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**FOSTERING AN INVESTMENT AND LENDER-FRIENDLY ENVIRONMENT
(FILE)
BOSNIA-HERZEGOVINA
QUARTERLY REPORT**

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1. Background

Chemonics International, Inc. (Chemonics) and its subcontractors, Emerging Markets Group, Ltd. (EMG) and the National Center for State Courts (NCSC), were selected to implement USAID's Fostering an Investment and Lender-Friendly Environment (FILE) commercial law project in Bosnia-Herzegovina (BiH). The project, which will run approximately three years, was established to address a variety of commercial law issues, including bankruptcy and collateral law, court administration, and World Trade Organization (WTO) accession. Project activities are described more fully in the related Task Order (TO) and in FILE's previously submitted workplans.

In June 2005, USAID and Chemonics executed a TO Modification that, among other things, formally deleted the WTO component from the TO in its entirety and required FILE to complete all work under the collateral law component (Component One) by June 30, 2005 and adjust project staffing accordingly. FILE's work is now focused on bankruptcy (Component Two) and court administration (Component Three), and this report reflects only activities from those two project components.

The lack of investments and long-term lending is impeding the growth of the private sector in BiH. It also impedes the country's recovery from the war and transition from a command to a market economy. FILE's bankruptcy component is designed to make the bankruptcy and liquidation laws and procedures work by providing training and resource materials to relevant stakeholders (including judges, trustees, lawyers and appraisers), and by shepherding a number of pilot bankruptcy cases through the judicial process. Its court administration component is designed to streamline the ability of BiH courts to adjudicate commercial cases in a timely, predictable, and efficient manner by improving caseload management and providing case management software.

Each of the following sections corresponds to a TO component. Within each section, FILE describes the specific activities undertaken and accomplished during the reporting period.

2. Component One: Collateral Law

As indicated above, Chemonics and USAID executed a Task Order Modification in June 2005 that, among other things, required FILE to complete all work under the collateral law component by June 30, 2005. FILE completed its collateral law work in June 2005, demobilized its expatriate technical specialist, and reassigned its local technical specialists to support ongoing project components.

3. Component Two: Bankruptcy Law

A. Introduction

FILE's bankruptcy's activities have continued to have notable success over the last quarter. Specifically, our bankruptcy team has continued to provide technical assistance to bankruptcy practitioners, including extensive support on numerous, ongoing bankruptcy cases. In addition, our team successfully tested new auction procedures in the Livnica liquidation case, generating 32% more in auction proceeds than expected; conducted intensive preparations for training events; provided ongoing advice and attended hearings relating to ongoing bankruptcy pilot cases and interventions; and provided assistance to local organizations interested in promoting bankruptcy. The FILE team conducted a train-the-trainers program for bankruptcy judges and bankruptcy training for first and second instance judges; preparing training and user materials relating to the Bankruptcy Restructuring Model (BRM) and executing training for a focus group of trustees on the topic. Finally, the team continued to provide technical guidance on issues arising in its pilot cases and in other bankruptcy cases.

At the same time, the bankruptcy team continued to develop and deliver training programs and resource materials to bankruptcy practitioners. A summary of FILE's training, resource material development, and pilot case activities follows.

This quarter also marked an upturn in media coverage of bankruptcy, with several articles published about companies and creditors benefiting from bankruptcy. The highlight was USAID's dissemination in local newspapers of an article about the successful reorganization of Unis Tativ, the first reorganization under BiH's new bankruptcy laws. Journalists also reported favorably on developments in other bankruptcy cases, including Energoinvest TNNO and CAJAVEC Elektromehanika, writing articles on trustees' successes and highlighting obstacles to more efficient implementation of the bankruptcy law.

B. Training Activities

Since its inception, FILE has designed and delivered training programs to develop the competency and efficiency of bankruptcy professionals. FILE has also worked to identify a local institution with the potential and capacity to continue such trainings after FILE closes. In furtherance of this effort, all judicial bankruptcy training programs have been conducted in conjunction with BiH's entity-level judicial training centers (JTCs) to institutionalize the trainings and pave the way for their eventual transfer to the JTCs. In addition, FILE has also provided copies of its training materials and related training curricula to the JTCs for use in future training.

During the last quarter, our bankruptcy team has taken key steps to institutionalize bankruptcy training and prepare for its eventual transfer to the JTCs. On February 13, 2006, FILE conducted a train-the-trainers program in Dobož for five experienced bankruptcy judges. Each judge had expressed interest in leading future bankruptcy trainings sponsored by the JTCs; similarly, each had attended FILE's prior training sessions and worked closely with FILE on various bankruptcy cases.

While the session included discussion of some technical issues, the focus was on providing the future trainers with necessary adult learning, facilitation, and presentation skills. Participants received copies of training and resource materials previously developed by FILE, including training curricula and teaching methodologies.

The five judges put their training skills to work on February 23-24, 2006, leading a training session for other bankruptcy judges, as well as second instance judges, on bankruptcy issues commonly arising in appellate practice. The session, held in Sarajevo, was attended by thirty bankruptcy and seven appellate judges, and addressed topics such as: the different phases of the bankruptcy proceeding; the roles and relationships of the judge, trustee, creditors' committee and creditors' assembly; the rights of secured creditors and creditors with the right to separate recovery; liquidation of the bankruptcy estate; distributions; and experiences in reorganization. The training was very well-received, with participants requesting that additional sessions be held before FILE closes.

The FILE team also held focus group trainings in Sarajevo and Banja Luka on March 6-7, 2006 and March 13-14, 2006, respectively, at which it trained thirteen trustees on the bankruptcy restructuring model (BRM) functionality and use. The BRM was well received by the focus groups, which also provided helpful feedback that will be incorporated into the software. Once these updates are complete, country-wide training of bankruptcy professionals will take place in May 2006.

In addition, the bankruptcy team began preparations for a media roundtable on bankruptcy, scheduled to be held on April 7, 2006. The roundtable is designed to educate media on the benefits of, and success stories created through, BiH's bankruptcy system. Judges, trustees, labor representatives, and FILE staff will provide insights into the progress made in implementing BiH's new bankruptcy laws and describe the impact achieved through successful reorganizations and liquidations under these laws. Success stories, bankruptcy pamphlets and similar materials will also be provided to attendees in a press kit.

Finally, after several delays the Federation Ministry of Justice has begun its formal certification of trustees. Over 150 persons have applied for certification, and fifteen have already been examined and certified. Those trustees on "provisional lists" remain eligible to work on bankruptcy cases. FILE's training programs have received high praise from trustees seeking certification, with many indicating that lessons learned in FILE's sessions more than adequately prepared them for the certification exam.

C. Resource Materials

Over the past two years, FILE has designed and delivered various training programs and resource materials to its local partners, in its effort to further develop the competency and efficiency of bankruptcy professionals. FILE's efforts have been, and continue to be, well-received.

The last quarter has also seen great progress in FILE's development of resource materials, both to bankruptcy practitioners and to the public at large. In January, the bankruptcy team continued to update its Judges' Benchbook, adding templates of common judicial orders and decisions. The updated benchbook was distributed to bankruptcy and appellate judges at the February 23–24, 2006 training session. Several judges commented on the high quality of the materials and the underlying benefits of documenting and encouraging best practices.

In addition, FILE's team continues to seek ways to make resource materials available to the public at large. The project's resource and training materials are currently being posted on the JTCs' website, thereby becoming available to the broader public. And, to broaden the market for assets available for sale in bankruptcy, FILE – at the request of several trustees - has reached agreement with the Foreign Investment Promotion Agency of BiH (FIPA), pursuant to which FIPA will add bankruptcy content to its website. The bankruptcy materials will include a description of investment opportunities available through bankruptcy, a brief explanation of the bankruptcy process, a copy of the bilingual bankruptcy law developed by FILE, a feature story on investment opportunities recommended by trustees, and a list of assets available for purchase. Ultimately, its quality will depend on the continuing submission by trustees of quality information in a timely and structured manner.

FILE's work in resource material development is also giving tools to trustees. Our team previously determined that implementation of BiH's bankruptcy laws could benefit greatly from an efficient and simple software tool for trustees. Such a software tool would generate required reports and assist in modeling reorganization plans and liquidation strategies. A corporate restructuring application incorporating many of the desired functionalities was previously developed and deployed in USAID-funded projects in the Ukraine and in West Bank/Gaza. In Fall 2005, FILE modified and adapted the corporate restructuring model, creating a bankruptcy restructuring model (BRM) tailored to the specific needs and legal requirements of BiH bankruptcy practice.

The next phase of BRM development is now underway. In February, short-term experts finalized a user manual, designed related training materials, and prepared to train a focus group on the BRM. Such training will take place in early March 2006. Thereafter, the BRM will be adjusted by integrating the group's feedback, the user manual and training materials will be modified accordingly, and a country-wide training of bankruptcy professionals will take place.

D. Pilot Bankruptcy Cases and Interventions

1. Unis Tadv

As previously reported, the Unis Tadv reorganization, which has been approved and confirmed, marks a key success for FILE and for USAID's efforts in bankruptcy reform. This case continues to represent the most successful demonstration to date of bankruptcy reorganization's power to salvage productive assets, improve efficiency, save jobs, and help to revitalize local communities, all in the course of privatizing a state-owned enterprise. Based on the experiences and lessons learned from Tadv, FILE has derived, assessed, and formulated approximately forty model solutions, sixteen of which have already arisen in eleven other bankruptcy cases. This valuable experience continues to help bankruptcy trustees and judges to recognize situations and issues and to apply ready-made and replicable model solutions (tested responses), thereby saving

considerable time and significantly improving the efficiency of bankruptcy proceedings in BiH.

In December, the new Unis Tativ company, which will take over all assets of the bankrupt Tativ company, was established and its registration papers filed with the court. However, a series of procedural steps must still be taken for the case to be officially closed. The major procedural hurdle to closing the case is a perceived conflict between the bankruptcy law and the company registration law and lack of specific instruction on how to resolve the conflict.

FILE has been working with the company, its creditors and investor, as well as the cantonal and municipal courts, to address the registration issue. Unless resolution can be reached quickly, Tativ's reorganization could be at risk. More than four months have passed since the reorganization plan was approved. Operations continue, but the company's margins continue to decrease. The investor, who is also the company's primary customer, is only placing "subsistence" orders; he plans to purchase the controlling share of the new company, once registered, and is minimizing orders until he takes control. His strategy, however, jeopardizes the company's ability to meet its payment requirements under the reorganization plan.

The parties continued to work on registration of the new, successor company in March. On March 6th, the bankruptcy judge issued a supplemental decision on confirmation of the reorganization plan, which included the information necessary for registration (e.g., company seat, company representative, amount of capital, etc.). This supplemental decision was announced in the Official Gazette on March 13th, and the deadline for appeals against the decision expired on March 24th. Three appeals were filed, claiming that the new company is insufficiently capitalized. The trustee is currently filing his responses with the court.

Further delays in registration could play havoc with the reorganization plan: labor, creditors and customers are all troubled by the delay, with workers threatening to picket in front of the court if the issue is not soon resolved. Similarly, the main customer – which also intends to acquire a controlling block of shares once the reorganization is complete - has begun issuing ultimatums, threatening to reduce its orders unless the situation is quickly resolved.

2. Livnica

Livnica, an iron casting facility from Sarajevo, is a pilot liquidation case. Common BiH practice in the liquidation process has been to use the public auction procedures mandated by BiH's enforcement laws. This three-auction procedure encourages collusive bidding, discourages attendance by serious bidders, and often results in the sale of valuable assets for far less than they are worth. At FILE's urging, new auction rules were successfully tested in the liquidation of Livnica's real property in auctions held in October 2005 and January 2006. At the first auction, two of three lots offered for sale were sold for 66% more than the appraised value. On January 21, 2006, the third lot was sold for 32% more than its reserve price. The Sarajevo bankruptcy judge, who attended the auction, was extremely satisfied with the results and highly praised the new auction rules.

Proceeds from the October 2005 sale will cover 23% of approved claims of creditors. With the addition of proceeds from the January 2006 sale, the creditors' recovery rate has increased to 38%. Two real property parcels, comprising the majority of the company's operating assets, were offered for sale in March 2006. The bankruptcy team assisted the trustee in disseminating information about the sale to interested parties. In addition, FILE arranged for FIPA to publish information about the forthcoming sale on its website, as part of its effort to market bankruptcy investment opportunities to potential investors and to attract foreign capital. These parcels failed to sell at prior auction because bidders were unwilling to offer the reserve price - the minimum bid price set by the trustee.

Written offers for this remaining property were submitted by March 18th. Livnica's creditors committee rejected a bid worth 3.1 million KM, with which creditors might have recovered 91% of the recognized claims in bankruptcy, instead insisting that the property should not be sold for less than 4.5 million KM. FILE made clear to the creditors committee in advance of the auction that it was unrealistic in its expectations and may have missed a golden opportunity to sell the assets and satisfy creditors' claims.

A new auction was announced for April 21, 2006, with a reserve price of 3.36 million KM. The trustee's and creditor committees' justification for this price is that it is 30% of the appraised value; essentially, the number is meaningless. FILE has again voiced its concern that the reserve price is too high, but will assist the trustee in marketing the assets to potential investors.

FILE's intent in Livnica was to conduct a straightforward liquidation demonstrating the advantages of FILE's new auction rules. Unfortunately, bad decisions by the trustee and creditors committee are delaying completion of the liquidation and potentially undermining its results.

3. Alatnica

Alatnica's reorganization plan was approved by creditors on December 14, 2006 at a combined hearing for discussing and voting on the plan. The court confirmed the reorganization plan on January 17, 2006, and the deadline to file appeals expired in mid February. Only one appeal was filed by a worker who felt her rights were undermined by not offering her job in the new company established through bankruptcy. Both the judge and trustee agreed that there was no legal basis for the appeal.

However, prospects for the successful reorganization of Alatnica significantly diminished in March. Previously, the trustee drafted a sales contract that was submitted to Zlato, the buyer under the reorganization plan. One condition in the contract was that Zlato pay the agreed upon consideration upon executing the contract. Zlato sought a bank loan to finance the acquisition price, but its loan application was rejected. Without a loan, Zlato does not have the financial resources to complete the deal. The judge has called for a creditors' assembly within 30 days. If Zlato fails at that time to provide the funds needed to purchase Alatnica, the reorganization plan will fail and the company will likely be liquidated. FILE believes Zlato's ability to obtain the necessary funds from other sources within 30 days is minimal.

4. Energoinvest “TNNO”

Energoinvest, based in Dobož, was the only manufacturer of low-voltage electrical equipment in the former Yugoslavia, exporting 98% of its output to Serbia and Montenegro. It once employed 312 skilled workers, but loss of markets after the war led to mounting debt. Labor unrest over unpaid wages resulted in all production shutting down, and management filed a bankruptcy petition in October 2004. At the request of the bankruptcy judge and trustee, FILE has provided advice on numerous issues arising during the course of the proceedings.

Energoinvest's experience demonstrates the importance of accurate appraisals in helping creditors decide correctly whether liquidation or reorganization best serves their interests. Creditors first voted to liquidate the debtor, based on a flawed appraisal of 8.6 million KM that led them to expect that their 4.4 million KM in approved claims could be repaid in full by selling the assets. Creditors reversed course, choosing reorganization, when an accurate appraisal by FILE-trained appraisers showed the liquidation value of the assets was actually only 1.2 million KM.

FILE assisted the trustee, judge and creditors in formulating a reorganization strategy. Creditors voted in favor of Energoinvest's reorganization plan on December 21, 2005. The plan was confirmed by the court on January 4, 2006. Two appeals were filed within the statutory deadline, which expired on January 31, 2006. The bankruptcy team assisted in preparing responses to these appeals, and both appeals were rejected by the appellate court on March 24th.

This is a very positive development, allowing the bankruptcy judge to proceed with closing the bankruptcy case. Interestingly, Energoinvest and Unis Tadić have similar issues relating to registration of the new, successor company. In Energoinvest, however, the bankruptcy judge also serves as Dobož's registry judge, and she has made clear that she will immediately register the company upon completion of the new company's general assembly meeting, which is scheduled for April 26th.

After his appointment, the trustee, with advice and technical assistance from FILE, restarted production, bringing 86 employees back to work. New markets were identified, and new contracts for 1.93 million KM were signed. Employee wages and social contributions have been paid regularly, in full, and prospects are good for increasing production and hiring more workers.

The reorganization plan, developed with assistance from FILE, provides for the company to continue operations and employ approximately 80 workers. The workers, at their election, will also receive cash or equity in satisfaction of their claims. Other creditors will be repaid approximately 20% of their claims over the next five years. This is considerably more than they would receive if the company's assets were sold in liquidation.

5. Maglic & Stakorina

FILE received requests for technical assistance last year from Maglic Holding, once the biggest wood processing conglomerate in Eastern Herzegovina, and nine of its specialized subsidiaries, which were also in bankruptcy. The project also received a request from Stakorina, a producer of solid wood furniture organized into five units: a saw mill and initial processing facility; a final wood processing center; a parquet manufacturing unit; a furniture unit; and an auto-depot and machinery and equipment maintenance center.

In consultations with FILE, the trustees realized that these companies complement each other, and create synergies that enhance the current value of the bankruptcy estate of each company. They agreed to test the interest of foreign investors in purchasing the two companies as a package, since the sale of both as a combined wood processing and manufacturing complex could create the highest value for creditors of both companies. This creative approach was rewarded by a conditional offer from a Swedish company, Plena, to buy both companies in bankruptcy for 5.3 - 6.8 million KM, invest an additional 5.5 - 8 million to upgrade facilities, and employ 300 workers. Plena requested a long-term, fixed price supply contract, although this term was negotiable.

FILE discussed the request for technical assistance in the reorganizations of Maglic and Stakorina with USAID due to potential inconsistency with USAID's market and pricing strategies and its Cluster Competitiveness Activity (CCA). Due to U.S. Government restrictions on working with Republika Srpska's wood industry, the bankruptcy team ceased in November all activities relating to these bankruptcy cases.

Meanwhile, negotiations between the Swedish company Plena and the RS government continued, with no major breakthrough being reported by the trustee. Hearings on the reorganization plan of four Maglic companies took place in mid-November, and the bankruptcy trustee suggested a public tender for all four companies due to interest from two international investors: the Italian Arena group and the Swedish Plena group. The proposal was not accepted by the majority of creditors and a new reorganization plan was proposed.

In February, FILE received several requests for assistance from the bankruptcy judge and Maglic's two trustees. The judge seeks guidance on issues relating to the sale of the debtor's real estate holdings in Serbia. Similarly, creditors are expressing concern about certain actions of one trustee. Privredna banka complained about irregularities in the bankruptcy proceeding, asking that the trustee be replaced, and requesting that voting on the draft reorganization plan be postponed. In response, the judge canceled the voting hearing. Subsequently, the bankruptcy judge, the trustees, and Privredna banka collectively requested FILE's involvement on various technical issues.

FILE's involvement with Maglic remains suspended until policy issues relating to the RS wood sector are addressed. The bankruptcy team is currently evaluating potential appropriate interventions and means of limiting FILE technical assistance while discussions continue with USAID.

6. Polihem

The Polihem case further demonstrates the success and impact of FILE's training efforts. Polihem, as a part of "Soda So Tuzla Holding" was the leading chemical producer in BiH before the war. At its peak, Polihem generated 120 million KM in annual sales and employed nearly 1,200 people. Sales and profits diminished after the company's privatization, and the company ceased operations in 2000. The company's assets and workers sat idle for years. Bankruptcy proceedings were not opened until after hundreds of workers protested their condition. They and other creditors submitted claims for over 42 million KM against the company, which had appraised assets of approximately 12 million KM.

After years of sitting idle, the company's assets were offered for sale in bankruptcy. This was processed under the old bankruptcy law since proceedings were opened before the new laws came into effect. The trustee, a regular participant in FILE's training sessions, utilized the project's advice on selling strategies to maximize sale proceeds and create a working relationship between the buyer and Polihem employees. Specifically he used proceeds from the sale of non-operational assets to restart production of organic chemicals and re-employ over 200 workers, with plans for additional production and employment. This revitalization and future business prospects attracted the attention of Organika, the third largest sponge producer in the world. And, following FILE's advice, the judge and trustee used the flexibility of the bankruptcy law to create a bidding war between two interested buyers. Through a series of competitive bids and direct negotiations orchestrated by the trustee, Organika topped the other bidder, purchasing Polihem for 10.5 million KM and committing 30 million KM more in investments over a 3 ½ year period.

The sale represents a victory for all parties: Organika obtains an experienced producer of raw materials; Polihem's 260 skilled workers gain secure jobs; Polihem's creditors will receive a reasonable return on their claims once all assets are sold; and the Tuzla region gains a company that provides jobs and tax revenues, and will invest in new technologies to improve environmental conditions.

7. CAJAVEC Elektromehanika

Elektromehanika is a well known producer of electrical equipment for the car industry. The company's financial condition has continually declined, as liabilities continue to mount. Bankruptcy proceedings for Elektromehanika were opened in February 2005. In accordance with the creditors' instructions, the trustee developed a reorganization plan that was discussed on December 16, 2005, revised based on comments received at the hearing, redistributed to creditors, and approved in January 2006.

The reorganization plan assumes that a buyer, currently unidentified, will restart production in one of the existing production facilities, using the necessary minimum of equipment and workers. It further assumes that creditors will be paid from sales proceeds after production is restarted and requires the buyer to continue operating Elektromehanika's core business for at least two years and employ an "optimum" number of workers. The plan fails to provide details on the percentage of claims that creditors will be paid, but calls for realization within two years.

FILE believes that the plan fails to answer two main questions that are relevant for creditors: when their claims will be paid and in what amount. It is not an appropriate model for other reorganizations; instead, it puts off the hard decisions required in bankruptcy and unduly delays the creditors' realization of claims. Certain aspects of the reorganization plan could be reworked and developed into a model for a limited number of insolvent companies; however, the proposed plan incorporates elements that go beyond good practice, making the outcome dependent on future, unknown and unidentified events. FILE does not support this practice.

8. Bosna Express

Bosna Express is a key player in passenger transportation services due to its location and route licenses. Currently, the company has 92 licensed routes (local, regional, country-wide and international). It has incurred losses to maintain these licenses, which may have been avoided if the trustee had heeded FILE's earlier advice to terminate excess workforce. An auction for the sale of all assets and associated rights was held on November 21, 2005. The auction failed, however, because all three bidders placed conditions on their bids, which was not allowable under the auction rules.

An auction for the sale of all assets and associated rights was held on November 21, 2005. The auction failed, however, because all three bidders placed conditions on their bids, which was not allowable under the auction rules. The Creditors' then pushed the trustee to sell the assets anyway and suggested the company be reorganized based on one of the bids. The deepening conflict between the committee and trustee led to a FILE-brokered agreement that the general assembly of creditors determine the future course of proceedings.

The general assembly met on January 12, 2006, rejected the reorganization option, and instructed the trustee to hold another auction on or before February 14, 2006. FILE advised the trustee and the Creditors Committee on appropriate auction procedures, and they agreed to follow the procedures FILE developed and successfully implemented in the sales of Livnica's property (see above). The result was the sale of Bosna Express's assets in February to Centrotrans of Sarajevo for 2,600,100 KM. Creditors in the highest payment rank will be repaid 100% and others will be repaid between 60-70% of their claims.

Centrotrans paid the purchase price deposit, but never released the funds due to questions about Bosna Express' ability to transfer the route licenses. The deadline for payment expired on March 16th, which passed without Centrotrans releasing the funds. Ultimately, Centrotrans will not pay until the trustee registers it as a new "subcontractor" for the route licenses.

A creditors' assembly is scheduled for April 26, 2006, during which other solutions for Bosna Express will be discussed.

9. Alhos

Alhos was a garment and textile company that ultimately ended up in bankruptcy. The bankruptcy team has worked with the judge and trustee for the past several months, providing advice on various issues and helping to structure auction rules for sale of company assets. In March, Alhos' land and buildings were sold to Dnevni Avaz for 4.7 million KM, using auction rules developed by FILE. These sales proceeds are sufficient

to cover 47% of recognized claims against the company, with movable assets still to be sold.

10. Podgradci - Postscript

FILE identified “Podgradci,” a wood processing company in Gornji Podgradci, as a potential pilot case in February 2005, based on the recommendations of the RS Ministry for the Economy, the chief bankruptcy judge in Banja Luka, several different trustees with experience in the wood-processing industry, and other RS wood industry experts.

After significant research, FILE recommended and USAID approved Podgradci as a pilot case in March 2005. FILE’s role ended in April 2005 when the petitioning creditor, under pressure by the RS government, filed a written request to withdraw its petition. The government appointed new management, replaced the representative of the state-owned capital in the shareholders’ assembly, and met with stakeholders to develop a plan for resolving Podgradci’s insolvency outside of bankruptcy.

FILE’s Chief of Party and the USAID CTO held a meeting with the RS Minister of Economy on April 25, 2005 to discuss the government’s reversal of its previous commitment to support Podgradci as a pilot bankruptcy case. The Minister made it clear that the RS government preferred to provide local government and Podgradci’s new management an opportunity to restructure the company outside bankruptcy. The change in the RS government’s position from actively supporting Podgradci’s bankruptcy to actively discouraging it led to the decision, taken in collaboration with USAID, to discontinue further efforts on the company’s behalf.

Since FILE’s withdrawal, no progress has been made in implementing the RS government’s plan to resolve the insolvency outside of bankruptcy; no debt has been restructured, and no new investments attracted. The worsening situation was confirmed by the RS Chamber Commerce, which indicated that production had decreased below 2004 levels. The Government’s only intervention was to approve a special privatization program for sale of its shares. The deadline for offers expired on January 18, 2006, with no expressions of interest.

In March, Podgradci’s workers requested dismissal of the company’s supervisory board and general manager. According to a March 14 article in “Glas Srpske,” the company now owes over 1.5 million KM to its workers, who have not been paid for over four years.

E. Other Activities

1. Bankruptcy Related Law(s)

A draft law on financial restructuring was rejected at the Federal Government’s Session on January 19, 2006. A similar law has been drafted in the RS and is awaiting review by the RS Ministries of Justice and Finance before being submitted to the RS Government. Due to the current “crisis” in the RS Government, it is unlikely that the draft law will be a priority in the near future.

The goal of these draft laws is to avoid bankruptcy by offering distressed companies another opportunity for out-of-court restructuring. The proposed legislation is fundamentally flawed, however, as it offers no realistic or legally enforceable mechanisms for accurately determining the number and value of creditor claims, and no

mechanism for forcing creditors to compromise their claims. Pursuing such legislation will undermine the efficacy of bankruptcy.

2. Bankruptcy Data Collection

FILE continued to collect information on the number of bankruptcy cases filed since the new laws came into effect and the status of such cases in proceedings. This information will be reported in detail as part of FILE's Performance Monitoring Plan. A summary of the number of cases filed in each bankruptcy division, sorted by the party filing the petition is provided in Annex 1.

3. Embassy Presentation

On January 30, 2006, FILE provided a bankruptcy presentation to Embassy and USAID officials. The presentation described project objectives and successes, reviewed the ongoing dilemma and economic impact of corporate insolvency, illustrated how bankruptcy can be used to effectively address insolvency, and examined constraints that currently prevent bankruptcy from being utilized to its fullest effect.

4. Component Three: Court Administration

A. Court Administration

In December 2005, the court administration team deployed FILE's case management software (CMS) in Mostar Municipal and Konjic Municipal Courts and trained judges and court staff on its use. CMS "went live" in Mostar and Konjic in December 2005 and January 2006, respectively.

During the next few months, the court administration team continued to provide technical support to the staff of these two pilot courts, helping them adjust to using CMS as part of their daily work. FILE also used this initial deployment phase to continue refining court processes to better align them with the capabilities of CMS. All incoming cases in each court are now being processed through CMS.

A ceremony was held on February 2nd at Mostar and Konjic Municipal Courts to mark their automation, with the USAID Mission Director and US Ambassador providing introductory remarks. The ceremony was conducted jointly with USAID's JSDP and the High Judicial and Prosecutorial Council (HJPC), giving USAID the opportunity to showcase the accomplishments of both projects in these courts.

Additionally, FILE began training staff of its third and final pilot court, Capljina Municipal Court, on CMS utilization and CMS installation took place in February.

Several bugs have been detected during this initial deployment stage. These bugs are being chronicled, sorted into relevant categories (IT, legal, administrative, etc.), and addressed by the relevant subject matter expert. The fixes are then communicated to the court staff and related training provided.

The largest remaining hurdle to successful implementation is not software-related, however, but results from the parallel processing of older cases under prior, manual practices and new cases under CMS. The parallel procedures currently place an additional burden on intake and registry staff (the effect on judges is minimal); as a result, they are reluctant to fully embrace CMS. FILE, in conjunction with the pilot

courts, is exploring ways to fully integrate older cases into CMS as and when the next case processing step in each such case occurs.

In addition, FILE worked with USAID and the High Judicial and Prosecutorial Council (HJPC) to determine the additional courts to be automated prior to FILE's closure.

1. Software Development

During January and February, FILE continued to refine software functionality based upon the experiences and input of users within the pilot courts. For example, case types and phases were further differentiated, allowing court staff and management to more readily track events, tasks and actions relating to the specific phase of each case. This modification was coded, tested and implemented in February.

At the same time, FILE staff identified and pursued several functionality improvements from the original software design, such as a process to close and re-start repetitive phases within a case. The original design contemplated a "one phase per case" structure common in European courts; change was necessary, however, to reflect current BiH systems and practices. Additional functionality changes have been identified and will be evaluated for inclusion in future CMS releases. System review meetings were held in Konjic and Mostar Municipal Courts to gain insight from key court staff regarding functionality they believe would enhance the productivity of CMS. PING, FILE's software development subcontractor, has submitted a bid to complete coding and testing of the additional functionality and provide maintenance services until FILE closes.

2. Deployment of CMS to Pilot Courts

During the quarter, the court administration team conducted formal training activities in all three pilot courts - Mostar, Konjic, and Capljina Municipal Courts. In addition to classroom training, individual training sessions were held for staff with special learning needs or whose schedules did not allow them to attend scheduled training sessions. The court administration team has now completed formal training in all three pilot courts. As noted above, FILE continued to provide technical support to the staff of all three courts and thus training staff remain in the courts to provide technical support on an as needed basis, addressing specific questions and concerns as they arise. CMS trainers will be available for the remainder of the project term to provide continuing support to all three pilot courts.

In addition, FILE continued to refine its training materials and training curriculum, completing revisions to the CMS User's Manual. These revisions were reviewed with key members of the pilot courts and HJPC to ensure that they adequately reflect user needs.

Efforts also focused on finalizing entry of all backlog cases into the CMS application in all three pilot courts. FILE is funding the short-term services of five data entry clerks (3 in Mostar and 2 in Konjic) to assist the courts in entering all such cases into the CMS database.

3. Deployment of CMS to Additional Courts

FILE has previously identified several shortcomings in terms of the hardware and communications infrastructures needed to support CMS, which limit the number of courts in which CMS can be effectively deployed and maintained. In particular, HJPC has pursued a centralized architecture to support CMS, which requires a wide area

network (WAN) that links all courts to centralized, software application and database servers located at HJPC. The CIPS system is supposed to provide the WAN for the courts, but has been unable to provide reliable connectivity between the pilot courts and HJPC headquarters. As a result, FILE has been operating CMS in a stand-alone environment in each of its three pilot courts (the software can be used in either a centralized or stand-alone environment). As stated in previous reports, the CIPS infrastructure, if properly maintained, is capable of providing a reliable connection to most, if not all, courts in BiH. Currently, however, CIPS is not adequately maintaining the network. As a result, it has been unable to provide a reliable connection between the HJPC and the pilot CMS courts.

Providing reliable connectivity was one of HJPC's major obligations in the draft MOU. Given its problems in doing so, HJPC expressed reservations about deploying the software into multiple courts. After several meetings and discussions, culminating with a meeting on February 20, 2006, HJPC stated its desire to limit the future deployment of CMS to a small number of large courts. This desire was documented in its February 21, 2006 letter in which HJPC insisted that FILE "deploy [CMS] in a limited number of larger courts where a reliable CIPS link to the HJPC centralized server can be established," and recommended the commercial divisions of Sarajevo Municipal Court and Banja Luka Basic Court.

In subsequent discussions, HJPC, USAID and FILE agreed that FILE would conduct a CMS readiness assessment of Sarajevo Municipal and Banja Luka Basic Courts to determine if, in fact, these courts were viable candidates for automation. Discussions also centered on automating a limited number of divisions, rather than the entirety, of each court.

FILE and HJPC jointly conducted the readiness assessment in early March, concluding that both courts were appropriate candidates for automation. Successful implementation is dependent, however, on HJPC meeting critical technical support requirements and being able to provide sustainable communication links between the courts and the server facility at the HJPC.

USAID, HJPC, and Chemonics/FILE discussed HJPC's request at length, and all agreed that automating the commercial divisions of the Sarajevo and Banja Luka courts in lieu of 20 smaller courts was the optimal technical solution. After further discussion with USAID and in accordance with FAR 52.243-07 *Notification of Changes (Apr 1984)*, Chemonics therefore sent a notification of change letter to the project's Contracting Officer (CO), requesting a change in quantity for one of the deliverables of FILE's Task Order (TO). Specifically, the Court Administration and Case Management component of the TO, as amended, currently requires that FILE:

"...select (in close coordination with HJPC) and automate at least an additional twenty first instance or second instance courts."

Chemonics requested that the contract language be amended to require FILE to "...automate at least an additional two first instance or second instance courts," in accordance with HJPC's request and the CMS reality on the ground.

Chemonics is confident that the change from automating 20 smaller courts throughout the country to the two largest courts in the country can be done within the existing

parameters of the TO. The tasks are essentially equal. Automating a large number of smaller courts requires multiple CMS deployments affecting a limited number of users, with significant expenditures on logistical support. Comparatively, automating the two largest courts affects a higher number of CMS users (i.e., court staff), with greater emphasis on training than logistics. Further, it allows for the effective use of train-the-trainers methodologies due to user concentration, thus facilitating future CMS usage and deployment. Consequently this change would not entail any cost adjustments or extension of the TO.

4. Creation of Enforcement “Auction Center”

The working group for establishing the auction center met several times in February, making significant progress in startup activities. The formal incorporation and registration of the center was completed in February. In addition, advertisements were published and candidates were sought for the position of the center’s director (applications were accepted through March 8th). Bids were also solicited for warehousing and office space.

The working group reviewed director applications and analyzed proposed office and warehouse space, and will make recommendations on appropriate candidates and sites.

**Annex 1: Summary of number of cases filed in each bankruptcy division
(sorted by the party filing the petition)**

	Cases filed (2003-2005)			Workers	Tax/SF	State	Total
	Creditor	Debtor	Liquidator				
1 Brcko	0	2	5	0	0	0	7
							0
1 Livno	0	0	0	0	0	0	0
2 Orasje	3	0	0	0	0	0	3
3 Siroki Brijeg	2	0	0	0	0	0	2
4 Gorazde	0	0	3	0	0	0	3
5 Travnik	6	2	1	1	0	0	10
6 Bihac	6	4	0	0	0	0	10
7 Zenica	6	3	2	0	0	0	11
8 Mostar	3	10	2	3	0	1	19
9 Sarajevo	12	16	5	3	0	2	38
10 Tuzla	7	22	3	8	0	0	40
Total FBiH	45	57	16	15	0	3	136
11 Doboј	5	13	1	1	0	0	20
12 Trebinje	0	22	0	1	0	0	23
13 Bijeljina	12	18	4	4	0	0	38
14 Sokolac	28	37	0	0	0	0	65
15 Banja Luka	42	65	11	6	0	0	124
Total RS	87	155	16	12	0	0	270
Total BiH	132	214	37	27	0	3	413
%	32%	52%	9%	7%	0%	1%	100%