in English, Croatian or one of the three official languages of Bosnia and Herzegovina. This makes it very difficult to come by relevant information when attempting to research individual cases due to confidentiality in ongoing insolvency cases, as well as problems with technological modernization in different parts of the country. Due to such a state of neglect regarding the state authorities and domestic legal scholars' approach to this problem, it is challenging to collect and assess empirical data in order to examine whether the system currently

in place is functioning in reality. Perhaps the biggest challenge has been to identify a 'landmark' case with for illustrating the problems inherent in the existing bankruptcy system in Bosnia and Herzegovina. Unlike Croatia, for example, Bosnia and Herzegovina had not yet had its own *Agrokor* equivalent to stimulate public interest and discussion on bankruptcy-related issues.[3] The vast majority of registered businesses in BiH fall into the category of small and mid-scale enterprises, and very often are family-run businesses. Most are classified as a type of limited liability company[4] or joint stock company[5]. The high number of such businesses explains the proportionately high number of businesses being erased from the registries due to liquidation. The problem remains that the vast majority of bankruptcy proceedings are unsuccessful in the sense that they end with the debtor business in liquidation proceedings. In researching this topic, it is important to keep in mind the key differences in attitudes towards bankruptcy between the jurisdictions being compared. The bibliography used during the research of this topic includes books authored by renowned experts on US Bankruptcy Law, such as the late Lawrence P. King, handbooks and practitioner's guides, selected articles regarding insolvency and bankruptcy law from US and international law journals, as well as published reports by international financial organizations such as the WTO and the IMF. One book that was of particular help in researching bankruptcy in Bosnia and Herzegovina, and Croatia, was the primer titled 'Insolvency and Restructuring Law in Central and Eastern Europe', written by Christian Hoenig and Christian Hammerl.[6] This primer was written with the help of legal experts from Wolf-Theiss, one of the leading international law firms with office across the CEE/SEE region.[7]

[3] Referring to the case of Croatian retail business giant *Agrokor d.d.* which went into bankruptcy in early 2017. The company had a large number of smaller creditors outside of Croatia, especially in Bosnia and Herzegovina.
[4] Abbreviated as 'd.o.o.' (društvo sa ograničenom odgovornošću).
[5] Abbreviated as '*d.d.*' in FBiH or '*a.d.*' in RS (Bosnian /Croatian: *dioničarsko društvo*; Serbian: *akcionarsko društvo*).
[6] Hoenig, Christian, and Christian Hammerl. Insolvency and Restructuring Law in Central & Eastern Europe: An Introduction for Practicioners. Linde Verlag GmbH (2014).
[7] Central and Eastern Europe (CEE) and South East Europe (SEE).

V. Terminology Caveats

It is essential to clarify the terminology used in this paper, primarily because of the different definitions for bankruptcy used in the United States and European countries. The two terms are sometimes used interchangeably in common parlance, which is technically incorrect. In Europe, the term bankruptcy is used to refer to defaults on personal debt, while insolvency is the term used for business debt defaults. However, in the US bankruptcy has a broader meaning and includes all forms of statutory procedures triggered by insolvency. It should also be clarified that it is possible for a business to be insolvent without being bankrupt, especially if the insolvency is temporary. It is also possible for a business to initiate bankruptcy proceedings without being insolvent, if it is determined that the business is facing imminent insolvency. Since the focus will largely be on US terminology due to the comparatively larger number of US-based sources available, US-based terminology will be adopted for the purposes of this thesis. Lastly, the word *stecaj*, which has the same meaning in Bosnian, Croatian and Serbian can mean both bankruptcy and insolvency depending on the context. Therefore, in the context of legal proceedings, the term 'bankruptcy' will be used, with accompanying clarifications when making a distinction is necessary.

1. Chapter 1 – Bankruptcy Proceedings in Bosnia and Herzegovina

Bosnia and Herzegovina is a jurisdiction with a complicated political and legal system, split into two federal entities and one self-governing federal district, each with their own legal regime. Each entity has its own bankruptcy law, and consequently bankruptcy proceedings differ in some respects, although there is a conscious effort to keep the legislation harmonized to the extent possible country-wide. Recently, laws and amendments to existing laws have been proposed, in order to introduce pre-bankruptcy proceedings similar to those found in neighboring Croatia and

Serbia. The entity of Republika Srpska, for example, has already adopted a new bankruptcy law, with some encouraging results beginning to show already.

1.1 Bankruptcy Laws in Bosnia and Herzegovina

In Bosnia and Herzegovina, the Bankruptcy Laws of the entities contain the basic principles governing bankruptcy proceedings, general procedural provisions, as well as provisions regarding preliminary procedures, reorganization of the debtor, international bankruptcy and specific rules on civil and criminal liability and associated penalties. Bankruptcy proceedings are initiated before either commercial divisions of municipal courts in FBiH, or district commercial courts in RS, respectively. Both the Federation of Bosnia and Herzegovina and Republika Srpska have revised their bankruptcy laws several times. The current FBiH Law on Insolvency Proceedings[8] was enacted in 2003 and amended twice in 2004 and 2006, for example. Republika Srpska recently replaced its Law on Bankruptcy Proceedings with a new law, titled 'the Law on Bankruptcy', which notably includes the option of initiating pre-bankruptcy proceedings.

1.2 Grounds for Initiating Bankruptcy Proceedings

Under the FBiH Bankruptcy Law a bankruptcy petition must be filed within 30 days, or 60 under the RS Bankruptcy Law, from the occurrence of grounds for bankruptcy.[9] Among the reasons why most bankruptcy proceedings in Bosnia and Herzegovina end in liquidation is that, in practice, these statutory deadlines are often exceeded and bankruptcy proceedings are initiated well after

[8] Official Gazette of FBiH, no. 29/03, 32/04 and 42/06.
[9] Čustović N and Šarić J, "Bosnia and Herzegovina," in Hoenig/Hammerl (Eds), *Insolvency and Restructuring Law in Central & Eastern Europe: An Introduction for Practitioners*, Linde Verlag GmbH (2014) 89-214.

the initial grounds for bankruptcy occurred.[10] Usually at this point the debtor's state has deteriorated beyond any hope of restructuring or surviving the bankruptcy proceedings.[11]

The grounds for opening bankruptcy proceedings are strictly defined in the Bankruptcy laws as when the business either enters a state of illiquidity (*platezna nesposobnost*) or is faced with impending illiquidity (*prijeteca platezna nesposobnost*). By comparison, a business merely being over-indebted is not considered a sufficient legal ground for initiating bankruptcy proceedings.[12]

1.3 Main Bodies in the Bankruptcy Proceedings

The relevant bodies involved in the bankruptcy proceedings include the bankruptcy courts, judges, trustees, and creditors. The creditors' interests are represented by creditors' committee and creditors' meeting. Which bankruptcy court hears a particular bankruptcy case is determined based on the debtor's seat of business, depending on whether their seat is on the territory of FBiH or RS.

i. Bankruptcy Courts

In FBiH, the authority to hear bankruptcy cases rests with the commercial divisions of municipal courts, which also maintain commercial registries.[13] By comparison, the courts with jurisdiction in bankruptcy matters in RS are district commercial courts.[14] This difference in court structure between the entities is a reflection of the administrative complexity of FBiH, which has a federal structure composed of 10 autonomous cantons, while in comparison the RS is much more centralized. Bankruptcy courts are authorized to hear disputes related to the bankruptcy proceedings, ranging from such matters as avoidance of debtor's legal actions, wasting or loss of debtor's assets, to wrongful acts of bankruptcy administration, and matters relating to personal

[10] Ibid.
[11] Ibid.
[12] Ibid.
[13] Čustović and Šarić (n8) 99.
[14] Ibid.

liability of company members and shareholders.[15] The bankruptcy judge (*stecajni sudija*) oversees the bankruptcy proceedings, but also appoints and supervises both the bankruptcy trustee (*stecajni upravnik*), and the temporary bankruptcy trustee (*privremeni stecajni upravnik*), as well as any court experts when necessary.

ii. The Bankruptcy Trustee

The difference between a bankruptcy trustee and temporary bankruptcy trustee is that the latter is appointed for the duration of the preliminary bankruptcy proceedings. The temporary bankruptcy trustee steps down upon opening of formal bankruptcy proceedings and the bankruptcy trustee assumes his or her responsibilities. Both types of trustees are appointed by the bankruptcy court and acts as an intermediary between the bankruptcy court and the creditor's committee and creditor's meeting.[16] The bankruptcy trustee is authorized by the Bankruptcy Law to take all the necessary steps for the purpose of liquidating the debtors' estate and distributing assets in order to satisfy the claims of the creditors. In accordance with the broad authority vested in them, the responsibilities of a bankruptcy trustee are extensive. These include taking possession of the debtor's property, operating the debtor's business and managing the debtor's business books. Additionally, the trustee may sell the bankruptcy estate, or particular assets from the estate, with the creditor meeting's consent. The bankruptcy trustee also compiles lists of property belonging to the bankruptcy estate for the bankruptcy judge, as well as a list of creditors of the bankruptcy debtor. Upon the opening of bankruptcy proceedings, all rights of the bankruptcy debtor to administer and dispose of the property belonging to the bankruptcy estate (*stecajna masa*) are transferred to the bankruptcy trustee.[17] This transfer also encompasses all rights of the bankruptcy debtor's boards, authorized procurators and representatives, including the debtor's attorney.[18]

[15] Ibid.
[16] Čustović and Šarić (n8) 101.
[17] SEE Legal Group. "Restructuring and Insolvency Handbook 2016," 17-26.
[18] Ibid.

Bankruptcy debtors are largely at the mercy of the bankruptcy trustee and the creditors in this situation, since the concept of debtor-in-possession[19] is absent in the Bankruptcy Laws of BiH and business operations, if approved by the creditors, will be run by the bankruptcy trustee. In addition, any appointment by the debtor as a procurator, legal representative or agent prior to the opening of bankruptcy proceedings will become void.[20] While evidently trustees are given broad authority, their actions are supervised by the bankruptcy judge, to whom they have to report their findings and ask for approval when drafting a reorganization plan or initiating liquidation proceedings.

iii. The Creditors' Committee and Creditors' Meeting

The creditor's meeting (*skupstina povjerilaca*) and creditor's committee (*odbor povjerilaca*) represent the interest of the creditors over the course of the bankruptcy proceedings. The creditor's meeting votes and decides on major issues which may affect the interests of the creditors, such as matters relating to the bankruptcy estate or the debtor in bankruptcy. After the first meeting with the bankruptcy trustee the creditor's meeting may ask the bankruptcy judge to relieve the former and vote to elect a new bankruptcy trustee.[21] Voting rights are given to those creditors who have registered their claim with the bankruptcy trustee, provided the claim is not disputed or rejected by the bankruptcy trustee or other creditors who have voting rights.[22] Decisions are adopted by a majority of votes, but also based on the proportion of the claim by individual voting creditors. The creditor's committee is elected by the creditor's meeting and must have an odd number, but no more than seven. The members of the committee must represent creditors with the highest and lowest claims, secured creditors (*razlucni povjerioci*), and the debtor's employees.[23] In some circumstances the bankruptcy judge may appoint a preliminary creditor's committee to protect the

[19] Under US Bankruptcy Law, a debtor who after filing a bankruptcy petition remains in control of the bankruptcy estate.
[20] Čustović and Šarić (n8), 107.
[21] Čustović and Šarić 102.
[22] Čustović and Šarić 103.
[23] Čustović and Šarić 101-103.

creditor's interests until such a time as a creditor's committee may be put together.[24] Any decision taken by the creditor's committee must be approved by the bankruptcy trustee, and in turn, the bankruptcy trustee is required to obtain the consent of the creditor's committee when undertaking significant transactions. Such transactions may include, among others, assuming of obligations, sale and purchase of real estate, initiating or participating in civil proceedings, the preparation of a bankruptcy plan, or proposing termination of business operations of the bankruptcy debtor, which would affect the bankruptcy estate.[25] If the creditor's committee has not been appointed, either the creditor's meeting or, in some circumstances, the bankruptcy judge will make a decision on the matter at question. Additionally, in cases when there is a deadlock during voting in the creditor's committee, the bankruptcy judge will make the final decision. The bankruptcy judge has the authority to dismiss any member of the creditor's committee *ex officio*, or alternatively, upon request by the creditor's meeting or any of its members.[26] Directors, shareholders and employees are effected to a lesser extent by the bankruptcy proceedings, insofar as claims against them on the basis of personal liability can be made during the proceedings.

1.4 Reorganization

The underlying principle behind the bankruptcy proceedings, as defined in the Bankruptcy Laws, is to settle the creditor's claims through the distribution and sale of the bankruptcy debtor's assets.[27] The process of liquidation is manifested through the sale of the debtor's total assets, whereupon the resulting proceeds are distributed among the creditors according to their payment classes at the main distribution hearing.[28] Following the hearing, the bankruptcy judge will

[24] Ibid.
[25] Ibid.
[26] Ibid.
[27] Čustović and Šarić (n8) 117.
[28] Ibid.

terminate the bankruptcy proceedings and the decisions will be published in the official gazette, and, consequently, the debtor business will be deleted from the company registries of the entities.[29]

The Bankruptcy Laws of the entities until very recently recognized only formal bankruptcy proceedings. Currently, the entity of FBiH provides for reorganization within the framework of the bankruptcy proceedings. In this case, the creditor's meeting in the relevant case shall decide early on whether to allow the debtor business to continue operating on a provisional basis or to terminate.[30] In that case, the creditors will instruct the bankruptcy trustee overseeing the case to prepare a plan of reorganization and to specify its purpose.[31] The rules contained in the Bankruptcy Laws pertaining to the reorganization of debtors in bankruptcy proceedings were largely inspired by the 1996 German Bankruptcy Code[32] and some institutes directly transposed into the Bankruptcy Laws.[33] While no official statistics regarding reorganization have been published, the unofficial data available shows that reorganizations are very rarely performed, mostly due to late bankruptcy petitions resulting in too much financial distress for debtor businesses to have any hope of reorganizing successfully. Reorganization proceedings may either be initiated by the bankruptcy trustee or the debtor, however the debtor is additionally already entitled to file a petition for reorganization in conjunction with the petition for opening bankruptcy proceedings. Reorganization may be initiated by filing a petition for reorganization before the final hearing for the main distribution of the debtor's estate (*rociste za glavnu diobu*) concludes, provided it is accepted by the creditors and approved by the bankruptcy judge.[34] Once successfully filed, the reorganization plan must be voted on during a special hearing. The Bankruptcy Laws explicitly provide for the bankruptcy creditors who have filed their claims, secured creditors, the bankruptcy trustee and debtor to be invited to the voting hearing. Bankruptcy creditors and secured creditors

[29] Ibid.
[30] SEE Legal Group (n16) 24.
[31] Ibid.
[32] BGBl. I 1996 S. 1013, 'Gesetz zur Änderung des AGB-Gesetzes und der Insolvenzordnung'.
[33] Čustović and Šarić (n18) 117.
[34] Čustović and Šarić 118.

whose claims the plan does not affect have no right to vote on it. A plan is adopted once each class of creditors votes on it and when either the total amount of votes in favor of the plan, or total claims of those creditors voting in favor outnumbers those against. However, a bankruptcy court may decide to reject a reorganization plan on the basis that conditions for filing had not been satisfied. Additionally, the court may reject the plan if there is no prospect that the plan will be adopted by the creditors and subsequently approved by the court, and if the plan is filed by the debtor and it is obvious that it is impossible for claims to be paid in the manner and on terms set forth in the plan.

1.5 The Reorganization Plan

A reorganization plan offers a series of options to debtor businesses like allowing the debtor to retain all or part of their property in order to continue operating their business, for example. In a reorganization plan, all or part of the bankruptcy debtor's property may be transferred to existing legal entities or newly created ones, or the debtor may merge with one or more legal entities.[35] The idea is that the resulting legal entity or entities will be unencumbered by financial distress, or in other words 'healthy'. Under a plan of reorganization, it is also possible to sell all or part of the debtor's property, either subject to or free of security instruments, to distribute all or part of the debtor's property among the creditors, to perform debt-to-equity swaps, convert obligations into loans, or issue other types of security instruments in order to settle debtor obligations.[36] A plan of reorganization may also include an agreement to satisfy creditors with competing claims, to reduce or postpone payment of debtor's obligations, or determine the debtor's liabilities after the conclusion of bankruptcy proceedings.[37] A reorganization plan must contain a declarative part,

[35] Ibid.
[36] Ibid.
[37] Ibid.

which contains a description of measures taken before commencement of bankruptcy proceedings, as well as how, when and in what amount claims of secured creditors and other classes of creditors will be settled.[38] The substantive section of the reorganization plan must contain provisions relating to the effect on and subsequent legal status of the debtor and other parties affected by the plan in the bankruptcy proceedings.[39]

1.6 Recent Developments

In 2016 the Constitutional Court of the Federation of Bosnia and Herzegovina issued a decision which had the effect of freezing all bankruptcy proceedings until two articles of the FBiH Law on Bankruptcy Proceedings, which were in violation of the FBiH Constitution, were revised.[40] A proposal for a new law was presented to the FBiH Parliament in 2017 but has yet to be adopted. The text of the proposed law provides for the possibility of a pre-bankruptcy settlement, providing for the possibility to resolve the debtor's outstanding debt before commencement of formal bankruptcy proceedings. The current FBiH Bankruptcy Law provides for no such possibility, as any sort of debt restructuring must occur after the start of bankruptcy proceedings. In fact, before the entity of Republika Srpska adopted its new Law on Bankruptcy (*Zakon o stecaju Republike Srpske*) in 2016, no alternative forms of debt recovery and restructuring existed in Bosnia and Herzegovina.[41] The new law introduced the option of restructuring debtor businesses without having to file for bankruptcy, as a way of helping firms pay off their debts and bounce back, but also in order to keep debtor businesses operating as a going concern.[42] The new law already

[38] SEE Legal Group (n16) 25.
[39] Čustović and Šarić (n8) 118.
[40] The Constitutional Court of the Federation of Bosnia and Herzegovina ruled in its March 2016 decision (U-27/15) that Article 33 and Article 40 of the Law on Insolvency Proceedings of FBiH were unconstitutional.
[41] Published in the Official Gazette of Republika Srpska No. 16/16.
[42] ifc.org, "In Bosnia and Herzegovina, a New Law Helps Firms Bounce Back" (January 2018). https://www.ifc.org/wps/wcm/connect/news_ext_content/ifc_external_corporate_site/news and events/news/impact-stories/bosnia-and-herzegovina-new-law-helps-firms. Accessed April 4, 2018.

showed results in 2017, the following year. A total of 11 restructurings being initiated and 600 jobs retained as a result.[43] One concrete example is the Banja Luka-based manufacturing company *Kosmos a.d.* which successfully restructured, paid off its debt and stayed in business, promoting local development and preserving 200 jobs in the process.[44] A mechanism of debt restructuring and collective settlement agreement was previously absent from the Bankruptcy Laws in Bosnia and Herzegovina. In the case of both the new RS Bankruptcy Law and the proposed one in FBiH, the main purpose behind the legislation is to expedite proceedings. The idea is that proceedings related to the bankruptcy case should be resolved as quickly as bankruptcy proceedings. Related proceedings include litigation, as well as administrative and execution proceedings connected to the bankruptcy case.[45]

2. Chapter 2 – Bankruptcy Proceedings in Croatia

The current bankruptcy system in the Republic of Croatia is based on the 1996 Croatian Bankruptcy Act, which has undergone many revisions in order to increase the efficiency of bankruptcy proceedings.[46] The Bankruptcy Act is supplemented by legislation such as the Company Law, which regulates matters relating to company status, and the Obligatory Relations Law, which regulates the area commercial contracts.[47] The Bankruptcy Act contains provisions on proceedings regarding liquidation and reorganization of a debtor business and is strongly creditor-oriented unlike the US Bankruptcy Code, instead being more similar to the German and Austrian

[43] Ibid.
[44] Ibid.
[45] International Monetary Fund, "IMF Financial Stability Assessment: Bosnia and Herzegovina (2015)," 48.
[46] Grubešić A, and others, "Croatia," in Hoenig/Hammerl (Eds), Insolvency and Restructuring Law in Central & Eastern Europe: An Introduction for Practitioners, Linde Verlag GmbH (2014) 165-200.
[47] Vukelić, Mario. "Overview of the Croatian Bankruptcy System" (March 2010) 2-3

bankruptcy codes.[48] As in Bosnia and Herzegovina's Bankruptcy Laws, reorganization of debtor businesses is primarily carried out in order to organize the former's legal status and relations with creditors. A secondary aim is to attempt to keep the debtor business operating as a going concern. Bankruptcy proceedings in Croatia are under the exclusive competence of commercial courts.[49]

2.1 Bankruptcy Proceedings

There are many similarities between the BiH Bankruptcy Laws and the Croatian Bankruptcy Act, which are reflected in the proceedings, especially in the FBiH Bankruptcy Law. This similarity may be attributed to a shared legal traditions from the era of Yugoslavia when they shared a common legal system, and from finding a common inspiration in the German bankruptcy code following independence. Like in BiH, bankruptcy proceedings have historically ended up in favor of liquidations, with very few successful cases of reorganizations recorded.[50] The prevailing view was that bankruptcy proceedings would inevitably lead to asset liquidation and the termination of business operations, providing debtors with little incentive to file for bankruptcy, which was perceived as a last resort for the debtor.[51] Creditors would often respond by obtaining court orders to freeze the debtor's bank accounts and to seek enforcement against the debtor's estate and other assets. However, some debtors would go to great lengths to find clever ways of avoiding filing. Sometimes debtors avoided filing for months or even years with blocked accounts, using tool such as barters and set-offs with preferential creditors in order to continue operating.[52] Bankruptcy proceedings were criticized for their slowness and complexity, which is corroborated by publically available data, which shows hundreds of proceedings taking anywhere between 3 and 10 years.[53]

[48] Ibid.
[49] Ibid.
[50] Grubešić and others (n8) 168.
[51] Ibid.
[52] Ibid.
[53] Ibid.

The statistics from 2012 also showed problems relating to accumulation of a large backlog of unresolved cases filed before the courts, which coincided with the global Great Recession, following the financial crisis of 2007-2008. Statistics also highlighted problems with debt collection by creditors, with only about one third of claims being collected during proceedings.[54] Furthermore, because of fears of incompetence and corruption of bankruptcy trustees, who possessed extensive powers over the proceedings, filing for bankruptcy was seen as a last resort for creditors as well. Following recommendations put forth by major international financial organizations such as the EBRD, IMF, World Bank, UNCITRAL and INSOL International, the Croatian Parliament passed the Financial Operations and Pre-Bankruptcy Settlements Act (Pre-Bankruptcy Act) in 2012.[55] The Act introduced so-called pre-bankruptcy settlement proceedings (*postupak predstecajne nagodbe*), intended to provide a more flexible alternative to bankruptcy proceedings. Under the Bankruptcy Act, proceedings may be conducted either as bankruptcy proceedings (*stecajni postupak*), which results in the sale of assets and dissolution of the debtor; or, as judicial reorganization proceedings (*preustroj*), which results in the transfer of debtor's assets to a new entity incorporated by the debtor.[56]

2.2 Grounds for Initiating Bankruptcy Proceedings

The grounds for initiating bankruptcy proceedings include illiquidity (*nelikvidnost*), insolvency (*nesposobnost za placanje*) and over-indebtedness (*prezaduzenost*).[57] Illiquidity is defined under the Act as the inability of the debtor to meet its monetary obligations in a given time period. The statutory presumption of illiquidity is activated if a debtor spends more than 60 days in default on more than 20% of its liabilities, or if it is more than 30 days overdue on its obligations to pay

[54] Ibid.
[55] Official Gazette of Croatia No. 108/12, 144/12, 81/12 and 112/13.
[56] Grubešić and others (n8) 169-170.
[57] Ibid.

employee wages.[58] However, in the case that the debtor settles the obligations at issue during the preliminary bankruptcy procedure, they will no longer be considered illiquid. In the case of grounds of insolvency, the debtor is unable to settle their debt obligations on a long-term basis. The ability to pay some of its outstanding obligations does not make mean that the debtor is solvent. The statutory presumption for insolvency involves a blockage of debtor's accounts over a period of more than 60 days. The debtor will cease to be insolvent if during preliminary proceedings it manages to settle all due claims or if a third party jointly takes on the debt. A debtor may also propose opening of bankruptcy proceedings if they demonstrate that they will likely not be able to pay existing obligations when they become due.[59] Generally, over-indebtedness is the state when the book value of the debtor's assets is lower than that of its liabilities. A debtor will not be considered over-indebted if a reasonable assumption may be made, on the basis of future indicators of positive cash-flows, such as development programs, that the continuation of business will enable the debtor to settle its outstanding obligations in due course. Furthermore, ad debtor will not be considered over-indebted if one of its shareholders is an individual who is jointly and severally liable for the company's obligations, such as for instance a general partner in a limited partnership.[60] In practice, however, the majority of cases are initiated based on a statutory presumption of under the Bankruptcy Act, in which a continuous blockage of a debtor's bank accounts for a period exceeding 60 days will result in automatic grounds for opening bankruptcy proceedings.[61]

2.3 Main Bodies in the Bankruptcy Proceedings

[58] Ibid.
[59] Ibid.
[60] Ibid.
[61] Ibid.

According to the Bankruptcy Act, bankruptcy proceedings are conducted before the bankruptcy division of the Commercial Courts. There are currently four Commercial Courts in Croatia, located in the cities of Zagreb, Split, Rijeka and Osijek, respectively.[62] For the purposes of this chapter, the bankruptcy divisions of the Commercial Courts may be referred to as 'Bankruptcy Courts', for the function they perform is the identical to specialized bankruptcy courts in other jurisdictions. Despite the fact that the Bankruptcy Courts have significant oversight and authority to appoint or remove trustees and experts, and confirm any decisions made by other parties in the proceedings, the bankruptcy trustee has a far more prominent role in the bankruptcy proceedings, because of their direct involvement in managing the bankruptcy debtor's property and acting as a liaison to creditor's representatives. Aside from the Court and bankruptcy trustee, the main parties in the bankruptcy proceedings include the bankruptcy judge, and the creditors' representative bodies; the creditor's assembly and creditor's committee.

i. The Bankruptcy Courts

As defined under the Bankruptcy Act, bankruptcy judges possesses significant sway over the conduct of the bankruptcy proceedings, acting as the final arbiter in cases when a decision by the other parties in proceedings cannot be reached due to deadlock, or if circumstances call for intervention by the Court. The bankruptcy judge is authorized to make decisions on all matters which are relevant to the bankruptcy proceedings, except in those matters which are specifically provided for by the Bankruptcy Law to be decided by other parties in the bankruptcy proceedings. Among others, the powers of the bankruptcy judge powers include the authority to decide on initiation of preliminary proceedings to determine whether grounds for a bankruptcy exist, and the power to commence the proceedings. The judge also has the authority to appoint and dismiss bankruptcy trustees, to supervise their actions and to issue legally-binding instructions. Another

[62] Grubešić and others (n8) 175.

important role of the bankruptcy judge is to oversee the actions of the creditors' committees and approve any payments made to creditors.

ii. The Bankruptcy Trustee

The bankruptcy trustee is selected from a pool of individuals who have filled out the required criteria, including a university degree and passing a special licensing exam, maintained by the Ministry of justice and published in the official gazette of Croatia.[63] The first bankruptcy trustee is appointed by the Court from the Ministry of justice's list at the opening of the bankruptcy proceedings. While not named differently than the subsequent trustee who takes over, the first trustee's role and function is identical to the temporary bankruptcy trustee found in the BiH Bankruptcy Laws. A court-appointed trustee may be removed at any time by the creditor's assembly and replaced with another who may not necessarily be selected from the Ministry's list. However, such situations have rarely occurred in practice because creditors rarely manage to agree on a substitute acceptable to a majority.[64] The bankruptcy trustee has a central management role in all forms of bankruptcy proceedings, except in the case of 'personal administration' (*osobna uprava*), where they are limited to a supervisory role. The duties of the bankruptcy trustee are identical to those of their colleagues in BiH, and may be categorized into four main types, including administrative duties, duties relating to the management of a debtor's business operations, preserving the debtor's estate and ensuring the collection of the debtor's receivables and the distribution of any proceeds to the creditors.[65] In judicial reorganization proceedings, the bankruptcy court may instruct the bankruptcy trustee to supervise an adopted reorganization plan following the conclusion of bankruptcy proceedings. The bankruptcy trustee also performs an important supervisory role during personal administration; the debtor is allowed to continue managing their business, but may only incur obligations outside of the ordinary course of business

[63] Ibid.
[64] Ibid.
[65] Grubešić and others (n8) 176.

after obtaining the trustee's consent.[66] The bankruptcy trustee may also require all the proceeds of the debtor over the course of personal administration and to satisfy any payments the debtor is due for.[67]

iii. The Creditors' Committee and Creditors' Meeting

Similar to the practice in BiH, creditors may choose to establish a creditor's committee (*odbor vjerovnika*) and appoint its members (odd-numbered and no more than seven) at the first creditor's meeting. Likewise, the bankruptcy court may also establish the creditor's committee at its own discretion before the meeting, and also appoint its members. The committee must include members of at least one representative of creditors with the largest claims, creditors with small claims, and former employees of the debtor, except in the case when their claims are insignificant.[68] Secured creditors, as well as parties who are not creditors may be added to assist in the committee's work, if their expertise is required.[69] The creditor's committee supervises and assists the work of the bankruptcy trustee, but has relatively few actual functions and is relatively unimportant compared to other jurisdictions.[70] The creditor's meeting may be made up of secured creditors, unsecured creditors, and the bankruptcy trustee. However, like in BiH, only creditors whose claims have been confirmed are entitled to have a vote in the meeting. Other creditors may also be granted voting rights based on either an enforceable title, assent by the trustee and creditors with voting rights, or via a decision by the bankruptcy court.[71] Unlike in the BiH Bankruptcy Laws, the Croatian Bankruptcy Act does not provide for any preliminary voting rights of creditors before the claims are examined.[72]

[66] Ibid.
[67] Ibid.
[68] Grubešić and others (n8) 177.
[69] Ibid.
[70] Ibid.
[71] Grubešić and others 176.
[72] Grubešić and others 177.

2.4 Judicial Reorganization Proceedings

Judicial reorganization proceedings were introduced into Croatian bankruptcy law in order to enable viable business entities to overcome financial distress. This type of proceedings was modeled after US Chapter 11 reorganization proceedings, but seldom used and with only a few notable cases in practice, such as the successful reorganization of the large retail chain *Pevec d.o.o.* in 2011.[73] Probable reasons for the lack of such proceedings may be the complexity of the proceedings and inexperience of judges and trustees with the procedure, but also the introduction of the Pre-Bankruptcy Act. Pre-bankruptcy proceedings offer many of the same advantaged, with the added benefits of less rules allowing for more speed and flexibility.[74] However, since the debtor is solely authorized to initiate pre-bankruptcy proceedings, judicial reorganization proceedings may provide an incentive to creditors who are unable to reach a settlement with a debtor's management. In such a case, the creditors might find the possibility of restructuring the debtor's operations without the future involvement of its management an attractive proposition.[75]

2.5 The Reorganization Plan

The bankruptcy trustee may submit a reorganization plan to the court at any point between the date of opening of the bankruptcy proceedings and before the date of the final bankruptcy hearing. Once the bankruptcy trustee, assisted by the creditor's committee, has drawn up a proposal, the plan must be accepted by a majority of the creditors in a voting hearing and subsequently confirmed by the bankruptcy court. In cases when a plan is withdrawn, rejected by the creditors or

[73] Vukić, Igor. "Overly-Ambitious Agreement Deadline" (2012) 5 Croatian Business & Finance Weekly. www.privredni.hr/pvint/PVI0206.pdf. Accessed 4 April 2018.
[74] Grubešić and others. 190.
[75] Ibid.

fails to be confirmed by the court, regular bankruptcy proceedings will continue. As in BiH, the reorganization plan includes a preparatory part and an operative part. The preparatory part contains a list of prerequisite actions for restructuring either taken already or ye to be taken, as well as all data necessary for creditors to decide on the plan. The operative part contains detailed descriptions of restructuring measures, including their effects on the legal position of the debtor and creditors. The principal aim of a reorganization plan is to restructure the debtor into a going concern; in other words, to make its business operations viable again. Methods to achieve this may include reduction of debtors liabilities or a relaxing of terms, debt-to-equity swaps, full or partial waiver of claims, transfer of debtors assets to a new entity without the burden of associated liabilities which led to the statutory assumption of bankruptcy.[76] Reorganization plan hearings are linked to the first bankruptcy examination hearing, where creditor voting rights are allocated to creditors based on the bankruptcy trustee's evaluation of their claims. Therefore, while the reorganization plan may not be scheduled before the examination hearing, the two hearings may be held together. Generally, voting is organized by classes of creditors, unless the plan affects the rights of all creditors equally. Those creditors whose rights are not affected by a proposed plan of reorganization do not have voting rights.[77] The reorganization plan also requires the debtor's consent in principle. In practice, however, this consent is automatic if the debtor is not negatively affected by the plan and if the plan does not provide creditors additional payment exceeding their claims.[78] Lastly, the plan must be approved by the bankruptcy court. The court may not approve a plan of reorganization if there are formal defects in the approval process, or if the position of a creditor is negatively affected by the plan compared to their position in the bankruptcy proceedings.

[76] Grubešić and others. 191.
[77] Grubešić and others. 192.
[78] Ibid.

2.6 Summary Bankruptcy Proceedings

Summary bankruptcy proceedings may only apply to debtors with no employees and were introduced in order to expedite the process of terminating inactive companies. A petition for summary proceedings may be filed before the Croatian Tax Authority (*Porezna uprava*). Once it assesses the company's assets, if the bankruptcy court finds that the assets are insufficient to cover the cost of bankruptcy proceedings, the judge will render a single decision, both opening and immediately concluding the proceedings. However, if the conditions for summary proceedings are not met and assets are sufficient, the case will continue in regular bankruptcy proceedings.

2.7 Pre-Bankruptcy Procedure in Croatia

In 2012 Croatia introduced the Financial Operations and Pre-Bankruptcy Settlement Act (Pre-Bankruptcy Act) with the aim of addressing the widespread liquidity issues Croatian companies at the time were experiencing, especially following the aftershocks of the 2007-2008 financial crisis.[79] The pre-bankruptcy settlement (predstečajna nagodba) was introduced in the Act as an option, specifically for distressed entrepreneurs (encompassing legal entities and traders) to force their creditors to negotiate outside of formal bankruptcy proceedings.[80] The pre-bankruptcy settlement is envisioned as a first resort for companies in early stages of illiquidity or insolvency, with bankruptcy proceedings being the next option in case an agreement with creditors cannot be reached.[81] Before the introduction of the Act, bankruptcy proceedings conducted before the commercial courts were viewed as excessively long and both debtors and creditors were distrustful of the trustees' and courts' efficiency.[82] One of the principal goals behind the Pre-Bankruptcy Act

[79] Grubešić and others, 196-200; Vukelić L. and others. "Trends in Corporate Restructuring – Croatia and Serbia Examined and Contrasted" EBRD Law in Transition Online (2014) 2-4.
[80] Vukelić and others, 3.
[81] Ibid.
[82] Grubešić and others, 196.

was to introduce a method to 'fast-track' the reorganization proceedings and to improve the debtor's chances of recovery.[83] Unlike standard bankruptcy proceedings, the courts play a minor role in pre-bankruptcy proceedings. Debtors file a case before the Croatian Financial Agency (FINA), which retains full jurisdiction in the first stage of proceedings, while the bankruptcy court only confirms the pre-bankruptcy settlement in the second stage.[84] The pre-bankruptcy settlement procedure has some similar features to the judicial reorganization proceedings,[85] but generally has a much shorter timeframe, and is supervised by a FINA 'settlement committee' appointed by the Croatian Ministry of Finance.[86] The settlement committee also appoints a pre-bankruptcy trustee for the case, in order to assist with managing the debtor and its expenditures. Under the Pre-Bankruptcy Act, only the debtor may initiate pre-bankruptcy proceedings, within a statutory period of 60 days from illiquidity or 21 days from insolvency arising, and debtors who fail to meet this statutory time limit may be fined up to 130,000 euros.[87] As the aim of Pre-Bankruptcy Act was to expedite the proceedings, the first stage must be concluded within a period of 120 days. Upon the opening of pre-bankruptcy proceedings, the case is published by the settlement committee in charge of the case on FINA's website, whereupon creditors have 30 days to register their claims.[88] During the proceedings, the debtor is required to prepare and present a restructuring plan to creditors, including an overview of acknowledged and disputed claims, a debt repayment plan, as well as a possible proposal of debt-to-equity swaps for creditors in the debtor business.[89] Additionally, if creditors representing more than half of the acknowledged plan dispute the debtor's proposal, they may submit a competing plan.[90] There are three main groupings of creditors, including public authorities and state-owned companies, financial institutions such as

[83] Vukelić and others, 3.
[84] Grubešić and others, 197.
[85] See section 2.4 of Chapter 2.
[86] Vukelić and others, 3.
[87] Ibid.
[88] Ibid.
[89] Ibid.
[90] Ibid.

banks, and all other types of creditors.[91] Voting is organized much in the same way as in judicial reorganization proceedings, with at least half of each creditor class, or creditors representing two-thirds of total claims represented in votes, being necessary for confirmation of a plan. In practice, most plans have been adopted as a result of the latter, because usually majority claims originate from banks, which also means banks may outvote other types of creditors.[92] Hypothetically, a pre-bankruptcy plan may be adopted with the consent of a single class of creditors, provided that class represents over two-thirds of total acknowledged claims against the debtor.[93] Following the acceptance of the plan by the required majority of creditors, the proceedings accede to the second stage, where the plan must be confirmed by a decision of the commercial court. With the court's decision, the settlement becomes final and pre-bankruptcy proceedings are brought to an end. From this point, creditors are able to use the settlement as a directly enforceable instrument.[94]

2.8 Recent Developments

Despite the advantages in saving costs and time, the introduction of the Pre-Bankruptcy Act has caused no small amount of controversy within legal circles in Croatia. With the introduction of the Act, part of the subject-matter jurisdiction of commercial courts over bankruptcy matters was transferred to FINA – an administrative agency, raising questions of the constitutionality of the law. Article 20, paragraph 1 of the Constitution states that, "everyone shall be entitled have his or her rights and obligations, or suspicion or accusation of a criminal offence decided upon fairly before a legally established, independent and impartial court within a reasonable period."[95] The fact that the proceedings are supervised by a government-run administrative agency is viewed by

[91] Grubešić and others, 198.
[92] Vukelić and others, 3.
[93] Ibid.
[94] Grubešić and others, 199.
[95] Article 29 Paragraph 1 of the Constitution of the Republic of Croatia, reads: "Everyone shall be entitled have his or her rights and obligations, or suspicion or accusation of a criminal offence decided upon fairly before a legally established, independent and impartial court within a reasonable period."

legal theorists as a direct violation of Article 20. In the same vein, questions of compliance with the European Convention on Human Rights have also been raised, in particular Article 6, paragraph 1, regarding the right to a fair trial, which states that "in the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law."[96] Another argument levied against the Pre-Bankruptcy Act is the lack of proper governance in admission of claims.[97] Under the Act, the debtor is the only one with the power to acknowledge or refute a claim which is not based on an enforceable title under Croatian law. This has created a legal loophole which would theoretically allow dishonest debtors to induce a third party to file a fictitious claim, which the debtor could then acknowledge. Should the amount of that claim be large enough, it could potentially allow the third party with a fictitious claim to outvote creditors with genuine claims, when voting on a pre-bankruptcy plan.[98] While the other creditors may appeal any decision by FINA before the Ministry of Finance, there is no mechanism for creditors to dispute the validity of other creditors' claims.[99] Nevertheless, the Pre-Bankruptcy Act has already undergone several revisions over the years, and more are planned for the future, in order to deal with a number of legal loopholes and deficiencies that are currently present in it. These amendments include the extension of deadlines for the conclusion of pre-bankruptcy proceedings, as well as approving new means of debtor refinancing in restructuring. Croatia recently also introduced a specialized legislation titled the 'Law on Proceedings of Extraordinary Administration in Companies of Systemic Importance for the Republic of Croatia, also known as Lex Agrokor,[100] after the largest Croatian retail firm whose bankruptcy directly led to the adoption

[96] Article 6 Paragraph 1 of the European Convention on Human Rights.
[97] Vukelić and others, 4.
[98] Ibid.
[99] Ibid.
[100] 'Zakon o postupku izvanredne uprave u trgovačkim društvima od sistemskog značaja za Republiku Hrvatsku', published in the National Gazette no. 32/2017.

of the *lex specialis*. Lex Agrokor has been sharply criticized, and some, like the owner of the distressed Agrokor, have even put its constitutionality in question.[101]

3. Chapter 3 – Bankruptcy Proceedings in the United States

Unlike most European countries, business bankruptcy is fairly common as a strategic measure in the United States. This is true especially when compared to some European countries, where a generally negative attitude towards bankruptcy – in other words, a strong bankruptcy 'stigma' exists. Because the US possesses a highly developed bankruptcy culture, it may serve as an example of a jurisdiction with a comparatively low 'bankruptcy stigma.' The lack of prevalent negative attitudes towards business bankruptcy contributed to the development of a number of institutes in the US Bankruptcy Code dedicated to rescuing distressed debtor businesses.

3.1 Chapter 11 Bankruptcy Proceedings

Chapter 11 of the United States Bankruptcy Code[102] in particular deals with the reorganization of financially distressed businesses. When a business is no longer able to pay back their debts to creditors, depending on whether it is voluntary or involuntary, either the debtor business or its creditors will file for bankruptcy before a federal bankruptcy court. Chapter 11 bankruptcy proceedings are mainly voluntary and initiated by the debtor. However, proceedings may also be initiated by the creditors forcing a debtor into Chapter 11 if they violate certain legal standards,

[101] Maja Garaca, "Ivica Todorić submits complaint to EC over Lex Agrokor" (11 January 2018). https://seenews.com/news/ivica-todoric-submits-complaint-to-ec-over-lex-agrokor-597415#sthash.lXEqOQiu.dpuf. Accessed 4 April 2018.
[102] Also known as 'Title 11 of the United States Code'.

such as failing to pay their debts as they fall due.[103] Under US bankruptcy law, the debtor will retain control and keep operating the business as a debtor in possession (DIP) during the bankruptcy proceedings, unless the court specially appoints a bankruptcy trustee for the case.[104] In any case, the DIP will remain under the supervision of the federal bankruptcy court. The court affords a degree of protection to the debtor in possession in restructuring, in addition to statutory protections such as automatic stay, which has the effect of preventing or delaying aggressive actions by creditors, such as collection attempts against the DIP after a bankruptcy has been filed.[105] In fact, the availability of protection under automatic stay is a compelling reason why some businesses experiencing severe financial distress may prefer Chapter 11 proceedings to alternatives such as an out-of-court restructuring.[106]

3.2 The Chapter 11 Reorganization Plan

A Chapter 11 plan is the method by which reorganization is conducted under Chapter 11 proceedings, allowing any party of interest to the bankruptcy to propose a plan. Afterwards, creditors vote on the plan, which is then put forward to the bankruptcy court for approval, upon which it becomes binding. In some cases, a reorganization plan may be approved by the court, even if a number of creditors objected to it, provided the plan meets requirements for a court-imposed cramdown.[107] After petition for bankruptcy and opening of Chapter 11 proceedings, protection from creditor's collection attempts under automatic stay starts to run, and the debtor

[103] 11 U.S.C. §§ 301, 303; in Steven L. Schwarcz. "Basics of Business Reorganization in Bankruptcy", 68 Journal of Commercial Bank Lending 36-44 (1985) (reprinted in Bankruptcy: A Special Collection from the Journal of Commercial Bank Lending 79-87 (1987)) 80.
[104] "11 U.S. Code § 1101 - Definitions for this chapter". Legal Information Institute. Cornell Law School. https://www.law.cornell.edu/uscode/text/11/1101
[105] "11 U.S. Code § 362 - Automatic stay". https://www.law.cornell.edu/uscode/text/11/362
[106] Yost, Keven. "The choice among traditional Chapter 11, prepackaged bankruptcy, and out-of-court restructuring." ETD Collection for Purdue University (2002) 1.
[107] Bloomberg Financial Glossary.

may begin negotiating a reorganization plan.[108] The effects of automatic stay will remain in place until the conclusion of the proceedings, unless it is waived by a decision of the bankruptcy court. Automatic stay may be waived after a hearing, on behalf of a particular creditor if that creditor satisfies specific legal requirements for lifting automatic stay.[109] The acceptance of a reorganization plan depends on voting by each impaired class of creditors, requiring the cast votes to encompass at least two-thirds of claims and one half of creditors.[110] The bankruptcy judge, may however at their discretion impose, or cram down a proposed plan, provided it is deemed to be reasonably fair toward the affected parties.[111]

3.3 Main Bodies in the Bankruptcy Proceedings

i. Bankruptcy Courts

Bankruptcy cases in the US are handled by federal bankruptcy courts, which function as a division of United States district courts, with subject-matter jurisdiction over bankruptcy matters. The district courts possess original and exclusive jurisdiction over all cases which arise under the Bankruptcy Code.[112] There are bankruptcy courts for each judicial district in the US, with 90 bankruptcy district in the United States in total.[113] A US bankruptcy judge is a judicial official of the district court and decides on matter connected with the bankruptcy case, such as grounds for filing and whether a debtor should be discharged of its debts.[114] Since most of the work in a

[108] 11 U.S. Code §362(a).
[109] 11 U.S. Code §362(d).
[110] Yost, 5-6.
[111] Ibid.
[112] 28 U.S.C. § 1334(a)
[113] "Process - Bankruptcy Basics." United States Courts. https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/process-bankruptcy-basics. Accessed 4 April 2018.
[114] Ibid.

bankruptcy case is administrative, most of it is conducted by the bankruptcy trustee, who may sometimes be appointed by the judge in Chapter 11 cases.[115]

ii. The Bankruptcy Trustee

Bankruptcy trustees in the US are officially called United States Trustees and are appointed by the US Attorney General. The duties of the U.S. Trustee in a Chapter 11 bankruptcy case are set forth in Title 28 of the U.S. Code, titled 'Duties; supervision by Attorney General.'[116] The main role of the US bankruptcy trustee is to take up and perform the administrative responsibilities for the bankruptcy judge, who in turn performs judicial duties.[117] Additionally, the bankruptcy trustee monitors the progress of Chapter 11 cases and has the authority to act in order to prevent delay.[118] The trustee also submits reports and comments on proposed reorganization plans to the bankruptcy judge.

ii. The Creditors' Committee

One of the first actions undertaken by a bankruptcy trustee assigned to a case is to appoint a creditors' committee. The Bankruptcy Code specifies that members of the committee should usually include those creditors holding the seven largest claims in the case. These will typically include representatives of banks, insurance company lenders, and trade creditors, who may clash due to differing interests.[119] However, the trustee will in practice try to balance the committee by also including representatives from the other claims in the case. In fact, it is not uncommon to have twelve or more members in a creditors' committee in more complex bankruptcy cases.[120]

[115] Ibid.
[116] "28 U.S. Code § 586 - Duties; supervision by Attorney General". https://www.law.cornell.edu/uscode/text/28/586
[117] 28 U.S. Code § 581
[118] 28 U.S. Code § 586(a)
[119] Schwarcz, 81; For example, representatives of banks typically prefer to recover claims quickly by liquidating the debtor, while trade creditors might prefer to preserve the debtor as a going concern, especially if it is a major customer.
[120] Id.

Sometimes multiple creditors' committees may be formed, in cases of certain creditors' claims being contractually subordinated to other, more senior claims against the debtor. In that case, the holders of the subordinated claims may petition the bankruptcy judge to form a separate committee in order to adequately represent their interests.[121] Although technically each creditor has a right to be heard in the proceedings, the bankruptcy judge will be more inclined to listen to the position of a creditor's committee. Under the Bankruptcy Code, a creditors' committee may hire legal counsel, accountants, and business advisors.[122] The former may contribute greatly to the persuasive power of a creditors' committee and the fees and expenses incurred will be financed from the debtor's estate directly.[123]

3.4 Prepackaged Bankruptcies

Prepackaged bankruptcies appeared relatively recently as a sort of hybrid form, combining some of the best advantages of Chapter 11 bankruptcy proceedings and workouts.[124] These advantages include the benefits of cost-efficiency, speed, flexibility and cooperation found in workouts, combined with the statutory provisions such as voting thresholds and cramdown.[125] While a prepack offers an effective way of implementing financial restructuring, it is not as useful for businesses seeking operational restructuring, which often involve more complex disputes and creditor relationships.[126] Prepacks require a substantial level of planning and work in order to be ready before Chapter 11 filing.[127] A prospective debtor must utilize the expertise of legal counsel,

[121] Schwarcz, 82.
[122] 11 U.S. Code § 1103(a)
[123] Schwarcz, 82.
[124] McConnell JJ and Servaes H. "The Economics Of Prepackaged Bankruptcy" (1991) 4 Journal of Applied Corporate Finance 93-98.
[125] John D. Ayer, Johnathan P. Friedland and Michael L. Bernstein, 'Out-of-court Workouts Prepacks and Pre-arranged Cases A Primer' Apr 2005. ABI Journal. https://www.abi.org/abi-journal/out-of-court-workouts-prepacks-and-pre-arranged-cases-a-primer. Accessed 4 April 2018.
[126] Steven Krause, A Practitioner's Guide to Prepackaged Bankruptcy 19; McConnell and Servaes 94.
[127] Krause, 20.

financial advisors and other professionals in order to engage with creditors whose claims a proposed prepack plan will affect.[128] Sometimes financial creditors, especially banks, may form committees in order to act in concert, but also making it easier for the debtor to work with them on negotiating a plan.[129] Prepackaged bankruptcies are superficially similar to pre-negotiated Chapter 11 bankruptcies; in both cases, the debtor negotiates prior to a Chapter 11 filing and reaches an agreement with its majority creditors on the terms of a reorganization plan[130] The Bankruptcy Code allows bankruptcy courts to recognize votes solicited before a bankruptcy filing.[131] Under a pre-negotiated reorganization plan, the debtor may impair or solicit classes of unsecured creditors other than lenders and noteholders. Furthermore, the solicitation of votes on the plan will not take place until after the prospective debtor has filed for Chapter 11 and the disclosure statement of the plan has been approved by the bankruptcy court. Therefore, a pre-negotiated Chapter 11 case lacks the benefit of certainty regarding the outcome of voting on the reorganization plan.[132] In theory, the relative shortness of time spent in bankruptcy in a prepack case will be cheaper and less damaging to the prospective debtor than a Chapter 11 case.[133] This is important for some types of businesses, such as retailers, whose reputation may become tarnished if they spend too much time in bankruptcy.[134] It is in the interest of such businesses to spend as little time in bankruptcy proceedings as possible, which is why they may opt for a prepackaged case instead. There are instances when prepacks may not be the right option. For example, if there are hundreds of smaller creditors and little concentration of debt, it is unlikely that a prepack agreement would be successful.[135] Prepacks are mainly suited for debtors with smaller groups of creditors, such as bondholders, and where the debt is fairly concentrated, making

[128] Krause, 21.
[129] Ibid.
[130] Krause 7.
[131] 11 U.S. Code § 1126(b); 'Out-of-court Workouts Prepacks and Pre-arranged Cases A Primer'.
[132] Krause 8.
[133] 'Out-of-court Workouts Prepacks and Pre-arranged Cases A Primer'
[134] Ibid.
[135] Ibid.

it easier to come to an agreement.[136] In practice, companies who go through successful prepackaged bankruptcies already had all the necessary prerequisites for a workout agreement before opting for a prepackaged plan.[137]

3.5 Out-of-Court Restructuring

In recent times, more and more companies are opting for alternatives to formal bankruptcy proceedings. The most prominent among these alternatives are out-of-court restructurings or workouts (OOCR/OOCW), which allow distressed companies to reach a workout agreement with creditors without having to go to a bankruptcy court. Although no international legal framework for OOCR exists, many countries have included provisions in their bankruptcy laws to allow for this option prior to bankruptcy proceedings. Conversely, many jurisdictions also provide for specialized pre-bankruptcy procedures, in order to allow debtors to restructure their debt outside of bankruptcy proceedings, although still requiring court approval of the restructuring plan.

Outside of the scope of the federal bankruptcy system, state law in the United States provides for informal non-judicial procedures which include debtor-creditor negotiation.[138] These procedures, known as out-of-court restructurings or corporate workouts, involve the reorganization of a commercial debtor's business and financial affairs. However, the reorganization is negotiated and implemented outside formal judicial proceedings, and without the need for assistance or approval from a bankruptcy court.[139] The debtors, creditors as well as the main shareholders and bondholders voluntarily participate in such workouts in order to make rearrangements concerning financial investments and rescheduling or restructuring debt. A substantial level of cooperation

[136] Ibid.
[137] McConnell and Servaes 97.
[138] Lawrence P. King, and Michael L. Cook. Creditors' Rights, Debtors' Protection, and Bankruptcy 3rd Edition. (New York: M. Bender, 1997), 93-97, in *Comparative Bankruptcy Law*, Prof. Tibor Tajti, CEU Department of Legal Studies (2017) 51.
[139] Ibid.

between creditors is a vital precondition for the success of such a restructuring, as workouts are entirely dependent on the voluntary agreement of the creditors.[140] Conversely, this also means that workout agreements are ineffective against non-assenting creditors, also known as 'holdouts'.

Creditors may be receptive to workout agreements because this means the suppliers of goods and services will be able to continue dealing with the debtor as a customer. Creditors may also obtain some measure of control over the debtor's future operations as part of the agreement. Secured creditors may be placated to an extent by having continued use of inventory-collateral in place of direct debt payment. Another reason is that workouts are more popular in certain industries, which have associations specialized in helping with workouts. In the US workouts tend to be especially popular with small and mid-scale enterprises which have relatively few creditors. Creditors expect to see greater returns in less time, as opposed to going to court. Workouts are especially popular with debtors who have a small of medium-sized business with relatively few creditors, usually numbering less than thirty creditors.[141] At least one study found that, despite efforts to introduce reforms to Chapter 11 proceedings to make them more conducive for reorganizing small and mid-scale enterprises, the use of Chapter 11 proceedings by SMEs did not increase on because of high costs, excessive influence of secured creditors, monitoring difficulties, and other procedural obstacles.[142] Opting for an OOCR provides debtors and creditors with an opportunity to avoid a wasteful liquidation. In this case, creditors might stand to gain more benefit in the long run by keeping the debtor as a going concern. When a forced liquidation occurs, not only will creditors be affected, but also stockholders and partners. In workouts, two main concepts were developed to rescue struggling debtors: composition agreements, and extensions, otherwise known as moratoriums. A composition agreement allows a debtor to make partial payment in full satisfaction

[140] Ibid.
[141] Ibid.
[142] Referring to the study conducted by Thomas Small on behalf of the National Bankruptcy Conference (2010), "Could Bankruptcy Reform Help Preserve Small Business Jobs?"; in Wolfgang Bergthaler, Kenneth Kang, Yan Liu, and Dermot Monaghan, 'Tackling small and medium sized enterprise problem loans in Europe', IMF (March 2015).

of the accepting creditor's claims; while a moratorium or 'extension' provides for the creditor's postponing of enforcement of their claims, receiving full payment over a period of time.[143] In the US, both techniques may be used simultaneously, but require the agreement of the debtor and at least two creditors due to a common law contract rule which says that one creditor cannot be bound by an agreement to accept less than the full amount of its claim.[144] Using a combination of both OOCR and Chapter 11 proceedings based on the concept of a 'revolving-door bankruptcy' is also common; in fact, the Bankruptcy Code encourages workouts, with refuge in bankruptcy being seen as a last resort for the debtor.[145]

i. OOCR vs. Chapter 11 Proceedings

Although workouts are generally cheaper in terms of direct and indirect costs in comparison to Chapter 11 bankruptcy proceedings, they are not without their own deficiencies. In the simplest terms, the goal of a workout is to improve the financial condition of the debtor in order for them to be able to successfully service their debt. However, in order for this plan to work, all creditors have to make certain concessions on a *pari passu*[146] basis, such as reducing or writing-off a portion of the debt, providing extensions, parceling out payments and so on. The minimum required for a workout to work is for the creditors with the largest share of debt to participate in the workout agreement, but generally - the greater the number of creditors participating in and making these types of concessions, the better the debtor's position will be upon completion.[147] One major problem is what to do in a situation where, while creditors would collectively be better off under a workout agreement, one party will be even better-off if they decline to participate in the agreement.[148] These 'free riders' are creditors that do not contribute to a restructuring but

[143] King and Cook (n137).
[144] Ibid.
[145] King and Cook (n50) 95.
[146] Meaning 'on an equal footing'.
[147] Clifford Chance and Rick Antonoff. "Out-Of-Court Debt Restructuring And The Problem Of Holdouts And Free Riders." Metropolitan Corporate Counsel 21, no. 10 (October 2013): 17.
[148] Squire 36-37.

obtain the benefit of a financially healthier debtor at the expense of those creditors that made concessions.[149]. Holdouts are thus creditors that are in a position to block a restructuring and use that leverage to extract additional value for themselves.[150] Such creditors will usually take their chances, hoping to have enough leverage to be repaid in full without giving away any concessions, while other creditors take up the burden of making concessions instead. Problems arise when the other creditors decline to pay the holdout. In such a situation, the restructuring will fail and the debtor will be forced to either liquidate or commence formal bankruptcy proceedings. These collective-action problems arise from changes in the debt-equity or 'leverage' ratio of a company; that is, when a company's owners decide engage in borrowing to boost investments, increasing risk, but also expecting significantly higher returns.[151] Forcing a holdout to participate is often a considerable challenge in a workout. In addition to automatic stay, a Chapter 11 filing offers the dual advantage of the voting threshold and cramdown provisions, with which to bind dissenting creditors. In some cases, debtors seeking a workout agreement have even used the threat of Chapter 11 filing to persuade holdouts.[152] However, even in workouts, participating creditors may persuade a holdout to cooperate by exerting pressure on them if the participating creditors conduct other business with the holdout. For example, if a holdout in one case is a participating creditor in another case and requires the cooperation of the other creditors in the next restructuring, they will be more likely to want to participate.[153] Moreover, one way that parties involved may prevent holdout problems altogether is to include special clauses in debt agreements. For example, certain types of bond indentures may stipulate that holders of a majority or supermajority of the bonds may amend the indenture in order to make all bondholders bound by it.[154] Another advantage in workouts is that debtors may avoid any stigma attached to a bankruptcy filing. Despite a

[149] Chance and Antonoff 17.
[150] i.e., payment in full from the debtor, other creditors or a hedge counterparty (metrocorpcounsel.com).
[151] Chance and Antonoff 17.
[152] McConnell and Servaes 95.
[153] Ibid.
[154] Squire 37.

comparatively low bankruptcy stigma in the US, Chapter 11 bankruptcy proceedings may still sometimes damage relations necessary to keep the business alive; customers are reluctant to deal with a manufacturer who may not survive to honor the warranty of his product or with the lessor who cannot guarantee the habitability of their premises.[155] Additionally, when word of the debtor's financial difficulty spreads, their own debtors will often decline to pay as promptly as they normally would. Furthermore, legal costs are especially high in cases when the bankruptcy court must assign a value to the debtor's assets. If the court is required to enforced the absolute priority rule in a reorganization plan, the valuation will more likely than not be disputed and will lead to lengthy proceedings involving litigation between creditors, with the accompanying expenses of hiring legal counsel and experts.[156] One study estimated that the direct costs of Chapter 11 proceedings may equal between 1 and 7 percent of debtor's assets, while indirect costs reduced the value of an average debtor's assets by up to 13 percent.[157] Due to such disadvantageous costs, creditors should weigh whether the advantages offered by the voting threshold and cramdown provisions in Chapter 11 justify the potential costs of the proceedings.

ii. OOCR vs. Prepackaged Bankruptcies (Prepacks)

Like OOCRs, pre-packaged bankruptcies, or prepacks, are essentially restructurings which are conducted outside of a bankruptcy court. However, the difference is that prepacks must be confirmed by a bankruptcy court and go through what amounts to a shortened bankruptcy procedure.[158] There are some advantages that prepacks have over OOCW, primarily revolving around the protection and creditor-binding mechanisms available under the Bankruptcy Act.[159] Debtors considering a financial restructuring may therefore opt for prepacked bankruptcy in order

[155] King and Cook 93-97.
[156] Richard Squire. Corporate Bankruptcy and Financial Reorganization. (New York: Wolters Kluwer, 2016) 35-36
[157] Ibid.
[158] Steven C. Krause, 'A Practitioner's Guide to Prepackaged Bankruptcy', American bankruptcy Institute (2011) 12
[159] Ibid.

to avoid the difficult hurdle of getting individual creditors to agree on a workout plan.[160] Prepacks allow the debtor to take advantage of the Bankruptcy Act's class voting threshold and cramdown provisions in order to bind them to the debtor's proposed plan.[161] This has the effect of eliminating dissenters and essentially solving the holdout problem, which would otherwise present a significant obstacle in reaching a workout agreement. Directors and officers of a debtor business may prefer prepacks to OOCR in that their plan of restructuring would have the added authoritative weight of official approval by a bankruptcy court, possibly providing additional exculpations and releases.[162] Depending on the debtor company's tax attributes, a prepackaged bankruptcy may offer additional tax benefits, including retaining tax loss carryforwards, and eliminating cancellation-of-debt (COD) income taxes, which would be unavailable under an OOCR.[163]

3.4 Recent Developments

Prominent reorganization cases, such as the General Motors prepackaged Chapter 11 case[164], have contributed to a gradual shift towards reforming existing US Bankruptcy Law. A 2015 report by the American Bankruptcy Institute's commission on recommending possible reforms to Chapter 11. [165] The report, spanning over 400 pages, recommended a significant overhaul of the federal bankruptcy system, focusing on the role of secured creditors in large Chapter 11 cases, including some recommendations on how to constrain the former's rights.[166] Furthermore, in the recent LTV

[160] Ayer, John D. and others. 'Out-of-court Workouts Prepacks and Pre-arranged Cases A Primer' Apr 2005. ABI Journal. https://www.abi.org/abi-journal/out-of-court-workouts-prepacks-and-pre-arranged-cases-a-primer. Accessed 4 April 2018.
[161] Krause, 12; 11 U.S. Code §§ 1126(c), 1129(b).
[162] Krause, 12.
[163] Krause, 12; McConnell JJ and Servaes H. "The Economics Of Prepackaged Bankruptcy" (1991) 4 Journal of Applied Corporate Finance 93-98.
[164] Warner B, "Reconciling Bankruptcy Law and Corporate Law Principles: Imposing Successor Liability on GM and Similar 'Sleight-of-Hand' 363 Sales" (2016) vol 32, Emory Bankruptcy Developments Journal 538-574.
[165] Kobi Kastiel, "ABI Commission to Study the Reform of Chapter 11 Report" (January 4, 2015). https://corpgov.law.harvard.edu/2015/01/04/abi-commission-to-study-the-reform-of-chapter-11-report/. Accessed 4 April 2018.
[166] Ibid.

bankruptcy case, the court held that, for the purposes of a claim in bankruptcy, bondholders who participated in a swap could only value their bonds at the discounted value, and not their face value.[167] This ruling may lead to a worsening of the so-called holdout problem in informal workout agreements, which may also lead to a rise in prepackaged cases.[168] This development According to some financial economists, because private reorganizations are much less expensive than formal bankruptcy proceedings, there may be a rise in the 'privatization of bankruptcy,' and the rise in popularity of prepackaged bankruptcies may be seen as one of the argument in support of this trend.[169]

4. Conclusion

In its 2015 Financial System Stability Assessment, the IMF made several recommendations towards reforming the bankruptcy framework in Bosnia and Herzegovina, such as measures to introduce incentives to initiate proceedings early, but also to expand the bankruptcy framework to cover businesses run by individuals, such as SMEs.[170] The report also stressed a need to streamline execution procedures, introduce incentives to facilitate corporate debt restructurings and resolution, and to adopt out-of-court restructuring guidelines.[171] Furthermore, with regard to the endemic slowness of the bankruptcy proceedings, the report stated that an effort should be made to improve the institutional framework by hiring more commercial court judges with relevant experience and improving the mechanisms for regulation of the bankruptcy profession.[172] The

[167] PBG Corp. v. LTV Corp., 496 U.S. 633 (1990) in McConnell and Servaes, 95.
[168] McConnell and Servaes, 96.
[169] McConnell and Servaes, 97.
[170] "Press Release: IMF Executive Board Approves Bosnia and Herzegovina's 2015 Financial System Stability Assessment." International Monetary Fund (July 2015). https://www.imf.org/en/News/Articles/2015/09/14/01/49/pr15327. Accessed 3 April 2018.
[171] Ibid.
[172] Ibid.

report also concluded that all of the mentioned deficiencies in the bankruptcy and judicial framework contribute to the proliferation of non-performing loan crisis which further exacerbates economic instability in the country.[173] It should be noted that these problems are in no way unique to Bosnia and Herzegovina which had an overly complicated legal and political structure. Similar problems are present globally in transition countries, of which Bosnia and Herzegovina is one, but like other transition countries the most beneficial course of action is to enact reforms targeting key issues present in existing domestic law, but also by learning from experiences of other states in transition, as well as from developed countries' bankruptcy systems.

Croatia and Bosnia and Herzegovina have many common problems caused by similar inefficiencies in their bankruptcy systems, including the aforementioned issues with non-profitable loans.[174] The United States bankruptcy framework serves as an example of a highly developed system, however in this particular case, wholesale adoption of certain concepts from its particular bankruptcy culture to Bosnia and Herzegovina or Croatia would be awkward, due to vast cultural and developmental differences. Bosnia can learn far more effectively from the example of Croatia than the United States, in terms of short-term reform goals. Already, the introduction of reforms partially modeled on the Croatian example after is working, as seen in the example of Republika Srpska's new Law on Bankruptcy. In both examples, of the RS law and the Croatian Pre-Bankruptcy law, it was demonstrated how early restructuring can help debtors keep operating and stay in business. More such companies surviving as going concerns means more jobs are kept and less proliferation of non-profitable loans, which is a definite step in the right direction. Some concepts and institutes from US Bankruptcy Law could perhaps be of great help in the two other jurisdictions, if domesticated properly. A provision similar to automatic stay would be very useful

[173] Ibid.
[174] "Croatia must create framework for out-of-court NPL restructuring – EBRD." https://seenews.com/news/croatia-must-create-framework-for-out-of-court-npl-restructuring-ebrd-548088#sthash.tGVfhry1.dpuf. Acessed 4 April 2018.

in both Croatia and Bosnia and Herzegovina, where aggressive collection attempts by major creditors often lead to business liquidation and other creditors being left with little to nothing from their claims.

On the track of recommendations by international institutions, OOCR as a long term solution, could be introduced into Bosnia and Herzegovina. However, if workouts function as a flu shot or antibiotic to widespread liquidations, the problem of inadequate bankruptcy proceedings still remain. As not every company may have the necessary prerequisites for a workout agreement, introducing pre-bankruptcy procedure, may serve as a viable fail-safe. Additional experience may be required in order to get both bankruptcy practitioners and. One downside to an increase in debt restructuring cases is an overall increase of cases in court, as well as less debt collection by creditors. A possible solution may lie in adopting new legal and business practices and reforming bankruptcy laws in accordance with needs of the domestic market and local cultural mores. OOCR and debtor-in-possession culture is slowly being introduced into the European legal tradition, but there are still significant challenges to be overcome, from complex private international law, to simple linguistic matters. Some European languages, for example, don't have an equivalent to the English term 'debtor in possession' and must invent new definitions. Recently, the European Commission has drafted a proposal for a directive[175] which some have called the EU's answer to Chapter 11.[176] The Directive includes measures including the implementation of a preventive restructuring framework, the concept of a second chance for entrepreneurs, and introducing measures to raise the efficiency of restructuring, bankruptcy and second chance more generally.

[175] Proposal for a Directive of the European Parliament and of the Council on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency and Discharge Procedures and Amending Directive 2012/30/EU [2016] COM/2016/0723 final - 2016/0359 (COD). http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016PC0723&from=EN. Accessed 3 April 2018.

[176] Freshfields Bruckhaus Deringer, "Europe's answer to Chapter 11?" (23 November 2016) http://knowledge.freshfields.com/m/Global/r/1719/europe_s_answer_to_chapter_11_. Accessed April 4 2018.

Croatia could benefit from the Directive in the future by being part of this framework, as would Bosnia and Herzegovina after its accession to the European Union in the future.

In summation, in order to alleviate the problems caused by inadequate bankruptcy laws and practices, there should be an introduction of the concept of workout agreements and domestication of OOCR culture in Bosnia and Herzegovina, as well as Croatia. There exists a need for more skilled financial mediators, as well as need to educate practitioners and train local experts on OOCR culture, as well as to raise public awareness, in order to successfully embed the idea of restructuring as a common practice, and not as a rarity in situations financial distress. Both Croatia and BiH can benefit from creating a domestic OOCR framework in the long term, as well as to reform their existing bankruptcy legislation in line with international developments. Future participation in EU bankruptcy reform and harmonization of bankruptcy provisions may also lead to a future boom in business in the SEE region, as foreign companies will become more attracted to markets which have a firm bankruptcy framework and a developed system of debt restructuring.

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