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PILOT TEST CASE TRIAL ANALYSIS: BORJA (TESLIC RS)

USAID FOSTERING AN INVESTMENT AND LENDER-FRIENDLY
ENVIRONMENT (FILE)

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**USAID FOSTERING AN INVESTMENT AND LENDER-FRIENDLY ENVIRONMENT
(FILE)**

BiH NEW BANKRUPTCY AND LIQUIDATION LAWS

Program for Bankruptcy Pilot Cases

PILOT TEST CASE TRIAL ANALYSIS

BORJA
(Teslic RS)

INTRODUCTION

Borja is a diversified wood products company based in Teslic, RS. Apparently, it historically has been one of the most important employers in Teslic, where a high-percentage of families include, or included, a bread-winner who worked there or had some other economic connection to the company.

The company today is more or less a holding company for four different wood products operations: Primary sawmilling, Secondary milling, Parquet manufacturing, and Veneer manufacturing.

All of the company's operations have effectively ceased, due to lack of working capital, suppliers' refusals to supply materials on credit, and utilities having cut off services.

For the past several years, all parts of the company were operating well below capacity. Machinery is antiquated and inefficient. The reputation of the company's products in the market place had become poor (although it formerly had a good reputation). Only the veneer part of its business is considered to be "revivable," but that is the company's smallest component.

Because of its financial problems, the Company is undeniably a candidate for bankruptcy – most likely for liquidation, but a "reorganization" (based on the veneer operations) is not out of the question. However, Borja today is not a good choice as a Pilot Case in either context, based on the following facts provided to FILE by the Strategic Privatization Team:

- Borja's creditors are not currently interested in putting Borja into bankruptcy;
- Borja's management decided to file for bankruptcy, was strongly opposed by the labor syndicates, and ultimately resigned, leaving the case with no one to initiate bankruptcy proceedings in the short-term;
- the labor syndicates are currently against any bankruptcy or liquidation and have blocked these processes in the past.

In order to consider this case as a potential pilot more information is needed and FILE should meet with all relevant parties to see whether this is salvageable case.

APPLICATION OF THE SELECTION CRITERIA

The First Twelve Screening Criteria.

The first three Criteria ask whether the case would be significant and positive enough to reinforce our training plans, provide a good learning experience, and have a significant impact towards advancing our overall goal of initiating a fully-implemented bankruptcy system in BiH.

Specifically, the Criteria are:

1. Would the process of adjudicating the proposed case serve as a good example, which would reinforce our training plans and other implementation activities?
2. Specifically, consider whether the *process* would provide a good learning experience, which would benefit, especially, the trustees, bankers, and business professionals involved.
3. Would an adjudication of the proposed case ultimately have a *significant* and positive enough impact to help build confidence in and encourage a broad implementation of the bankruptcy system?

Borja would be a big case, which would have significant impact in the municipality of Teslic (RS). The company used to provide significant number of jobs for the local community and bankruptcy liquidation or reorganization proceeding is regarded as something that will lead to huge increase of unemployment. Same time to the extent the system was ready to handle it (capable trustees, courts, judges, attorneys, etc., all in place, trained and certified) the process of adjudicating Borja in bankruptcy would reinforce our other training. If done well, with a good result, and not too many mishaps, it also could be one which would be described as a “good example.”

However, because of its importance for the municipality, other demands (labor syndicates), or unavoidable mishaps or problems (e.g., massive layoffs and increased unemployment, social tension, etc.), it might *fail* to be a *positive* example. There quite likely would be numerous demands made by the interested parties, most notably the employee group, and the representatives and attorneys of these parties, all of whom would be advocating diverse, perhaps even irreconcilable, interests. Given the size of the company, the magnitude of the claims against it, and the divergent interests, concerted action towards an orderly bankruptcy resolution might not occur; and the judge might be forced to make difficult rulings that would be certain displease someone. Along the same lines, the judge and the trustee, in particular, may be put into situations where they will simply make mistakes, perhaps big mistakes. In the end, Borja might

not be a case that could be cited as a good example of how a bankruptcy case should be conducted.

The application of these first three Criteria to Borja yields an inconclusive result. So far, we can only say that Borja might be a good choice for a Pilot Case but it might not be.

The Fourth Criterion asks whether Borja can be a “government/government” Privatization, where it is a government owned company (“SOE”) where the *controlling* creditor interests are also government held debts. In this case the controlling creditor interests are not government held debts, but rather debt owed to privatized banks. Accordingly, government decision-makers cannot be expected to provide controlling direction to the bankruptcy proceedings and this factor disfavors selecting Borja as a Pilot Case.

The Fifth Criterion provides a critical, objective financial test, asking simply whether there are sufficient assets (liquid or realizable at reasonable market values) to pay the costs of the proceedings, pay the priority and secured creditors, and still allow for the payment of a dividend or other consideration to the general creditors. For Borja this is a close question.

Total liabilities are now in the vicinity of 15.7 Million KM.

Inventories are valued at only 1.7 KM, and receivables at a paltry .37 Million KM. The fixed assets are booked at 22.8 Million KM. Thus, if one could take the fixed assets at “book,” one would suppose that enough assets would be available to pay liabilities and meet some of the bankruptcy adjudication related costs. However, the market value of the Company’s fixed assets is not known, now, to any degree of certainty. Further, an adjudication of Borja would constitute a fairly large, complex proceeding. Accordingly, there is some risk that the proceeding itself would be expensive in terms of fees.

The application of this Criterion to Borja, on this “first look” basis, is simply inconclusive. If Borja remains under serious consideration as a Pilot Case candidate, closer scrutiny must be given to this Fifth Criterion, to relevant data and asset valuations, and to reasonably reliable estimates of professional’s fees and the like.

Criteria Six through Eight ask one to consider the possibility of “streamlining” the case and its likely time constraints. Those that can be “streamlined,” e.g., where pre-packaged Plans are feasible, clearly have an advantage over other cases that may be unavoidably or unexpectedly contentious or time-consuming.

Specifically these Criteria ask:

6. Can the case be adjudicated under a pre-packaged Plan?

7. If a pre-packaged Plan is impracticable, are deadlines/time schedules flexible and favorable?
8. Irrespective of whether or not a pre-packaged Plan is feasible, it is necessary to consider whether the proceedings can be executed in a timely and efficient manner so that a final adjudication and asset or dividend distribution and/or Plan consummation can be accomplished within six to 18 months.

The application of these Criteria appear to militate *against* the selection of Borja as a Pilot Case.

For one thing, a pre-packaged Plan seems to be out of the question because of anticipated intense opposition from workers and workers' unions. Further, this worker opposition is likely to make the whole of the proceedings contentious and delayed. Additionally, from a business perspective, there is no one viable part of the plant that can be pre-packaged.

For another thing, deadlines and time schedules may be problematic right from the start. Currently there is no one that would like to take the responsibility to initiate the bankruptcy procedure. The Company's creditors are most likely to step in first, but their reaction in time is still uncertain. The Directors of Borja resigned after pressure from the labor syndicates. The New Bankruptcy Laws have very rigid, short deadlines. It is a near certainty that these time-schedules and deadlines will cause significant disruption in the adjudication process if Borja were a Pilot Case.

The Ninth Criterion only asks whether the debtor Company meets an appropriate insolvency test, so that a bankruptcy filing is legally appropriate. Clearly, Borja meets this test. Its current ratio of current assets to current liabilities is a mere .28, having dropped in half since the end of last year. It belongs in bankruptcy.

The Tenth Criterion focuses on an issue which could be a critical stumbling block for Borja, that is whether debts owed to former or redundant workers for wages are likely to be a significant obstacle to an orderly liquidation or a reorganization, given not only the amounts owed, but also the ages, attitudes and sophistication of the workers and their representatives. However, more information about the workers should be gathered before reaching a firm conclusion on this issue. Perhaps their reemployment and future employment prospects in the aftermath of a liquidation can be convincingly cast in a favorable light. However, on first look, this Criterion seems to weigh against choosing Borja as a Pilot Case.

The Eleventh Criterion asks whether the debtor company's assets are heavily liened and whether or not it can service its secured obligations. Borja has borrowed 4.2 Million KM secured by a mortgage on its real property. This loan constitutes almost half of Borja's long-term debt. Borja's net cash flow from operations is negative – for the first half of 2003 this negative cash flow appears to have been approximately 1.2 Million KM. At this rate Borja clearly cannot service its secured debt. This means that in a

bankruptcy liquidation, the secured creditors are likely to take control of its assets in short order, preventing an orderly liquidation and leaving nothing for general creditors.

Further evaluation under this Criterion may be appropriate, but it appears to be another factor which weighs against the selection of Borja as a Pilot Case.

The Twelfth Criterion is subjective. It asks whether an adjudication of the Company would present other unavoidably sensitive complications. In this respect, the fact that Borja has such a significant presence in the regional economy of Teslic appears to constitute a “sensitive complication” which would burden the proceedings. This, too, could weigh against selecting Borja as a Pilot Case.

CONCLUSION

Further diligence and a more subjective examination of Borja in light of the Criteria discussed is necessary before one can reach a firm conclusion as to whether or not Borja could be a good Pilot Case. However, on the information available to us at this time the more likely conclusion is that Borja is probably not a good candidate for our Bankruptcy Pilot Case Program. With USAID’s agreement, FILE will begin to undertake additional diligence

Is Borja a good candidate for the Bankruptcy Pilot Case Program?

Criterion to be evaluated	Degree at which the Case meet the Criterion					Score points
	Does not meet at all	Does not meet	Neither meets nor does not meet	Meets	Completely meets	
1			X			0
2				X		+1
3		X				-1
4		X				-1
5			X			0
6	X					-2
7		X				-1
8		X				-1
9					X	+2
10	X					-2
11		X				-1
12	X					-2
<i>Case Total Score</i>						-8