Croatia: The New Bankruptcy Act Aims to Accelerate Bankruptcy Proceedings and Resolve Non-Liquidity in the Market

The recently adopted Croatian Bankruptcy Act ("SZ")¹ sets out a new integrated pre-bankruptcy and bankruptcy regime. SZ has entirely replaced the previous bankruptcy act that was in force for 18 years, as well as provisions regulating pre-bankruptcy settlement proceedings prescribed under the Act on Financial Operations and Pre-bankruptcy Settlement ².

It is expected that SZ shall accelerate pre-bankruptcy and bankruptcy proceedings and help to gradually eliminate illiquid companies from the market.

Changes to Pre-Bankruptcy Proceedings

(A) Change of authority

One of the most important changes under SZ is that pre-bankruptcy proceedings will no longer be conducted before the Financial Agency ("FINA") but will fall under the commercial courts. FINA will still be present in the proceedings, but it will now only provide some purely technical support to the courts.

(B) New grounds for initiation of pre-bankruptcy proceedings

A clear distinction between the grounds for initiating pre-bankruptcy and bankruptcy proceedings has been stipulated. Pre-bankruptcy proceedings can be initiated only in the event of the imminent insolvency of a debtor (prijeteća nesposobnost za plaćanje) which shall be presumed in the following cases:

(i) if a debtor has one or more due and unsettled obligations recorded in the Register of Due Obligations kept by the FINA ("Register")³ or;

(ii) if a debtor has failed to pay salaries to its employees for more than 30 days from the date when salaries were last due or;

(iii) if a debtor has failed to pay contributions and taxes related to salaries of its employees for more than 30 days from the date when salaries were last due.

(C) Creditor's right to initiate pre-bankruptcy proceedings

Along with the debtor, a creditor can also initiate pre-bankruptcy proceedings (provided it has obtained the debtor’s consent).

¹ Official Gazette no. 71/15.
² Official Gazette no. 108/12, 144/12, 81/13, 112/13.
³ The Register was introduced under the Act on Foreclosure Over Monetary Assets ("ZPONS") (Official Gazette no. 91/10, 112/12).
Changes to Bankruptcy Proceedings

(A) FINA’s duty to initiate bankruptcy proceedings

One of the most important newly introduced provisions by SZ is an ex officio initiation of bankruptcy proceedings against companies whose accounts have been blocked\(^4\) for more than 120 days. Some statistics show there are approx. 20,000 such companies in Croatia at the moment.

In the event where a company's account has been blocked for more than 120 days continuously, the FINA has a duty to initiate bankruptcy proceedings within eight days from the expiry of this period. According to the Croatian Ministry of Justice, the intention is to firstly initiate bankruptcy proceedings against companies without employees and whose accounts have been blocked for more than a thousand days continuously\(^5\), and then by June 2016, to initiate proceedings against all other candidates qualifying for bankruptcy under SZ.

(B) Changes of the grounds for initiating bankruptcy proceedings

The grounds for initiating bankruptcy proceedings have been reduced to insolvency (nesposobnost za plaćanje) and over indebtedness (prezaduženost) (while illiquidity (nelikvidnost) has been left out).

Insolvency of a debtor is presumed in the following cases:

(i) if a debtor has one or more due and unsettled obligations recorded in the Register for more than 60 days or;
(ii) if a debtor has failed to pay three consecutive salaries to its employee/s.

Further, a company is deemed to be over indebted when its liabilities exceed its assets.

(C) Possibility to carry out business operations of the debtor

SZ has reintroduced restructuring plans and the possibility of the debtor continuing to operate its business during bankruptcy proceedings (both which were abandoned in the previous act). The continuation of debtor’s business operations is allowed for a maximum of one and a half years as of the day of the reporting hearing\(^6\), unless the restructuring plan has been submitted to the court.

(D) Rightful challenging of debtor’s actions

Under the old regulations, the creditor who challenged a legal action of a debtor had to bear all costs of such proceedings and then would share the benefit with other creditors. Under SZ each creditor has a right to contest legal actions of a debtor or on its own account and at its own expense, and would then have priority in the settlement order if the actions are successfully challenged and the monetary benefit thereof is returned to the bankruptcy estate.

\(^4\) According to ZPONS an account of a company is blocked when payments and transfers of monetary assets from such account are not allowed.

\(^5\) Statistics show that there are 15,000 companies without employees owing approx. HRK 14.5 billion.

\(^6\) A hearing where creditors decide of the way forward in bankruptcy proceedings based on the report of the bankruptcy administrator.
(E) Changes to the sale of debtor’s assets

SZ brought further changes to the sale of debtor's assets. Namely, unless decided otherwise by the creditors, debtor's assets will most likely be sold within four rounds of an electronic public auction organized by FINA. At the first auction, debtor's assets cannot be sold below three-quarters of their estimated value, at the second auction, debtor's assets cannot be sold below one-half of their estimated value, and at the third auction, debtor’s assets cannot be sold below one-fourth of their estimated value. At the fourth and final auction, the starting price will be HRK 1.00 (approx. EUR 0.14).

Sale of real estate, ships, aircrafts, or rights entered in public records which are encumbered by a pledge, can be conducted exclusively within the bankruptcy proceedings, depriving the secured creditor of a possibility to initiate enforcement proceedings (as was previously allowed).

(F) Changes to costs of the proceedings

SZ stipulates further changes to settlement of the costs of bankruptcy proceedings. The court shall, inter alia, order the shareholders and the members of the debtor’s supervisory board who failed to duly initiate bankruptcy proceedings to pay up to HRK 20,000 (approx. EUR 2,650) in advance as costs for the bankruptcy proceedings.

(G) New announcement and delivery regime

SZ abandons the practice of publicizing documents in the Official Gazette replacing it with the announcement on the official website of the courts (e-Oglasna ploča). Delivery of documents in the proceedings is considered to be perfected upon the expiration of eight days from the announcement of the documents on the respective website. Most of the documents (eg, proposals for the initiation of the proceedings, notifications and reporting of claims etc.) are to be strictly submitted in prescribed forms; otherwise, the court shall reject them as being inadmissible.

(H) Bankruptcy of affiliated persons

A further interesting development is the introduction of Chapter X of the SZ relating to the bankruptcy of affiliated persons. In bankruptcy proceedings against two or more affiliated persons where the debtor has a dominant influence, the following is stipulated: a) one bankruptcy administrator will be appointed for all affiliated persons, b) unified creditors' bodies deciding on the outcome of the joint bankruptcy proceedings will be established (creditors' assembly and committee), c) one joint bankruptcy estate for all affiliated persons will be deemed to exist, d) the court of territorial jurisdiction for the debtor who has a dominant influence will be competent for the bankruptcy proceedings of all affiliated persons and e) all mutual claims between affiliated persons will cease to exist.

(I) Lists of bankruptcy administrators

Bankruptcy administrators will be distributed into a "list A" and a "list B". On "list A", more experienced bankruptcy administrators eligible for more complicated bankruptcy proceedings will be listed, whereas on "list B", less experienced bankruptcy administrators eligible for handling bankrupt companies having up to two employees will be listed.