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Legal possibilities concerning restructuring of companies in business difficulties

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Abstract

Since difficulties during business are an integral part of entrepreneurship, the Croatian legislative offers several restructuring models for companies who have business issues. The pre-bankruptcy agreement is available in cases when the debtor is threatened by insolvency and during this procedure, the business of the company is still managed by the existing management board. However, it is necessary that the pre-bankruptcy procedure is finished within a short deadline. The bankruptcy procedure is commenced on grounds of over-indebtedness and when in a state of incapacity to make payments, Future business is managed by the insolvency practitioner. The extraordinary administration procedure in companies of systemic importance for the Republic of Croatia is initiated in cases where large enterprises are faced with bankruptcy or pre-bankruptcy reasons. During this procedure, the business of the parent-company is conducted by the extraordinary trustee. Each of the aforementioned procedures (models) has its specifications and legal consequences for all stakeholders involved (debtor, management board and creditors). This paper will use the comparative legal research methodology to analyze the differences between them: the grounds for commencing the procedures, continuing company’s business operations, deadlines and the aftermaths for the creditors and shareholders of the company. The focus of the paper will be to demonstrate that each procedure can preserve financially positive business of the companies in problems.

Several legal models should enable timely restructuring of companies, which can secure the safety of sustainable businesses and help create and maintain employment, while also can reduce the risk in the finance sector connected with converting loans to poor credits. However, the success of the negotiations with relevant stakeholders, namely creditors, and the percentage of creditor’s payment returns largely depend on early detection of business problems and prompt opening of appropriate proceedings.

Keywords: insolvency, bankruptcy, pre-insolvency, restructuring in bankruptcy, extraordinary administration

JEL Classification: K220, K200, L530

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1. INTRODUCTORY REMARKS

Conducting business and company growth always poses a risk and, additionally, the business
environment is constantly generating new threats to entrepreneurship. Seldom exist entrepreneurs
who, on a long enough timeline, do not face a business crisis. If the crisis is not swiftly dealt with,
it could ultimately lead to business failure and termination of the company. The aforementioned
problems have been detected by legislators and they made early restructuring of a company
possible- even without entering the bankruptcy procedure- in accordance with European
Commission Recommendation from 12th of March 2014 on a new approach to business failure
and insolvency. ¹

The current Bankruptcy Act² regulates the pre-bankruptcy procedure³ which is initiated when the
debtor is facing insolvency. If that is the case, the business of the company is still managed by the
existing management board, while the procedure itself has to be finished within a short deadline.
This procedure does not last long and only demands an agreement between the debtor and creditors
prior to initiating the judicial part of the procedure so that the parties can conclude a settlement in
a short time period.⁴

After the bankruptcy procedure is initiated, the bankruptcy creditors have a possibility to start the
restructuring by enacting a bankruptcy plan. However, enacted bankruptcy plans are a rarity in
practice⁵. In addition, it can be argued that the regulations regarding the bankruptcy of connected
companies⁶ are inadequate and vague.⁷ The argumentation for this is that the law stipulates
territorial jurisdiction, the existence of a creditor assembly and a creditor board and one insolvency
estate. Also, it regulates that claims between connected legal persons end and that the eventual
surplus after the final division is proportionally split between connected companies in depending
on how much each of the connected companies provided for the insolvency estate. Hence these
dules do not address numerous other issues of the bankruptcy of connected companies, nor whether
one or more insolvency practitioners are appointed. In addition, the BA has explicitly introduced
a limitation on the duration of the debtor's business because the law notes that the continuation of

² Bankruptcy Act (in Croatian: Stečajni zakon) Official Gazette 71/15, further in text: BA.
zakonu, Pravo i porezi, vol. 24, n. 7-8, pp. 3.-12.
⁴ The regulations indeed are, though brief, in line with the 2014 recommendations. The recommendations haven’t
produced the wanted results, therefore in 2016 the European Commission proposed new rules in the form of the
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
content/EN/TXT/?uri=CELEX:52016PC0723
⁵ See: Sajter, Domagoj (2010) Procedura i praksa restrukturiranja u stečaju u Republici Hrvatskoj, Zbornik Pravnog
⁶ Article 391 of BA.
⁷ For further reading on bankruptcy proceedings against connected companies see Garašić, Jasnica (2017)
pp. 175 - 176.
the business is permitted for a maximum of one and a half year starting from the day of the
reporting hearing unless a bankruptcy plan has been submitted to the court.\(^8\)

The lack of existing legal solutions had obviously motivated the legislator to pass a new law\(^9\) that
would urgently address the issue of restructuring a large-scale entrepreneur who is in difficulty. However, as it has been decided to create a new law only for this specific case\(^10\), a large number of new legal issues are opened, which could result in a significant number of special litigation.

Namely, the EAPA -in some parts- invokes the subordinate application of Bankruptcy Act and the
basic rule is that the procedural rules are applied unless regulated otherwise by the EAPA.\(^11\) In this
case, the motive was probably the different purpose of the proceedings because the purpose of the
bankruptcy proceedings is to reimburse the creditors of the bankruptcy debtor, the liquidation of
his assets and the distribution of funds collected to the creditors\(^12\), while the EAPA was adopted
in order to protect the business sustainability of companies of systemic importance for the Republic
of Croatia which- independently or together with their dependent or affiliated companies- impact
the overall economic, social and financial stability in the Republic of Croatia.

As these three procedures have similarities and differences,\(^13\) the conditions for initiating the
procedures, conducting business, time frames and consequences for the creditors of that company
and shareholders of the capital will be presented for each of these procedures and compared. It is
important to note that each of these procedures is able to ultimately preserve an economically
profitable business.

2. PRE-BANKRUPTCY SETTLEMENT

A pre-bankruptcy procedure is conducted to regulate the debtor's legal position and his relationship
with creditors and the maintenance of his business. In the bankruptcy and pre-bankruptcy
proceedings the debtor may be a legal person (company) as well as the debtor's assets where a

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8 Article 217(3) of BA.
9 Extraordinary Administration Procedure in Companies of Systemic Importance for the Republic of Croatia Act (in
Croatian: Zakon o postupku izvanredne uprave u trgovačkim društvima od sistemskog značaja za Republiku Hrvatsku), Official Gazette 32/17. Further in text: EAPA.
10 As the extraordinary administration is a new type procedure it has impact on European regulations. In order to apply
conditions have to be met. First, the procedure has to be a bankruptcy procedure which will as a consequence have a
partial or complete sale of debtor's assets and the appointment of an insolvency practitioner. The second condition is
that it has to be a procedure which is explicitly listed in Annex A of the Regulation. The same definition is in the new
Regulation 2015/848 (OJ EU L 141/19, 2015, pp. 19–72) which is in force since 26th of June 2017. Since the Republic
of Croatia opted for the bankruptcy procedure only in the Annex A of the Regulation, other procedures do not fall
under the rules of the Regulation. For further reading see: Garašić, Jasnica (2005) Europska uredba o insolvencijskim
11 Article 8 of EAPA.
12 Article 2(2) of BA.
13 Bankruptcy law terms are discussed in: Sajter, Domagoj, Hudeček, Lana (2009) Temeljni pojmovi i nazivi
debtor is a natural person. However, these proceedings can not be carried out against the Republic of Croatia and the funds financed from the state budget of the Republic of Croatia, the Croatian Health Insurance Institute, the Croatian Pension Insurance Institute and local and regional self-governments. In addition, the pre-bankruptcy process can not be carried out over a financial institution, a credit union, an investment fund and an investment fund management company, a credit institution, an insurance and reinsurance company, leasing company, a payment institution and an electronic money institution.

A pre-bankruptcy procedure may be opened if the court determines the existence of an imminent insolvency. The imminent insolvency exists if the court believes that the debtor will not be able to meet his existing obligations on maturity. A presumption that there is an imminent insolvency will apply if there are no circumstances that the debtor is facing imminent insolvency and if:

- the debtor has one or more registered unfulfilled grounds for payment in the Registry of scheduled grounds for payment led by the Financial Agency which, on the basis of valid grounds of payment, should have been paid without any further consent of the debtor from any of his accounts or;

- the debtor fails to pay wages for a period of more than 30 days the employee is entitled to in accordance with the Employment Agreement, Labour Ordinance, Collective Agreement or any special regulation that is any other act regulating the obligations of the employer to the employee or;

- the debtor fails to pay contributions and taxes to the wages referred to in sub-paragraph 2 of this paragraph, within 30 days counting from the day when the wages were required to be paid to the employee.

2.1. PROPOSAL SUBMISSION AND OPENING OF THE PROCEDURE

A proposal for the opening of pre-bankruptcy procedure, that cannot be withdrawn, shall be filed to a court using a prescribed form by the debtor or creditor if the debtor agrees to it. Along with the proposal financial statements, draft of the negotiations with the creditors, evidence of the assets and income of the company and the restructuring plan are submitted.

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14 Debtor as a natural person is a natural person who is obligated to pay the tax for independent profession as regulated in the Income Tax Act and a natural person who is obliged to pay the corporate income tax as regulated in the Corporate Income Tax Act.

15 However, they may be subject to bankruptcy procedure.


18 For further discussion on the problem of pre-bankruptcy reasons (ground) see: Dika, Mihajlo (2016) Predstečajni postupak, Pravo u gospodarstvu, n. 3, pp. 372-377.

19 The contents of the plan are regulated in Article 27 of BA.
The bodies of the pre-bankruptcy procedure are the court\textsuperscript{20} and the trustee\textsuperscript{21}. The trustee is obliged to: examine the debtor's business; examine the list of debtor's assets and liabilities; examine the credibility of reported claims; challenge claims if he, on the basis of a creditor's statement or for some other reason, suspects their existence. Furthermore, he has the obligation to supervise the debtor's business- in particular the financial business of the debtor, the creation of obligations towards third parties, the issuance of payment security instruments and the sale of goods or services, while ensuring that the debtor's property is not damaged; file a claim to the court if the debtor acts contrary to the rules on eligible payments; issue warrants and claim certificates that can be enforced during the pre-bankruptcy procedure; oversee that the costs of the pre-bankruptcy procedure are paid on time and in full; perform other tasks. However, irrespective of the appointment of a trustee, the debtor's business is managed by the existing management. Furthermore, during the pre-bankruptcy procedure the holders of capital still retain all rights, so they must agree to any changes in the subscribed capital.\textsuperscript{22}

The petitioner is obliged to pay the advance for the costs of the pre-bankruptcy procedure in the amount of HRK 5,000.00 and submit all the necessary documentation\textsuperscript{23} with the proposal. The procedure must be completed within 120 days from the submission of the proposal. The court may exceptionally allow an extension of the deadline for a further 90 days if the court considers it appropriate in order to conclude the pre-bankruptcy agreement.\textsuperscript{24}

If the court finds that the prerequisites for the opening of the pre-bankruptcy procedure are met, it will issue a ruling on the opening of the pre-bankruptcy procedure\textsuperscript{25} in which the trustee will be appointed, if the court considers it necessary and will publish it on the court’s E-Notice Board web page. With this ruling, the creditors are invited to file their claims within 15 days of the date of publication of this ruling to the Financial Agency’s competent unit. Also, creditors are invited to dispute, within eight days from the date of publication of statements on the claims by the debtor and the trustee (if appointed), claims that they consider being non-existent, with a mandatory indication of the amount for which the claim is contested and the reasons for the dispute. Furthermore, the ruling calls upon the debtor and the trustee (if he has been appointed) to submit a written statement regarding each reported claim to Financial Agency’s competent unit within eight days of the publication of the table with reported claims. In the statement, they have to report whether or not they recognize or dispute the claims with the mandatory indication of the amount for which the claim is contested and the reasons for the dispute. Finally, the ruling invites the debtor to provide access to documents resulting from the claims listed in the asset and liability list to the creditors and the trustee (if appointed) and calls the debtor's debtors to pay their mature

\textsuperscript{20} The court decides on opening of the pre-bankruptcy procedure, names and dismisses the trustee, monitors his actions, monitors the Financial Agency, decides on confirmed and disputed claims, decides on discontinuance of the procedure and other issues.

\textsuperscript{21} Also see: Dika, Mihajlo (2016) Predstečajni postupak, Pravo u gospodarstvu, vol. 55, n. 3, pp. 367-425.

\textsuperscript{22} In the case of restructuring plan also containing a proposal that creditor's claims are to be transformed into shares of the company or that a recapitalization should be performed by investing into subscribed capital.

\textsuperscript{23} See Articles 26 and 27 of the BA.


\textsuperscript{25} An appeal against the court's ruling on opening of the pre-bankruptcy procedure may be filed by the person legally entitled to present the debtor or the sole debtor, while against the court's ruling against opening of the procedure may be filed by the proposer.
liabilities without delay and calls for a hearing to examine the claims. A restructuring plan is also announced with this ruling.\textsuperscript{26}

From the day when the proposal is submitted to the day when the ruling on the opening of the pre-bankruptcy procedure there is a restriction on the business. The debtor must not alienate and burden his assets and may only perform the payments necessary for regular business\textsuperscript{27} and must not meet the obligations incurred and due before the opening of the pre-bankruptcy procedure. Once the proceedings have been opened the debtor may alienate and burden his assets only on the basis of a prior approval of a trustee or a court if the trustee has not been appointed.\textsuperscript{28} Thus, during the pre-bankruptcy procedure, the business is run by the existing management of the company with certain restrictions.

2.2. DEBTOR’S CREDITORS

The pre-bankruptcy procedure does not affect the right of separate payment of secured\textsuperscript{29} and excretory\textsuperscript{30} creditors’ claims, employee claims and claims of former employees (in gross amount), severance payments up to the amount prescribed by law or Collective Agreement and claims on compensation for a work-related injury or professional illness. Also, the procedure does not affect the security measures in criminal proceedings and the taxation procedures regarding the determination of law abuse.

However, the opening of the pre-bankruptcy settlement procedure affects the creditors, i.e. the entities who at the time of opening of the proceeding have a claim against the debtor. They must report their claims that were incurred up to the day of the opening of the proceedings, and those

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\textsuperscript{26} For more on this institute see: Čuveljak, Jelena (2017) Predstečajna nagodba – nova pravila, stare navike, Pravo u gospodarstvu, vol. 56, n. 3, pp. 409-430. \\
\textsuperscript{27} It is considered that for regular business operations, necessary payments are gross payments for employees and former employees whose claims have matured to the date of the opening of the pre-bankruptcy procedure, severance payments up to the amount prescribed by law and collective agreement, claims on compensation for damages sustained by a work-related injury or professional sickness, or salary of an employee increased by the amount of contributions on the salary basis and other material rights of the employees in accordance with employment contracts and collective agreements that have matured after the submission of the proposals for opening a pre-bankruptcy procedure, payments for pre-bankruptcy procedure expenses and other payments necessary for regular business regulated by \textit{lex specialis}. \\
\textsuperscript{28} See also Galić, Ante (2015) Predstečajni postupak prema novom Stečajnom zakonu, in: Kuzmić, Marica (ed.), Reforma hrvatskog insolvencijskog prava – Novi Stečajni zakon, Inženjerski biro, Zagreb, pp. 77-104. \\
\textsuperscript{29} Secured creditors exclude other bankruptcy creditors up to the amount of their claims from the settlement of their repented claims from the value of things or rights on which the secured right is based. The pre-bankruptcy settlement may not intervene with the right of a secured creditor to settle his claims on the items on which the secured right is based, unless otherwise provided by the settlement. If a pre-bankruptcy settlement had indeed specified otherwise on the rights of secured creditors, it will elaborate in detail on which part of their rights are reduced, for how long the payment to them is postponed and which other provisions of the pre-bankruptcy settlement have impact on them. \\
\textsuperscript{30} Excretory creditors are not bankruptcy creditors and they do not settle their bankruptcy claims from the insolvency estate. Based on some property or personal right, they can prove that some object should not be in the insolvency estate. This right is based on the right of ownership of an excretory creditor on a particular item or right, or on the fact that a particular thing or right does not belong to the bankruptcy debtor’s property.
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claims may be exercised only in the framework of the pre-bankruptcy procedure. Therefore, those creditors lose the right to engage civil and enforcement proceedings against that debtor.

During the course of the procedure, all debtor's claims are determined and the court issues a ruling on established and disputed claims and after determining who the creditors are and how much their claims amount to, which leads to a voting on a decision whether or not the settlement will be accepted. In order for a particular pre-bankruptcy settlement to be adopted, it is necessary to be accepted via a so-called double confirmation. A double confirmation is met if- first- the majority of the creditors voted for it and- second- that in each group of creditors the sum of the claims of the creditors who voted for the plan twice exceeds the sum of the claims of the creditors who voted against accepting the settlement. If this is not the case, a delay of the hearing for up to 15 days may be requested once for a restructuring plan change.

If the creditors do accept the restructuring plan, the court will, by issuing a ruling, determine the acceptance of the restructuring plan and confirm the pre-bankruptcy settlement- unless any of the creditors make the reduction of rights below a reasonable measure plausible because of the restructuring plan, where the reasonable measure is below the level if they can reasonably expect to achieve more in the event of a failure to restructure the debtor's business; then if there is no likelihood that the implementation of the plan will enable the debtor to pay the debt up to the end of the current and the next two calendar years; then if the restructuring plan does not determine the amount of credit which would be paid to the creditors hadn’t their claim been successfully disputed; or it has been proposed to convert the claim of one or more creditors in the share capital of the debtor, and debtors’ members haven’t not (in compliance with the Company Act) made a decision to allow it. If the prerequisites for the ratification of the pre-bankruptcy settlement aren’t fulfilled, the court will issue a ruling stating that the pre-bankruptcy settlement is not confirmed and suspend the proceeding.

A confirmed pre-bankruptcy settlement has a legal effect on both creditors who have not participated in the proceedings and to creditors who have participated in the proceedings whose disputed claims are subsequently determined. Debtor’s profit from obligations which, on the basis of the pre-bankruptcy settlement have been canceled, has to be kept until the expiration of the deadline for paying all obligations determined in the pre-bankruptcy settlement. The creditor whose claim has been canceled by the pre-bankruptcy settlement notes the canceled claim as a tax-recognized expense.

3. BANKRUPTCY PROCEDURE

Bankruptcy (insolvency) procedure is a special type of non-contentious procedure which occurs when a debtor is no longer able to settle his mature obligations towards creditors. The pre-bankruptcy procedure is conducted before the opening of the bankruptcy proceedings, but if the

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32 This requirement is actually very demanding, and the practice demonstrated that achieving such a majority is in fact very difficult.
entrepreneur is in a state of incapacity to make payments\textsuperscript{34} or over-indebtedness\textsuperscript{35} then the bankruptcy procedure will be carried out.\textsuperscript{36} However, it is also possible to deviate from this goal and also carry out a bankruptcy plan during bankruptcy proceedings in order to regulate the legal position of the debtor and his relations with creditors, particularly in order to maintain the enterprise.

Thus, by opening bankruptcy procedure, the purpose of the proceedings is changed, since the primary goal is to satisfy the debtor’s creditors by liquidation of his assets and paying the creditors, while only if the creditors agree or if it is in their economic interest, they will decide on reaching an arrangement in a bankruptcy plan.

If the legal conditions have been met, a petition to commence insolvency proceedings may, however, be filed both by a debtor and by a person claiming to be a creditor\textsuperscript{37}, while the Financial Agency has an obligation to file a petition within eight days of the lapse of an uninterrupted period of 120 days in which the legal person has registered unfulfilled grounds for payment in the Registry of scheduled grounds for payment.

When the prerequisites for opening a bankruptcy procedure have been met,\textsuperscript{38} the court opens the procedure with a ruling. Many legal aftermaths follow, \textit{inter alia} all bodies of the company (management, supervisory board) cease their operations which are transferred to the insolvency practitioner.\textsuperscript{40} Also, all debtor’s accounts are shut down and all rights of persons who were authorized to use the assets of the debtor in those accounts. Furthermore, the insolvency practitioner has an obligation to take possession of and manage all assets entering the insolvency estate (bankruptcy estate).

After the opening of the bankruptcy proceedings, the firm name adds an “in bankruptcy” mark at the end, alongside the new account numbers through which the debtor's business is performed. Furthermore, the opening of bankruptcy proceedings is a particularly justified reason for termination of all employment contracts.\textsuperscript{41} By opening a bankruptcy procedure, former holders of business shares or shares in a company can no longer exercise their rights, except for the right to be handed over to the rest of the insolvency estate.\textsuperscript{42}

\begin{itemize}
\item \textsuperscript{34}The entrepreneur is in a state of incapacity to make payments:
  - the debtor has one or more registered unfulfilled grounds for payment in the Registry of scheduled grounds for payment led by the Financial Agency for a period of more than 60 days, which, on the basis of valid grounds of payment, should have been paid without any further consent of the debtor from any of his accounts or
  - the debtor fails to pay three consecutive to his employees, who are entitled to them in accordance with the Employment Agreement, Labor Ordinance, Collective Agreement or any special regulation that is any other act regulating the obligations of the employer to the employee or
\item \textsuperscript{35}The company is in a state of over-indebtedness when the assets of the company are less than his existing obligations.
\item \textsuperscript{36}Also see: Eraković, Andrija (1997) Stečajni zakon s komentarom i primjerima, RRIF Plus, Zagreb pp. 1-257.
\item \textsuperscript{37}Čuveljak, Jelena (2016) Poredjaj za otvaranje stečajnoga postupka, Pravo i porezi, vol. 25, n. 9, pp. 21-25.
\item \textsuperscript{38}The proposal for opening the bankruptcy procedure will be opened if the requirements are met and the proposal is filed by an authorized party. See more: Šernhorst, Nevenka (2015) Postojanje tražbine kao uvjet dopuštenosti prijedloga za otvaranje stečajnog postupka, Pravo i porezi, vol. 24, n. 4, pp. 31-33.
\item \textsuperscript{39}Dika, Mihajlo (2002) Pravne posljedice otvaranja stečajnog postupka, Narodne novine, Zagreb, pp. 165 – 170.
\item \textsuperscript{40}Further reading: Kovač, Vlatka (2016) Imenovanje, ovlast i dužnosti stečajnog upravitelja prema odredbama Stečajnog zakona, Pravo i porezi, vol. 25, n. 5, pp. 53-59.
\item \textsuperscript{41}See also Čuveljak, Jelena (2013) Stečajni zakon s komentarom i sudskom praksom i Zakon o financijskom poslovanju i predstečajnoj nagodbi s komentarom, \textit{4th} edition, Zagombić i partneri, Zagreb
\item \textsuperscript{42}If the company which is in the bankruptcy proceedings has adequate assets to pay all creditors and proceeding expenses, the remaining assets belongs to former shareholders.
\end{itemize}
In its ruling, the court will call on the creditors to report their claims to the insolvency practitioner within 60 days from the date of the announcement of that ruling, and call on secured and excretory creditors to inform the insolvency practitioner about their respective rights within the same timeframe stated supra via a motion. All applications for claims after the expiration of the 60-day application deadline are discarded. The types of creditors in the bankruptcy procedure is similar to that used in the pre-bankruptcy procedure. The bankruptcy proceeding distinguishes the legal positions of bankruptcy creditors whose claims were valid prior to the opening of the bankruptcy proceedings, secured and excretory creditors.

When bankruptcy proceedings are opened, the debtor's business is managed by the insolvency practitioner. The practitioner can and must settle only claims arising after the opening of the bankruptcy procedure. Until the reporting hearing, works which were already started and whose fulfillment is necessary to prevent damages to the assets of the bankruptcy debtor and those works that the insolvency practitioner find to be useful for the insolvency estate will be completed. At the reporting hearing, bankruptcy creditors decide whether or not the debtor's business will continue or suspend, and the continuation of the business is permitted for a maximum period of one and a half years from the day of reporting, unless the court receives a bankruptcy plan.

After the deadline for filing claims expires, the insolvency practitioner is obliged to submit to the court a table of registered claims, secured and excretory rights. At the examination hearing the claims are then examined according to their amounts and priority. At the same hearing the insolvency practitioner has to declare whether or not he declares each filed claim, and the bankruptcy creditors may also dispute claims. Secured and excretory rights are not examined. Finally, the court renders a decision deciding on the amount and ranks of claims that have been

43 Bankruptcy creditors are classified into ranks (payment levels) according to their claims. Creditors of a lower payment level can only be settled after the creditors of the higher payment order are fully settled. Bankruptcy creditors of the same payment level are settled in proportion to the size of their claims.

All creditors' claims are classified into two basic groups: as claims of higher payment levels and as claims of lower payment levels. First the claims from higher payment levels are determined and settled, while claims from lower payment levels are settled only in cases where claims for higher payouts are fully settled and when creditors of such claims are specifically invited by the insolvency practitioner to file their claims.

Claims from higher payment levels are:
1. First higher payment level payments include employee and former employees gross claims related to employment whose claims have matured to the date of the opening of the bankruptcy procedure, severance payments up to the amount prescribed by law and collective agreement, claims on compensation for damages sustained by a work-related injury or professional sickness.
2. Second higher payment level payments are claims from debtor’s creditors which are not in the lower ranked payment levels.

Claims from lower payment levels are determined and settled in the according order:
1. interest on the claims of bankruptcy creditors incurred after the opening of bankruptcy proceedings;
2. creditor's expenses incurred because of their participation in the proceedings;
3. fines for a criminal or misdemeanor offense as well as any indirect consequences of a criminal or misdemeanor offense imposing a payment obligation;
4. Claims for the free performance of the debtor, and
5. Claims for repayment of loans replacing the capital of a member of the company or an equivalent claim.

The interest on the claims of the bankruptcy creditors of lower payment levels and the expenses incurred by these creditors because of their participation in the procedure are at the same level as claims of those creditors.

44 Insolvency estate creditors are a special rank of creditors, specifically they are creditors whose claims were (mostly) incurred after the opening of the bankruptcy procedure.

45 The reporting hearing is the first assembly of creditors held after the claims have been determined. At the assembly the creditors decide upon should the assets be liquidated or should they draft a bankruptcy plan.
either confirmed or disputed, and also decides on referral to litigation in order to determine or disprove the claim.

3.1. BANKRUPTCY PLAN

The bankruptcy plan enables debtor’s creditors to alter principal rules concerning liquidation of debtor’s assets and the distribution of funds collected to the creditors. The settlement may contain regulations concerning:

- the return all or a part of debtor's assets to the debtor for business continuance reasons;
- the transfer all or a part of debtor's assets to one or more existing or newly founded companies, suspending Civil Obligations Act rules on accession to debt in the case of asset transfer; as well as suspending Court Registry Act rules on the obligation to issue a statement of the non-existence of a debt ;
- the merger models for merging the debtor with one or more companies;
- the liquidation of all or a part of debtor’s assets (assets encumbered or not encumbered with secured rights);
- the distribution of debtor’s assets to the creditors;
- the method of payment to the creditors;
- satisfaction or modification of secured rights;
- the reduction or postponement of payment of debts;
- the transformation of the debtor's debts into credit;
- opting for a personal guarantee or other means of insurance for payment of debts;
- the future of debtor’s obligations after the settlement has been accepted.

The insolvency practitioner has the right to file the bankruptcy plan. If at the creditor's hearing, the insolvency practitioner was ordered to file a bankruptcy plan, he is obliged to submit the bankruptcy plan to the court within the time limit set by the creditor’s decision. With the insolvency practitioner in drafting the bankruptcy plan, the creditors’ committee, if it is established, and the borrower, cooperate in an advisory manner. The creditors’ council (if established) and the debtor serve as consultative guidance to the insolvency practitioner while drafting the bankruptcy plan.

Participants in the bankruptcy plan are divided into ranks (payment levels) during the determination of their rights. Creditors with different legal status are classified in the bankruptcy

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46 Bankruptcy plans have been alternated several times. Further readings on the topic: Garašić, Jasnica (2013) Stečajni plan nakon izmjena i dopuna Stečajnog zakona 2012, in: Djelotvorna pravna zaštita u pravičnom postupku - Izazovi pravosudnih transformacija na jugu Europe, Liber amicorum Mihajlo Dika, Collection of papers in honor of Mihajlo Dika's 70th birthday (ed. Uzelac, Alan; Garašić, Jasnica; Maganić, Aleksandra), Pravni Fakultet, Zagreb, pp. 469-493.

47 Article 303 of the BA.

plan into special ranks. This should be distinguished:

1. creditors with rights of separate payment, if the bankruptcy plan affects their rights
2. debtor’s creditors which are not low-ranked
3. debtor’s creditors from lower payment ranks, if their claims do not cease.

Creditors with the same legal status can be classified into ranks by the similarity of economic interests. Such categorization must be based on valid reasons, and in the bankruptcy plan, the classification criteria will be defined. The special rank consists of workers. If the bankruptcy plan regulates that its effects are equal for all bankruptcy creditors, those creditors will not be classified into special ranks.

Each bankruptcy plan must have a preparatory basis and an implementation basis. The preparatory basis shall state the measures taken prior to the opening of the bankruptcy proceedings or are still to be undertaken in order to provide grounds for the planned exercise of the rights of the participants. It also needs to define all other information about the elements and the consequences of the plan which are important for the decision of the creditors about the plan and the plan’s court certificate. Implementation basis contains provisions on how the plan will change the legal position of the debtor and other participants in the proceedings.

Each rank of creditors with voting rights votes separately on the bankruptcy plan. It shall be deemed that the creditors accepted the bankruptcy plan if the majority of creditors in each group vote (either positively or negatively) and if the sum of creditors’ claims that voted for the bankruptcy plan exceeds twice the amount of creditors who voted against the bankruptcy plan.

After the creditors accept the bankruptcy plan, the court will audit the insolvency practitioner, the creditors’ council and the debtor, and decide whether the plan will be confirmed. The ruling on the confirmation of the plan contains the implementation basis of the plan accepted by the creditors, and it has an impact on all participants in the bankruptcy proceedings once it is in final force and effect (res judicata). Once the decision on the confirmation of the bankruptcy plan is in final force and effect, the court will render a decision on the conclusion of bankruptcy proceedings, although the insolvency practitioner is obliged to settle undisputed obligations and provide some form of insurance for the disputed obligations of the insolvency estate before the conclusion of the bankruptcy proceedings. By adopting the ruling on bankruptcy proceedings, the insolvency practitioner and the members of the creditors’ board terminate their services, and the debtor re-acquires the right of free disposal of the insolvency estate.

4. EXTRAORDINARY ADMINISTRATION

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EAPA was adopted to protect the business sustainability of companies of systemic importance for the Republic of Croatia, which affect-by themselves or jointly with dependent or connected companies- the total economic, social and financial stability of the Republic of Croatia, social and financial stability in the Republic of Croatia. The level of protection that is achieved is necessary, appropriate and proportionate to the interest of the Republic of Croatia to implement a rapid and effective process of preventive restructuring of companies of a systemic importance for the Republic of Croatia in order to ensure liquidity, sustainability, and business stability.\(^{51}\)

This procedure applies only to the joint-stock company\(^{52}\) of the debtor and all its connected and dependent companies\(^{53}\) if it is established that there is a pre-bankruptcy or bankruptcy reason in the debtor’s company, when that company (as a parent company or as a joint-stock company that is independently or jointly with its dependent or connected companies) is of systemic importance for the Republic of Croatia. For a company to be of systemic importance, the following conditions must be cumulatively fulfilled:

- that the company (alone or combined with its connected or dependent companies) has on average at least 5000 employees for at least one year before the proposal for opening of the extraordinary administration has been filed and;
- that the company (alone or combined with its connected or dependent companies) has balance debt for an amount not lower than HRK 7.500.000.000,00 (or the same amount in HRK for balance debts not in Croatian currency) on the day the proposal for opening of the extraordinary administration is filed.

The motion for an opening of the procedure shall be submitted to the Commercial Court in Zagreb. The motion can be filed by the debtor who meets the conditions; a creditor of the debtor or debtor’s connected or dependent companies (with the consent of the debtor). The Court will urgently conduct the proceedings and- if all requirements are met- will render a ruling on the opening of the extraordinary administration procedure and the decision on the appointment an extraordinary trustee in accordance with the proposal of the Government of the Republic of Croatia. Via the ruling the court will call on the creditors to report their claims to the extraordinary trustee within 60 days from the date of the announcement of that ruling, and call on secured and excretory creditors to inform the extraordinary trustee about their respective rights within the same timeframe stated supra, and also invite debtor's debtors to pay their mature liabilities without delay.

After the extraordinary administration procedure is opened, all rights and obligations of the debtor’s bodies are transferred to the extraordinary trustee. Therefore, he represents the debtor

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\(^{51}\) Article 1 of EAPA

\(^{52}\) These rules shall not apply to credit institutions as regulated in Article 4 (1) (1) of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 and financial institutions as regulated in Article 4 (1) (26) of the aforementioned Regulation.

\(^{53}\) The extraordinary administration procedure is opened on all affiliated and dependent companies, regardless of whether there is a pre-bankruptcy or bankruptcy reason for these companies. It is also defined that affiliated and dependent companies are companies with a seat in the Republic of Croatia, founded in accordance with the legislation of the Republic of Croatia, in which the parent company holds at least 25% of the shares.
independently and individually. Additionally, the trustee executes all the rights associated with the shareholder's share of the debtor in affiliated and dependent companies in the name of the debtor.

An extraordinary trustee independently carries out the debtor's business and undertakes all the actions in the procedure entrusted to him, and he is authorized, inter alia, to independently take all necessary actions for the regular business of the debtor, including all payments necessary for regular business as well as all claims of the debtor's employees and related And dependents from employment regardless of the date of occurrence. The business of the company is conducted by the extraordinary trustee and he may take any entrusted actions in the extraordinary administration procedure. He is entitled to take actions and payments necessary for maintaining debtor’s business, including employee claims resulting from employment—regardless of when the claim arose. However, he cannot, without the consent of the creditor’s council, make a decision or take action with the aim of disposing of debtor’s real estate, shares or shares in subsidiaries and other companies and transferring the economic entity if the value of the action exceeds HRK 3,500,000.00.

However, the extraordinary trustee only represents the parent-company, while the persons authorized to represent the dependent and affiliated companies of the debtor in the period before the decision on the opening of the extraordinary administration procedure are still authorized to represent the affiliated and dependent companies. These persons are obliged to submit all relevant documentation to the extraordinary trustee and to convene a meeting of the general assembly at his request. In addition, they are authorized to take the sole actions required to perform regular business activity, while activities which exceed the scope of regular business as well as the actions for which the approval of the supervisory board is required require consent from the extraordinary trustee.

With the approval of the creditor’s council, the extraordinary trustee may execute payments of mature claims arising prior to the decision to open the extraordinary administration proceeding, if the payments are necessary to reduce systemic risk, maintain business continuity, asset retention or if the claims arise from regular or operational business. In addition, with its consent, persons authorized to represent subsidiaries and affiliated companies may execute payments of mature claims arising prior to the decision to open the extraordinary administration proceeding, if the payments are necessary to reduce systemic risk, maintain business continuity, asset retention or if the claims arise from regular or operational business. Claims relating to delivery of goods and provision of services to the debtor or any of his subsidiaries of affiliated companies, which were not mature on the day of the opening of the extraordinary administration proceeding are deemed claims connected to regular business.

An important novelty of this procedure is that, during the process, a new debt can be created. The new debt, as a trade-off, will have priority of payment ahead of older debts. The EAPA further regulates that the extraordinary trustee may, with the prior consent of the creditor’s council, take a new debenture on behalf of and for the debtor’s account in order to reduce systemic risk, maintain business continuity, asset retention or if the claims arise from operational business. The new debt, as a trade-off, will have priority of payment ahead of older debts.

54 Claims arising from operational business are not financial and credit institution’s claims or securities holder’s claims unless they are priority payment claims.

55 The bankruptcy plan may foresee the so-called "Credit framework", i.e. the amount that a company can take on new debts after the bankruptcy plan has been approved and before it is fulfilled.
debentures will have an advantage when settling other claims of creditors, with the exception of worker and former employee claims. Creditors of this new debt will be considered creditors with the right of advantage in relation to creditors of the bankruptcy estate.

4.1. CREDITORS IN THE PROCEDURE

The EAPA, just as the BA distinguishes between three groups of creditors: creditors in the proceedings, secured creditors, and excretory creditors. The definitions of secured and excretory creditors are the same in both acts. However, the definition of a creditor in the proceedings is different and somewhat contradictorily defined in the EAPA. Specifically, the fundamental definition is that the creditors in the extraordinary administration proceedings are personal creditors who, at the time of opening an extraordinary administration procedure, have a claim against a debtor and/or against dependent and affiliated companies.

However, the rights of these creditors may be different, as the EAPA also regulates the right to pay mature claims arising prior to the decision on the opening of an extraordinary administration procedure if the payments are necessary to reduce systemic risk, maintain business continuity, asset retention or if the claims arise from regular or operational business.

A special gray zone is the following question: which mature claims will be paid in the extraordinary administration procedure and which claims will be filed by creditors in the proceedings. Furthermore, as virtually any claims can meet the descriptive legal criteria, creditors will be forced to negotiate with the debtor during the period of claim reporting in order to find out whether their claim is planned to be paid even though it has matured or not.

Claims relating to delivery of goods and provision of services to the debtor or any of his subsidiaries of affiliated companies, which were not mature on the day of the opening of the extraordinary administration proceeding are deemed claims connected to the regular business. This outcome *de lege lata* states that non-mature claims relating to delivery of goods and provision of services are not considered to be mature; however, they should be paid during the extraordinary administration procedure, meaning that the creditors of these claims do not report their claim in the bankruptcy proceeding.

The creditors of the main and all affiliated companies submit their claims to the extraordinary trustee, who sorts the claims into tables and decides upon admitting or disputing each claim.

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57 Article 29 (1) of EAPA
58 Article 40 of EAPA.
59 Claims arising from operational business are not financial and credit institution or securities holders claims unless they are priority payment claims.
60 This EAPA regulation gives great power to the extraordinary trustee and does not offer real possibilities of supervision of his decisions regarding these claims.
61 The creditors have no legal actions available in cases where payment of mature claims is rejected.
62 The problem with these creditors is their ineligibility of litigation initiation seeking payment of their claims against the debtor. However, as Article 11 (2) of EAPA enables appropriate usage of Article 92 and 93 of the BA, it in fact makes the debtor (who purposely violated his duties) obligated to reimburse damages to all parties.
Afterwards, other creditors may challenge any claim. As in the bankruptcy procedure, it is determined that the claims filed within the prescribed time period are deemed valid if the extraordinary trustee admitted to them and the claims are not contested by another creditor, or if the denial has been removed. Based on the table of claims with the trustee's statement on them attached, the court renders a ruling on the confirmed and disputed claims\(^63\) and also decides on referral to litigation for the purpose of determining or challenging the claim.\(^64\)

### 4.2. SETTLEMENT BETWEEN THE DEBTOR AND CREDITORS

Within 12 months\(^65\) of the opening of the extraordinary administration procedure, the extraordinary trustee may, with the consent of the creditors’ council, propose the payment of the creditors by settlement if he determines that such a model for regulating the relationship between the debtor and creditors is meaningful, particularly taking into account all the circumstances of the particular case.

If the extraordinary administration procedure is carried out over the debtor and his affiliated and subsidiary companies, a single draft settlement will be submitted. The settlement, among other things, can contain regulations concerning:

- the transfer all or a part of debtor's assets to one or more existing or newly founded companies, suspending Civil Obligations Act rules on accession to debt in the case of asset transfer; as well as suspending Court Registry Act rules on the obligation to issue a statement of the non-existence of a debt
- the return all or a part of debtor's assets to the debtor for business continuance reasons;
- the merger models for merging the debtor with one or more companies;
- liquidation of debtor’s assets (all or a part of) and the distribution of funds collected to the creditors;
- the reduction or postponement of payment of debts;
- the transformation of the debtor's debts into credit, loan or subscribed capital of the debtor's company or subsidiary companies or newly founded companies;
- opting for a personal guarantee or other means of insurance for payment of debts;
- the future of debtor’s obligations after the settlement has been accepted.

This settlement is voted by the creditors whose claims have been determined. The settlement is deemed accepted if the majority of all of the creditors voted for it and if in each group the sum of the claims of the creditors who voted for settlement exceeds the sum of the claims of the creditors who voted against the settlement. Exceptionally, creditors will be deemed to have accepted the

\(^{63}\) When considering upon rendering this ruling the court does not examine claims as in the civil proceedings. The reason is that the bankruptcy proceeding is in fact a non-contentious process, hence only the trustee’s admission or contest of a claim is satisfactory for the court.

\(^{64}\) Article 33 of EAPA

\(^{65}\) This deadline can be extended for three more months.
settlement if the total sum of creditor claims that voted for settlement is at least two-thirds of total claims. The settlement accepted by the creditors will be confirmed by the court by a ruling. Such ruling has the power of an execution (enforcement) document.

However, if the settlement fails to be agreed upon, then the extraordinary administration procedure will be suspended.

5. CONCLUDING REMARKS

Procedures which enable restructuring of businesses in difficulties exist for more than a century.\(^6\)\(^6\) They are usually followed by controversies since they *de facto* reduce the claims of the creditors *in favorem* of the debtor. However, when such procedures are missing, the debtors usually do not "survive" leading to further problems for the creditors.

Two interests are always involved. Firstly, there is the interest of the creditors to fully reimburse their claims. Secondly, the debtor's interest in a “second chance” and continuance of his company. The lawmakers have a difficult task to find a model or models which satisfy both interests, while also securing the safety of sustainable businesses and helping create and sustain jobs and the economy of a country in general.

The legislation in Croatia currently enables three types of procedures: the pre-bankruptcy procedure, bankruptcy procedure, and the extraordinary administration procedure in companies of systemic importance for the Republic of Croatia.

The pre-bankruptcy proceedings are initiated when there is a case of imminent insolvency. During this procedure, the business of the company is still managed by the existing management board and the board's rights can only be reduced by a shareholders decision.

However, if the company is in a state of incapacity to make payments or over-indebtedness, the bankruptcy proceeding is opened. During this procedure, the existing management stops its work and any further decisions during the process are de facto in the hands of the creditors- they decide whether they should draft and enact a bankruptcy plan, or will they rather simply sell the debtor's assets and proportionally distribute the proceeds.

Extremely large companies of systemic importance which affect-by themselves or jointly with dependent or connected companies- the total economic, social and financial stability of the Republic of Croatia can initiate the third type of procedure: extraordinary administration procedure. During this procedure, the business of the parent-company is managed by the extraordinary trustee, proposed by the Government of the Republic of Croatia and appointed by the court. His task is to draft a settlement acceptable to the creditors.

\[^6\] The Compulsory Reimbursement Outside of Bankruptcy Act was enacted in Slovenia and Dalmatia in 1914 and in Croatia and Slavonia in 1916. It was abolished in 1925 as controversial and that resulted in a significant increase in bankruptcy cases. When it was still in force in 1924 there were only 106 bankruptcy cases, while in 1925 (after it was abolished) there were 384 bankruptcy cases. In the year after there were 832 cases. See more: Politeo, Ivo: Stečajni zakon za Kraljevinu Jugoslaviju, Zakon o prinudnom poravnjanju van stečaja i Zakon o uvodenju u život obiju zakona, za sva tri od 22.XI.1929, Tipografija d.d. Zagreb, pp. 193-197. Because of the aforementioned growth of bankruptcy cases The Compulsory Reimbursement Outside of Bankruptcy Act was passed in 1929.
All three models enable creditors various options. The restructuring can be adapted to the entrepreneur in accordance with the current state of the business environment. The legislator offers different frameworks and the question when any of these will be used depends on whether the debtor's business is economically profitable or not.
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LEGISLATION:


OTHER:

Paper title (in Croatian): Pravne mogućnosti restrukturiranja poduzetnika u poteškoćama

Paper abstract (in Croatian):
Poteškoće u poslovanju su sastavni dio poduzetništva što je i zakonodavac uočio pa u Republici Hrvatskoj postoji više načina restrukturiranja poduzetnika koji je zapao u poteškoće. Predstečajna nagodba je postupak koji se otvara kada dužniku prijeti insolventnost pa poslovanje nastavlja voditi postojeća uprava, s tim da se sam postupak mora završiti u kratkom roku. Stečajni postupak se otvara kada je dužnik insolventan ili prezadužen pa poslovanje vodi dalje stečajni upravitelj. Postupak izvanredne uprave u trgovačkim društvima od sistemskog značaja za Republiku Hrvatsku se otvara nad velikim povezanim društvima kada postoje stečajni odnosno predstečajni razlozi s tim da izvanredni povjerenik nastavlja voditi poslovanje vladajućeg društva. Svaki od tih načina ima svoje specifičnosti i različite posljedice kako na samog dužnika, njegovu upravu i vjerovnike, stoga se u ovom radu analiziraju razlike u pogledu uvjeta za otvaranje postupka, vođenja poslovanja, rokova postupka te posljedica za vjerovnike tog društva i imatelje kapitala u društvu, uz naglasak da je u svakom od tih postupaka moguće očuvati ekonomski isplativo poslovanje.

Veći broj pravnih okvira bi trebalo omogućiti pravovremeno restrukturiranje kako bi se osiguralo očuvanje održivih dijelova poslovanja, pomoglo stvaranju i očuvanju radnih mjesta, ali i da se smanje rizici na financijskom sektoru povezani sa pretvaranjem zajmova u loše kredite. No uspješnost dogovora s vjerovnicima kao i postotak naplate tražbina vjerovnika najviše ovisi o ranom otkrivanju pogoršanja u poslovanju i pravovremenom pokretanju odgovarajućih postupaka.

Keywords (in Croatian): stečaj, predstečaj, restrukturiranje u stečaju, izvanredna uprava