LAW ON BANKRUPTCY

1.57

WHITE BOOK BALANCE SCORE CARD

Recommendations:	Introduced in the WB:	Significant progress	Certain progress	No progress
The provisions on automatic bankruptcy in the case of a debtor's permanent insolvency should be incorporated into the bankruptcy regulatory framework, but in a form that would be in accordance with the Constitution of the Republic of Serbia.	2012			√
It is necessary to additionally restrict possibilities for banning enforcement against the bankruptcy debtor's property during the procedure of the adoption of a prepackaged reorganization plan, in order to prevent bankruptcy debtors from averting an enforcement settlement over an indefinite period of time and without the support of a majority of creditors through multiple consecutive bankruptcy filings.	2016		√	
Regulate the procedure of personal insolvency either by amendments to the current Law on Bankruptcy or the adoption of a separate law.	2016			√
Regulate additionally the position of secured and pledge creditors in a way that provides two-instance procedures with respect to their settlement from the sale of pledged property.	2016			√
Stipulate that the opening of bankruptcy proceedings produces effects as of the date of publishing the notice of the opening of bankruptcy proceedings in the Official Gazette.	2017		√	
Stipulate the possibility and procedure for amending the adopted reorganization plan.	2016		√	
Regulate the issue of delivery in bankruptcy proceedings in a way to make it faster and more effcient and to specify the provisions related to the finality date and starting date for the implementation of the reorganization plan so that all participants can know with certainty when the adopted plan begins to be implemented.	2016		√	

CURRENT SITUATION

In December 2018, the National Assembly adopted new amendments to the Law on Bankruptcy. The Amendments entered into force on 8 December 2018 (RS Official Gazette No 104/2009, 113/2017, 44/2018, 95/2018). These were the fourth amendments to this Law since its entry into force in early 2010 and the second amendments to this Law made in 2018.

The main goal of the Amendments to the Law on Bankruptcy, as was the case with the earlier amendments, is to make the procedure more efficient and more transparent.

According to data available on the website of the Bankruptcy Supervision Agency, as of 3 June 2019 there were a total of 2,075 pending bankruptcy proceedings under way in the Republic of Serbia, with the exception of bankruptcy proceedings conducted under the Law on Enforced Collection, Bankruptcy, and Liquidation (SFRY Official Gazette Nos. 84/89, SRY 37/93, and 28/96) and bankruptcy proceedings conducted against banks, which are within the jurisdiction of the Deposit Insurance Agency. The average duration of the procedures is about 2 years and 8 months.

In the first five months of 2019 there were 181 bankruptcy proceedings initiated, and 98 bankruptcy proceedings terminated. This means that 36 bankruptcy proceedings were initiated per month. Compared to 2018, when the monthly average was 33 bankruptcy proceedings, the stability in the number of initiated bankruptcy proceedings is noticeable. That number is still significantly below the monthly average of 80 initiated proceedings in 2012. The grounds for such a decrease in initiated bankruptcy proceedings after 2012 were presented in previous editions of the White Book, and the main cause was the Decision of the Constitutional Court of Serbia on the unconstitutionality of automatic bankruptcy.

Due to the absence of automatic bankruptcy and the insufficient motivation of creditors to initiate bankruptcy proceedings against their debtors, a huge number of companies that have been de facto insolvent for a long period of time still, within the limits that their economic power and legal status allow, operate in the Republic of Serbia, which has a negative impact on economic flows and is unsustainable in the long term.

Most of the latest amendments are expected to improve the quality of the procedure, but actual results of the amendments will be seen in court practice in the following period.

POSITIVE DEVELOPMENTS

Due to the fact that the last Amendments to the Law on Bankruptcy came into force in December 2018, we are able to point out certain positive regulatory developments, which have yet to be confirmed in practice.

Examples of regulatory developments that are worth mentioning as positive are as follows:

Increasing the transparency of the procedure

The latest changes in the principle of publicity and information should improve the transparency of the procedure, since all creditors are now enabled by an explicit provision to request and receive from the bankruptcy manager all the information related to the bankruptcy debtor, the course of bankruptcy proceedings, the assets and management of the assets of the bankruptcy debtor in due time. In this way, the right of insight into the files of the court case has been amended, because now all creditors have the right to obtain from the bankruptcy manager all information on the procedure directly, which the bankruptcy manager is obliged to provide in due time. The law does not stipulate the deadline for the submission of this information, so a timely response by bankruptcy managers to such requests will be established in practice.

Selection and change of the bankruptcy manager and the enhanced role of the creditors' assembly

The legislature has intervened again with the latest amendments regarding the possibility of choosing and changing the bankruptcy manager. Now, in the case when bankruptcy proceedings are initiated on the proposal of the creditor, the proposal for opening a bankruptcy may also contain a proposal for appointing a bankruptcy manager from the list of active bankruptcy managers for the jurisdiction of the competent court. Therefore, the creditor proposing the opening of a procedure may propose the appointment of a specific bankruptcy manager, which the court will decide on in the context of the decision on the proposal for opening a bankruptcy proceeding.

Regardless of whether the court accepts the creditor's proposal regarding the specific person to be appointed as bankruptcy manager or if the bankruptcy manager is appointed by random selection, at the first creditor hearing, as one of the compulsory issues decided upon by the creditors' assembly, which provides for the approval of the appointment of the bankruptcy manager, and if consent is not granted, the assembly proposes the dismissal of the appointed bankruptcy manager and simultaneous appointment of a new one.

In addition, the provision stating that the creditors' board can replace the bankruptcy manager and appoint a new one with a three-quarter majority decision at any stage of the proceedings has been amended. The creditors' board continues to have this authority, which is now conditional on the consent of the creditors' assembly.

Thus, the creditors' assembly, as the most transparent body in bankruptcy proceedings, consisting of the persons most interested in the outcome of the proceedings, has been given the opportunity to appoint as bankruptcy manager a person trusted by a majority of creditors in the broadest creditor body.

Precisely defined ranges of the amount of advance costs of bankruptcy proceedings

The most recent amendments to the Law precisely sets the ranges of the amounts for determining the advance costs, depending on how the legal entity against which bankruptcy is opened is classified in accordance with the regulations governing the criteria for classifying legal entities. For micro legal entities, the amount of 50,000 dinars was kept, for small legal entities up to 200,000 dinars, for medium legal entities up to 600,000 dinars and for large legal entities up to 1,000,000 dinars.

This amendment represents a positive change, since it removes the possibility of discretionary decisions of bankruptcy judges regarding the amount of the advance costs, with the reservation that practice will show whether so determined amounts of the advance are sufficient to cover the costs of the bankruptcy proceedings.

REMAINING ISSUES

As mentioned in the previous editions of the White Book, it seems that the scope of the latest amendments did not solve the long-standing problem of the possible abuse of legal loopholes by bankruptcy debtors, especially in the reorganization procedure on the basis of a prepackaged reorganization plan.

Even after previous amendments, relating to the abolition of the ban on enforcement against pledged assets, and changes in connection with the reorganization procedure, the Law on Bankruptcy contains a provision that the bankruptcy judge will not render a decision on revoking the ban on enforcement if the bankruptcy manager proves that secured assets are of critical importance for the reorganization of the debtor or for the sale of the bankruptcy debtor as a legal entity. This wording provides the bankruptcy manager with the possibility to avoid revoking the ban on enforcement because it seems that the bankruptcy manager could easily prove that some assets are necessary for the reorganization or the sale of legal entity, while the secured creditor could hardly prove the opposite.

The Law on Bankruptcy contains provisions aimed at preventing potential abuses of the reorganization procedure that prescribe the constriction of the length of the ban on enforcement against a bankruptcy debtor's assets, and determine the term within which the bankruptcy debtor has to file a new extraordinary report of the auditor, as well as latest amendments such as the revocation of the possibility to prolong deadlines to submit a reorganization plan and reducing the number of amendments to a reorganization plan to only one. The goal of these provisions is to prevent the use of prepackaged reorganization plans as a means for postponing bankruptcy to avoid an appropriate settlement of creditors' claims. However, it seems that there are still certain loopholes related to these provisions, and despite the facts mentioned herein, bankruptcy creditors do not enjoy adequate protection, and that the realization of the purposes and aims of the Law on Bankruptcy related to the prepackaged reorganization plan cannot be achieved.

However, despite restrictions with respect to the duration of the prohibition of enforcement against the bankruptcy debtor's property (a stay cannot exceed six months), and despite the ban on submitting such a proposal more than once in the same bankruptcy proceedings, the practice has shown that bankruptcy debtors usually avoid such restrictions in practice and that they usually withdraw their bankruptcy application based on a prepackaged reorganization plan, and then almost simultaneously submit a new bankruptcy petition based on a virtually unchanged prepackaged reorganization plan. The Law does not prohibit the filing of a new bankruptcy petition, along with a fresh request for a stay of enforcement against the bankruptcy debtor's property, immediately after withdrawing the previous one. Although the issuance of such a measure depends on the bankruptcy judge's decision, the practice has shown that judges, as a rule, issue such a measure, thereby removing the only barrier against abuse of the Law. In practice, there are cases in which bankruptcy debtors avoid enforcement against their property for years, in this or similar ways. The latest amendments reduced the options to abuse the reorganization proceedings, but if there is no creditor interested to file for opening of bankruptcy proceedings, the said possibilities for abuse still remain.

In practice, a problem also arises in certain cases when the delivery of a decision on the confirmation of a plan lasts longer than the procedure of the adoption itself. This has direct negative implications on the duration and efficiency of bankruptcy proceedings.

It often happens in practice that it is necessary to change a reorganization plan which has already been confirmed by a court, but the current legislation does not allow it. This poses a serious problem, because it may happen that a bankruptcy debtor's business activity is not on the expected level after the adoption of the plan and therefore the debtor cannot comply with the payment dynamic envisaged in the adopted plan, whereas a majority of the creditors are willing to accept an amendment to the plan, which formally cannot be made.

We also underline the problem with the procedure of the distribution of funds collected through the sale of a bankruptcy debtor's property that was pledged in favour of secured and pledge creditors. The claims of secured and pledge creditors should be settled within five days from the date of receipt of the funds by the bankruptcy administrator. The bankruptcy administrator autonomously, independently, and without control by the bankruptcy judge, decides on the amount of settlement of secured and pledge creditors, who then do not have the right to appeal against this decision. The only legal remedy available to them is an objection to the work of the bankruptcy administrator

as decided by the bankruptcy judge of first instance, and no appeal is allowed against this decision of the court. The legal solution which envisages the right to appeal for unsecured creditors may seem unfair, while secured and pledge creditors are not only deprived of a second-instance review of the legality of the decision of the bankruptcy administrator, but also of a first-instance review.

According to current legislation, the opening of bankruptcy proceedings produces effects as of the date on which a notice of the opening of bankruptcy proceedings is posted on a court's notice board. In practice, this rule creates problems as in some procedural situations it is not clear which is the relevant date of the opening of bankruptcy proceedings. In order to eliminate uncertainties, it is recommended that the opening of bankruptcy proceedings produce effects as of the date of the publication of the notice of the opening of bankruptcy proceedings in the Official Gazette.

The huge number of companies that have been insolvent for a long time hinders economic development, so although the Constitutional Court of the Republic of Serbia has declared automatic bankruptcy unconstitutional per its decision in 2012, we consider it reasonable to find the appropriate legal solution which would enable a kind of automatic bankruptcy proceedings in the case of permanent insolvency.

One of the outstanding issues where no progress was seen is that of personal insolvency. Specifically, we believe that the resolution of this issue would benefit both creditors and insolvent debtors. The existing options available to creditors regarding insolvent debtors who are natural persons do not lead to the most favourable collective settlement. On the contrary, they result in the settlement of the claims of some creditors through some kind of enforcement procedure, while other creditors, in most cases, do not have any possibility to settle their claims with over-indebted natural persons. In that sense, we consider that the introduction of the concept of personal insolvency would ensure creditors higher settlement amounts, while at the same time protecting the integrity and basic needs of overindebted individuals.

Finally, many other questions arise with regard to improving and clarifying corresponding regulations in practice, such as the possibility and method of enjoying secured-creditor rights based on a pledge on claims; insufficiently precise definitions of entities to which Article 123, paragraph 2 of the Law refers, the ability to dispose of the subject of an exclusion request during a dispute regarding such a request; and others.

Some of the expectations presented in the previous editions of the White Book regarding comprehensive amendments to the Law on Bankruptcy have been met, but many other insufficiencies of legal solutions have not yet been fixed, and we sincerely hope to see at least concrete proposals of amendments this year.

FIC RECOMMENDATIONS

- The provisions on automatic bankruptcy in the case of a debtor's permanent insolvency should be incorporated into the bankruptcy regulatory framework, but in a form that would be in accordance with the Constitution of the Republic of Serbia.
- It is necessary to additionally restrict possibilities for banning enforcement against the bankruptcy debtor's property during the procedure of the adoption of a prepackaged reorganization plan, in order to prevent bankruptcy debtors from averting an enforcement settlement over an indefinite period of time and without the support of the majority of creditors through multiple consecutive bankruptcy filings.
- Regulate the procedure of personal insolvency either by amendments to the current Law on Bankruptcy or the adoption of a separate law.
- Regulate additionally the position of secured and pledged creditors in a way that provides the two-instance procedure with respect to their settlement from the sale of pledged property.

- Stipulate that the opening of bankruptcy proceedings produces effects as of the date of publishing the notice of the opening of bankruptcy proceedings in the Official Gazette.
- Stipulate the possibility and procedure for amending the adopted reorganization plan.
- Regulate the issue of delivery in bankruptcy proceedings in a way to make it faster and more efficient and to specify the provisions related to the finality date and starting date for the implementation of the reorganization plan so that all participants can know with certainty when the adopted plan begins to be implemented.