# LAW ON BANKRUPTCY

1.22

## WHITE BOOK BALANCE SCORE CARD

| Recommendations: | Introduced in the WB: | Significant progress | Certain progress | No progress |
|---|---|---|---|---|
| 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. | 2016 | | | √ |
| 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. | 2016 | | | √ |
| To regulate in detail the procedure of electronic sale, if possible, by following the example from the Law on Enforcement and Security. | 2020 | | | √ |
| To consider legal regulation of digitalization process in operations of creditors' bodies and communication between bankruptcy bodies. | 2020 | | | √ |
| 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 | | | √ |
| 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 | | | √ |
| Stipulate the possibility and procedure for amending the adopted reorganization plan. | 2016 | | | √ |
| Regulate the procedure of personal insolvency either by amendments to the current Law on Bankruptcy or the adoption of a separate law. | 2016 | | | √ |
| To establish electronic sale of debtor property. | 2020 | √ | | |

## CURRENT SITUATION

According to data on the Bankruptcy Supervision Agency's website, as of 1 July 2022 there were a total of 1,746 pending bankruptcy proceedings 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 Deposit Insurance Agency's jurisdiction. The average duration of the procedures initiated under the Law on Bankruptcy Proceedings is about 3 years and 11 months, while average duration of the proceedings initiated under the Law on Bankruptcy is about 1 year and 9 months.

228 bankruptcy proceedings were initiated in the first six months of 2022 . This means that approx. 38 bankruptcy proceedings were initiated per month. Compared to 2021, when the monthly average was 29 initiated bankruptcy proceedings, the increase 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 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.

After public consultations held on the Draft Law on Amendments to the Law on Bankruptcy and the Draft Law on Amendments to the Law on Bankruptcy Supervision Agency at the beginning of 2021, the procedure for consideration and adoption of the drafts before the National

Assembly of the Republic of Serbia has not yet been initiated. These are the fifth amendments to the Law on Bankruptcy since its entry into force in early 2010.

At the beginning of 2021, the Ministry of Economy has formed a working group to prepare a draft of a law that will regulate (previously introduced then abolished) the bankruptcy of entrepreneurs, following the Program for resolving problem loans for the period from 2018 to 2020 of the Government of the Republic of Serbia.

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

Most of the latest amendments are expected to improve the quality of the procedure, but actual results will be seen after their adoption end entry into force and in court practice in the following period.

## POSITIVE DEVELOPMENTS

In addition to the improvements indicated in the previous edition of the White Book made by the last amendments to the Law on Bankruptcy at the end of 2018, given that a new change in bankruptcy regulations is expected in the coming period, we can point out to certain potential improvements that are the subject of the Draft Law on Amendments to the Law on Bankruptcy and the Law on the Bankruptcy Supervision Agency.

Examples of proposed regulatory amendments that are worth mentioning as potential positive change are as follows:

**Improved position of secured and pledged creditors**

In the previous edition of the White Book, it was pointed out that one of the remaining problems related to the lifting of the ban on enforcement against pledged property in the reorganization procedure was the provision according to which the bankruptcy judge would not make a decision on lifting the ban on enforcement if the bankruptcy administrator proves that pledged property is crucial for reorganization of the debtor or for the sale of the bankruptcy debtor as a legal entity. This wording gives the bankruptcy administrator the opportunity to avoid lifting the enforcement ban because it seems that it can be easily proven that some of the property is necessary for reorganization or sale of a legal entity, while a secured creditor can hardly prove otherwise. One of the recommendations was to additionally restrict possibilities for banning enforcement against the bankruptcy debtor's property during the procedure of the adoption of a pre-packaged 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.

The proposed amendments to the Law on Bankruptcy introduce the authority for a bankruptcy judge to decide on the abolition of security measures, upon the proposal of a secured or pledge creditor, including a ban on enforcement against the pledged property of the bankruptcy debtor. It is also proposed that the bankruptcy judge may, when making this decision, request the opinion of an expert on cruciality of the pledged property for the reorganization.

If the proposed amendments are adopted, the possibility for the pledge and security creditor to get settlement from the value of the pledged property within the bankruptcy proceedings or outside of it will be significantly improved, and the possibility for abuse will be at least partially reduced in terms of multiple submission of a pre-prepared reorganization plan with a proposal for determining the measure of prohibition of enforcement against the pledged property of the debtor.

**Additional increase of transparency and efficiency of the proceedings**

Amendments to the Law on Bankruptcy have been proposed to expand the principles of publicity and information, to collect, process and analyze statistical data related to bankruptcy proceedings and now, in addition to allow all creditors to explicitly request and receive all information related to the bankruptcy debtor, on the course of the bankruptcy procedure, on the property and management of the property of the bankruptcy debtor and all state authorities have the obligation to submit to the bankruptcy administrator data on the property, rights and interests of the bankruptcy debtor, free of charge. Also, it is proposed to introduce the sale of the bankruptcy debtor's property electronically, through the portal of the authorized organization for the sale of property. It is proposed to shorten the deadline for filing bankruptcy claims from 120 to a maximum of 60 days and to shorten the deadline for

scheduling hearings to decide and vote on the reorganization plan from 90 to 60 days. The draft Law on Amendments to the Law on the Bankruptcy Supervision Agency proposes, among other things, the addition of two new articles, which regulate the implementation of actions in bankruptcy proceedings through an electronic portal, and collection and statistical processing of the data related to bankruptcy proceedings.

All proposed changes should lead to greater transparency and efficiency of bankruptcy proceedings.

**Better control of bankruptcy administrator's work and expertise**

The proposed amendments to the Law on Bankruptcy specify that the selection of bankruptcy administrators will be made either from the general or from a special list of active bankruptcy administrators, depending on the criteria for classifying legal entities into micro, small, medium and large legal entities. The Draft Law on Amendments to the Law on the Bankruptcy Supervision Agency prescribes the professional training of bankruptcy administrators, in order to develop and improve their profession. The existence of two lists of bankruptcy administrators from which the selection is made and the existence of the obligation of professional training should solve the issue of bankruptcy administrators' expertise. Finally, the proposed amendments to the Law on Bankruptcy and the introduction of additional reasons for the dismissal of bankruptcy administrators enable better control of their work.

## REMAINING ISSUES

The proposed amendments to the Law on Bankruptcy, if adopted, would significantly resolve the problems of secured and pledge creditors regarding possible abuses of legal gaps by bankruptcy debtors regarding the rendering and revocation of ban of enforcement against the pledged property of the debtor, especially in the procedure initiated based on a pre-packaged reorganization plan.

However, the proposed amendments do not cover all problems pointed out in previous editions of the White Book, so we hope that this will be done in the coming period.

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, since a bankruptcy debtor's business activity may not be on the expected level after the adoption of the plan and 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 distribution of funds collected through the sale of a bankruptcy debtor's property that was pledged in favor of secured and pledge creditors. The claims of these 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 decided by the bankruptcy judge of first instance, and no appeal is allowed against this decision. The legal solution envisaging the right to appeal for unsecured creditors may seem unfair, while secured and pledge creditors are deprived both of a first and second-instance review of the legality of the decision of the bankruptcy administrator.

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. To eliminate uncertainties, it is recommended that the opening of bankruptcy proceedings produces effects as of the date of the publication of the notice of the opening of bankruptcy proceedings in the Official Gazette.

Large 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 personal insolvency. The resolution of this issue would benefit both creditors and insolvent debtors. The existing options available to creditors regarding insolvent natural persons do not lead to the most favorable collective settlement. They result in the settlement of the claims of some creditors through enforcement procedure, while other creditors, in most cases, do not have any possibility to settle their claims with over-indebted natural persons. We consider that the introduction of the concept of personal insolvency would ensure creditors higher settlement amounts, while protecting the integrity and basic needs of overindebted individuals.

The situation caused by the COVID-19 pandemic with uncertain duration imposes the need for increasing digitalization in in bankruptcy proceedings, often requiring the presence of a large number of people at hearings, meetings of creditors, public sales, etc. In that sense, it would be useful to regulate in more detail the procedure of electronic sale and the functioning of creditors' bodies and electronic communication between the bodies in bankruptcy procedure.

Finally, the introduction of new reasons for the dismissal of bankruptcy administrators is not without flaws, as the reason relating to their inefficient work is still not prescribed, including prolongation of the sale of property or of the distribution of money obtained from the sale of the property of the bankrupt debtor, etc., which are more common in practice than violations of the duties of bankruptcy administrators. Hence, it would be useful to introduce such a provision to better prevent practical problems related to the work of bankruptcy administrators.

At the end, many other questions arise regarding 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, para. 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

- Regulate the delivery issue in bankruptcy proceedings 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.
- Regulate additionally the position of secured and pledged creditors to provide the two-instance procedure with respect to their settlement from the sale of pledged property.
- Regulate in detail the procedure of electronic sale, if possible, by following the example from the Law on Enforcement and Security.
- Consider legal regulation of digitalization process in operations of creditors' bodies and communication between bankruptcy bodies.
- 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.
- 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.

- Stipulate the possibility and procedure for amending the adopted reorganization plan.
- Regulate the procedure of personal insolvency either by amendments to the current Law on Bankruptcy or the adoption of a separate law.
- To establish electronic sale of debtor property.