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FROM THE AMERICAN PEOPLE

INTERIM REPORT ON LAWS AND ISSUES

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

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Program for Bankruptcy Pilot Cases:

INTERIM REPORT ON LAWS AND ISSUES

INTRODUCTION

Efficient restructuring or liquidation of failed or failing businesses promotes economic health by freeing capital to flow to sounder investments. The restructuring and liquidation processes must happen quickly and inexpensively, while guaranteeing fairness to both debtors and creditors.

The legal framework for Bosnia and Herzegovina (BiH) previously did not provide an efficient and fair process for bankruptcy. Accordingly, few restructurings or liquidations took place. Both the Federation and the RS have enacted new bankruptcy and liquidation laws that closely regulate bankruptcy proceedings and establish strict deadlines for the processing of cases.

This report summarizes the new legal framework for bankruptcy and liquidation proceedings and provides an initial analysis of issues likely to arise in applying these laws to Pilot Cases, including issues that should be considered in selecting appropriate Pilot Cases and issues likely to arise in the subsequent adjudication of the Pilot Cases.

This analysis is based on the review of laws applicable to bankruptcy and liquidation proceedings and discussions with relevant stakeholders and donor projects. This analysis, together with the ongoing dialogue established with critical implementing partners and colleagues from other projects, forms a key underpinning of the FILE Project’s bankruptcy training program, which will soon begin in earnest employing, among other things, the Training Modules previously developed and submitted to USAID.

Conversations with stakeholders and others interested in the effective implementation of BiH’s new bankruptcy and liquidation regimes (the “New Laws”) confirm both interest and willingness in establishing an operational legal framework that will free capital to flow to sounder investments. These conversations also highlighted several issues that could slow down the implementation of the New Laws and, ultimately, the transfer of capital:

1. the scarcity of well trained and experienced trustees, appraisers, judges, and lawyers – including, notably, that trustee certifications are necessary before any Trustees will be qualified to oversee Pilot Cases under the New Laws;
2. the current absence of commercial courts and the confusion inherent in having parallel proceedings under both the old and new bankruptcy laws going on at the same time. (Note that cases initiated under the old bankruptcy laws will continue to be adjudicated under the old law, which implies that these cases will continue to occupy the time and attentions of the court system and other bankruptcy actors for some time to come. The effect of these continuing “parallel” proceedings may be that cases initiated after the New Laws became effective will not be given due attention, be properly understood, nor be properly adjudicated, even though the

implementation of the New Law should be the first priority of the new commercial courts.);

3. the lack of public confidence in the court system due to generally slow and bureaucratic case management in the past; and
4. the lack of public education concerning the beneficial effects of bankruptcy and liquidation proceedings.

Analyzing the situation in both BiH entities as of 2002, FIAS (Foreign Investment Advisory Service) reported that, “With the increasing activity of small and medium enterprises and the ongoing privatization program in BiH, strong, clear and effective bankruptcy laws are essential to facilitate business restructuring and reorganization for private companies.” The New Laws on Bankruptcy and Liquidation that are now in effect in both entities address this need. These New Laws, in and of themselves, however, are insufficient to create an effective bankruptcy regime. Trustees, judges, other bankruptcy practitioners, and businesspeople must understand their respective roles and the tools for promoting economic efficiency through the swift and equitable resolution of business failures represented by and contained in these New Laws. Continuing professional education for relevant stakeholders not only on the New Laws but also on related laws, regulations, procedures and practices will provide the necessary skills to help stakeholders resolve complex, problematic and delayed cases through legal proceedings in a timely and equitable manner.

Interviews conducted in preparing this report show that most local stakeholders have basic knowledge about the contents of the New Laws. Interviews also confirmed that the most crucial task is to further educate these professionals to develop and apply their skills, to interpret the laws effectively, and to understand their respective duties and responsibilities, as many roles are either new or have significantly changed.

Based on information provided by government officials, judges, trustees, lawyers and other stakeholders, the FILE Project has identified a total of 34 laws, including the New Laws, themselves, that could impact a bankruptcy or liquidation proceeding. An understanding of all these laws is critical to our training programs, especially insofar as trustee certification is concerned. An appreciation of these laws is, also, useful for the preparation of appropriate implementation resource materials for FILE’s core bankruptcy training program. Such materials should include manuals for trustees, benchbooks for judges, guidebooks for appraisers, handbooks for creditors, Court Forms, and other materials for appropriate users. These resource materials will answer frequently asked ; treat practical situations; and provide case studies and fact patterns intended to familiarize stakeholders with potential solutions to complex and difficult bankruptcy and liquidation issues.

With respect to trustee certification, note that in March 2003, the RS Official Gazette # 6/03 (“Sluzbeni glasnik Republike Srpske”) published the “Manual on the Expert Exam for Bankruptcy Trustees,” which specifically identified the 34 laws listed below as those which cover the three major examination areas for the trustees: Bankruptcy Law; Elements of Civil and Commercial Law; and Basics on Accounting and Finance.

BANKRUPTCY AND LIQUIDATION LAWS

1) Law on Bankruptcy Proceedings (Official Gazette of Republika Srpska (OG RS), “Sluzbeni glasnik Republike Srpske”, No. 67/02 and 77/02 and “Sluzbene Novine FBiH” (OG FBiH 29/03) – syllabus:

- Basic Provisions
- General Processing Provisions
- Preliminary Proceeding
- Bankruptcy Proceeding (Instituting a bankruptcy proceeding; Bankruptcy estate and classes of creditors; Opening of bankruptcy proceedings; Legal consequences of opening bankruptcy proceedings; Administration and realization of the assets of the bankruptcy estate; Settlement of the creditors; Termination of the bankruptcy proceeding)
- Reorganization (Preparing the debtor’s reorganization; Acceptance and approval of the reorganization plan; Legal effect of the approved plan and supervision over implementation of the plan)
- International Bankruptcy Proceedings (International authority of the RS courts; Basic Provisions; Prerequisites and proceedings of the recognition of a foreign decision; Legal effects of the recognition of a foreign decision on the opening of a bankruptcy proceeding; Non-recognition of a foreign decision on the opening of bankruptcy proceeding; Foreign coercive agreement and other bankruptcy procedure)
- Punitive Provisions;
- Transitional and Final Provisions.

2) Law on Liquidation Proceedings (OG RS, No.64/02 and OG FBiH 29/03)

- Purpose and Subject of Liquidation Proceedings; Authorized Court; Reasons for Liquidation; Initiation of Proceedings; Institution of Liquidation Proceedings; Opening Liquidation Proceedings and Appointing Liquidation Trustees; Balance Sheet; Coercive Measures; Realization of Property, Mandatory Submission of Proposal for Initiating Bankruptcy Proceedings, Costs of Proceeding; Distribution; Accountability of Liquidation Trustees for Realization and Distribution; Obligations Related to Reporting and Rendering of Accounts; Conclusion of Proceedings; Deletion from Registry; Application of Bankruptcy Regulation; Transitional and Final Provisions.

COMMENTS(1-2): The basic novelties offered by the New Laws compared to their predecessors are that the institution of enforced settlement has been suspended and the institution of reorganization established, and that the legal status of bankruptcy debtor and creditors has changed. A very important change is reflected in a significant increase in the authority of the creditor, related decrease in the authority of the court, and elimination of the bankruptcy council (which used to have broad authorities).

Cases concerning voluntary liquidation are governed by a separate Law in RS - the new Law on Bankruptcy regulates the issues of bankruptcy and proceedings related to forced liquidation and reorganization only.

CROSS-REFERENCE WITH OTHER LAWS

- 3) Law on Courts (OG RS, No. 13/00 and 15/00, correction 16/00, Decrees 70/01 and 77/02; in Federation BiH – cantonal level)
- 4) Civil Procedure Code (Official Gazette of SFR Yugoslavia, “Sluzbeni list SFRJ”, No. 4/77, 36/80, 69/82, 58/84, 74/87, 57/89, 29/90 and 35/91 and Official Gazette of RS No. 17/93, 14/94 and 32/94; FBiH Sluzbene Novine (SN) 53/03)
- 5) Enforcement Procedure Law (OG SFR Yugoslavia No.20/78, 6/82, 74/87, 57/89, 20/90, 27/90 and 35/91 and OG RS No. 17/93 and 14/94; FBiH SN 59/03)

COMMENTS (3-5) These laws effect the administration, venue, and transfer of other cases in which a debtor company in bankruptcy proceedings may be involved. The trustee, the creditors, and the debtor company itself, as well as other entities against whom the debtor company has claims, may be effected by various provisions of these laws and should be knowledgeable about them.

- 6) Labor Law (OG RS No. 38/00, 40/00 and 47/02; FBiH SN 43/99, 32/00)
- 7) General Collective Agreement (OG RS No. 13/98, 39/99, 26/00 and 21/01; FBiH SN 19/00).

COMMENTS (6-7): A significant practical problem effecting bankruptcy proceedings is the “(un)employment issue.” Where there are unpaid workers, especially those having had long years of service these laws, which protect employees’ rights need careful attention.

- 8) Law on Ownership and Other Property Rights (OG SFR Yugoslavia No. 6/80 and 36/90; FBiH SN 6/98, 29/03)
- 9) Law on Real Property Acquisition (OG SR BiH No. 38/78, 4/89, 29/90, 22/91 and 29/94; SL BiH 38/78, 4/89, 29/90, 22/91, 21/92, 3/93, 13/94, 18/94)
- 10) Law on Real Property Cadastre (OG RS No. 19/96 and 15/00; SL BiH 22/84, 12/87, 26/90, 36/90, 4/93, 13/94)
- 11) Law on Real Property Register (Law on Land Registry) (OG RS No. 74/02; SN FBiH 19/03)
- 12) Law on Ownership of Parts of Commercial Building (OG SR BiH No. 37/77; SL BiH 35/77, 38/78, 22/84)
- 13) Law on Commercial Building Lease (OG SR BiH No. 33/77, 12/87, 30/90; and 7/92, 3/93, 13/94)
- 14) Law on land on which a building may be built (OG SR BiH No. 34/86, 1/90, 29/90 and OG RS No. 29/94; and 3/93, 13/94)

COMMENTS (8–14): These laws are critical insofar as the ownership and ability to transfer clear title to real estate are concerned. An understanding of their requirements is critical in any bankruptcy proceeding in which immoveable property is a significant asset.

- 15) Law on Obligations (OG SFR Yugoslavia No. 29/78, 39/85, 45/89, 57/89 and OG RS No. 17/93 and 3/96; SL BiH 2/92, 13/94)

COMMENTS (15): This law is central to civil and commercial matters, as it establishes the basic law of obligations, delineates debts and rights, governs transfers and ownership of moveable property, and otherwise provides an overriding legal regime in which all commercial bankruptcy cases will be adjudicated.

- 16) Law on Business Companies (OG RS No. 24/98 and 62/02; SN FBiH 23/99, 45/00, 2/02, 6/02, 29/03; SN FBiH 23/99, 45/00, 2/02, 6/02, 29/03)
17) Law on Sole Traders and Craftsmanship Activity (OG RS No. 16/02; SN FBiH 52/02, 29/03)
18) Law on Court Registry Records (OG RS No. 24/98 and 37/01; SN FBiH 4/00, 19/00, 49/00, 32/01, 58/01, 14/02, 19/03, 29/03)

COMMENTS (16–18): These laws establish the right of an entity to operate in the corporate form (that is, with limited liability); and provide rules of corporate governance, which are critical when a corporation becomes a debtor in bankruptcy, or a “reorganized” company emerges from bankruptcy in the form of a new corporate entity. The “Law on Sole Traders, Etc.,” similarly governs the right of an individual tradesman to conduct his trade, which in a bankruptcy may, of necessity, have to be administered by a trustee. The “Court Registry Records” law may need to be consulted to see if corporate entities and/or sole tradesman are properly registered.

- 19) Law on Banks (OG RS No. 74/02; SN FBiH 39/98, 32/00, 48/01, 7/02, 41/02, 58/02, 19/03, 28/03)
20) Law on the Banking Agency (OG RS No. 10/98, 16/00, 18/01 and 71/02; SN FBiH 9/96, 27/98, 20/00, 45/00, 58/02, 19/03)

COMMENTS (19–20): These laws are important for several reasons. For one thing, banks usually will be the most significant creditors in most critical bankruptcy proceedings. The recovery of their loans, or at least the limitation of their losses, will be critical to the whole banking system. Bank regulators, governed by the “Banking Agency” law, in turn, will be scrutinizing banks with bad loans, and, sometimes, taking them over and/or closing them on that account. Accordingly, an understanding of these laws is important to the bankruptcy training program.

- 21) Law on Insurance of the Property and Persons (OG RS No. 14/00; SN FBiH 2/95, 7/95, 6/98, 41/98)

COMMENTS (21): Insurance requirements set by law are important to both the preservation of the bankruptcy estate (i.e., “mass”), and to the trustee, who must answer for any unexplainable losses. Insurance is also important for other reasons, too, as debtor company’s prior losses often may be covered by insurance, the proceeds of which may be available to pay creditors.

- 22) Law on Accounting (OG RS No.18/99 and 62/02; SN FBiH 2/95, 14/97, 12/98)
- 23) Law on Finance Activity (OG RS No.12/01; SN FBiH 2/95, 13/00, 29/00)
- 24) Law on Internal Payments (OG RS No.12/01; SN FBiH 15/00, 54/01)
- 25) Law on Payment Transactions (OG RS No. 12/01; SN FBiH 32/00, 28/03)
- 26) Law on Penalty Interest (OG RS No. 19/01; SN FBiH 27/98, 51/01, 52/01)
- 27) Law on Money Laundering Prevention (OG RS No. 52/01; SN FBiH 3/00)
- 28) Law on Bill of Exchange (OG RS No.32/01; SN FBiH 32/00, 28/03)
- 29) Law on Cheque (OG RS No.32/01; SN FBiH 32/00)
- 30) Law on Negotiable Instrument (OG RS No. 4/02; SN FBiH 39/98, 36/99)
- 31) Law on Procurement and Tender Procedure (OG RS No. 20/01; FBiH 49/02, 37/03)

COMMENTS (22-31): Principles of corporate finance and accounting are found in these laws, an understanding of which is critical to the competency of the trustees and other bankruptcy participants. Accordingly, all stakeholders need to be trained on basic finance and accounting principles in the context of bankruptcy and liquidation proceedings. The above listed laws will be analyzed only in the context of a bankruptcy framework.

- 32) Law on Excises Taxes and Sale Taxes (OG RS No. 25/02 and 30/02; in Federation BiH (FBiH 49/02, 37/03)
- 33) Law on Taxes on Benefit (OG RS No.51/01) In FBiH cantonal level, SN FBiH 32a/97, 29/00
- 34) Law on Particular Revenues (OG RS No. 8/94, 29/00, 18/01 and 22/01).

COMMENTS (32-34): Tax laws provide for a critical component of a debtor corporation's indebtedness. Work-outs and reorganizations are only practicable when tax issues are minor, or taxing authorities can be flexible. Accordingly, understanding these basic laws is also important.