ALLEN & OVERY

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Restructuring Across Borders

Croatia: corporate restructuring and insolvency procedures

Contents

Introduction

The three principal restructuring and insolvency regimes for companies under Croatian law are:

- Bankruptcy proceedings (*stečajni postupak*);
- Pre-bankruptcy settlement proceedings (*postupak predstečajne nagodbe*); and
- Voluntary winding-up proceedings.

Bankruptcy proceedings (*stečajni postupak*)

Bankruptcy proceedings are regulated by the Bankruptcy Act. Bankruptcy proceedings are initiated primarily to jointly satisfy creditors' claims through the realisation of the debtor's assets and the distribution of those assets to creditors – ie bankruptcy is primarily used as the mechanism to liquidate an insolvent company. It is also possible to rescue the company through bankruptcy proceedings, as the Bankruptcy Act allows a bankruptcy plan (*stečajni plan*) to be agreed by the creditors and the debtor within the framework of bankruptcy proceedings. Therefore, depending on the result of the bankruptcy procedure, the indebted company may either be dissolved or it may continue with its business operations having been rescued as a going concern through a bankruptcy plan. However, bankruptcy proceedings in Croatia have a negative trend towards dissolving the indebted company upon completion of the bankruptcy procedure. Bankruptcy plans under the Bankruptcy Act tend to be rare.

Bankruptcy proceedings take place under the supervision of the competent Commercial Court (the **Court**). The debtor or any of its creditors may submit an application to the Court to commence bankruptcy proceedings. The Financial Agency is obligated to submit a proposal to commence bankruptcy proceedings if a legal person has due obligations evidenced in the respective registry of the Financial Agency which have been outstanding for longer than 120 days, within eight days as of the expiration of such a period. If the debtor or creditor submits the application to commence bankruptcy proceedings, it must show on the balance of probabilities that the debtor satisfies one of the criteria of incapability of payment or over-indebtedness. If the creditor submits the application to commence bankruptcy proceedings, it must also show, on the balance of probabilities, that it has a claim against the debtor.

Upon the opening of bankruptcy proceedings, a Court-appointed bankruptcy trustee takes over the management of the debtor and its assets. The bankruptcy trustee acts as the main advocate of the debtor.

From the moment bankruptcy proceedings are opened, enforcement procedures against the debtor are terminated and any litigation proceedings, which are not completed at the time of the opening of the bankruptcy proceedings, are stayed.

The Bankruptcy Act also regulates expedited bankruptcy proceedings for companies:

- with no employees and for which the conditions to initiate another deletion procedure from the Court registry are not met, and

- against which unpaid enforcement writs have been evidenced in the Financial Agency's Register of Unpaid Claims for over 120 days.

Where it is proposed to rescue the debtor as a going concern, a bankruptcy plan will need to be put together. The bankruptcy trustee is the only person authorised to propose a bankruptcy plan. The plan can be submitted at any stage of the proceedings, since the Bankruptcy Act does not specify a timeframe for submission. The only restriction is that the bankruptcy plan will not be considered by the Court after the final court hearing in the bankruptcy procedure has been held. A bankruptcy plan must consist of a preparation and implementation section. The preparation section details the measures that have been (or will be) taken in order to preserve the rights of those that it is proposed will participate in the bankruptcy plan. The implementation section sets out the manner in which the restructuring of the debtor's liabilities will be undertaken. Generally there are no restrictions as to what can be proposed in a bankruptcy plan (other than the principle of equal treatment within a creditor cliam) and the usual restructuring options are therefore available (for example, the postponement of payment of creditors' claims, a reduction in the amount to be paid to creditors, debt for equity swaps etc). As a rule all those parties who will participate in the plan must be given a chance to suggest the content of and comment on the proposed plan. The plan must include all creditors, with the exception of secured creditors. It is possible for creditors with a right to separate satisfaction (broadly a form of secured creditor) to be affected by the plan, but the creditor must specifically agree, in the plan, to the rights being affected. For this purpose creditors are organised into separate groups based on their legal rights and/or economic interest. For example, employees will form one group of creditors and creditors with the right to separate satisfaction will form another group if the plan affects their rights. If the approved bankruptcy plan will alter the debtor's title and rights in respect of assets which are recorded in public registries, the appropriate changes, in accordance with the relevant legal obligations, must be sent to the relevant registry.

As a general rule, the restructuring plan must treat all creditors of the same group (regardless of their status) equally. However, it is possible for creditors within the same group to be treated in an unequal manner, but only with the direct agreement of those creditors whose rights would be affected. Creditors must be protected and the Court can refuse to approve a restructuring plan which contains provisions which do not respect the equal treatment of creditors and the protection of the rights of the minority.

The restructuring plan, together with its supporting documents, will be published on the Court's webpage and in the Court's administrative offices so that they can be inspected by the debtor's creditors. The bankruptcy judge will schedule a hearing in order for the creditors to vote on whether or not they approve the plan. Creditors are separated into groups and every group has a separate vote. The groups are:

- creditors with a right to separate satisfaction to the extent that the restructuring plan affects their rights (ie secured creditors);
- creditors whose claims are not 'lower ranked' and creditors whose claims are 'lower ranked' to the extent the restructuring plan states that they are not extinguished (ie the general unsecured creditors including tax claims); and
- employees of the debtor.

The plan will be deemed accepted if, in each group, the majority of creditors in number voted in favour and, if the total sum of the value of creditor's claims who have voted in favour, surpasses by double the value of creditors' claims who have voted against. The debtor must also formally vote in favour of the plan. The debtor will be deemed to have voted in favour of the plan, if the debtor does not file an objection to the plan. After the plan has been voted upon by the creditors and the debtor, the bankruptcy judge decides whether or not to approve the plan. If the plan is confirmed, a copy is sent to all participants and its terms will be binding.

Pre-bankruptcy settlement proceedings (*postupak predstečajne nagodbe*)

Effective from 1 September 2015, the Bankruptcy Act also includes pre-bankruptcy settlement proceedings. Its purpose is to provide more effective solutions for companies which would otherwise face dissolution if bankruptcy proceedings were initiated. The pre-bankruptcy settlement procedure is voluntary and can only be initiated by (i) the debtor, or (ii) by its creditors if the debtor agrees. Upon the initiation of pre-bankruptcy settlement proceedings all prior proceedings initiated against the debtor are stayed for the duration of the proceedings and an application to commence bankruptcy proceedings cannot be made during pre-bankruptcy settlement proceedings. While the restructuring of the debtor through a bankruptcy plan is an exception in bankruptcy proceedings, in pre-bankruptcy settlement proceedings it is the obligation of the debtor to prepare a restructuring plan and put it before the creditors for their approval. The Bankruptcy Act sets out certain obligatory content which the restructuring plan must include. This includes, amongst others:

- a description of the facts and circumstances which gave rise to the existence of the conditions necessary for the commencement of pre-bankruptcy settlement proceedings;
- the financial restructuring measures to be implemented by the plan and a calculation of their likely effects on the debtor's lack of liquidity;
- the operational restructuring measures to be implemented by the plan and a calculation of their likely effects on the profitability of the business and the elimination of debtor's insolvency/threatened insolvency;
- a detailed three year business plan; and
- a formal offer to the creditors containing the terms on which their claims will be settled/amended.

Essentially, in the restructuring plan, the debtor proposes a way in which its debts and obligations will be settled and the period of time in which this will take place.

The creditors will vote on the restructuring plan in classes at a special hearing convened for the purpose of voting. Creditors can also vote prior to the meeting by postal ballot. The classes and the necessary majorities are the same as when a bankruptcy plan is adopted.

If the restructuring plan is approved by the requisite majority of creditors, the Court will make an order confirming the plan and the settlement entailed within. The settlement proposal will reflect the agreed restructuring plan. The pre-bankruptcy settlement procedure is concluded when the court order has been made. The pre-bankruptcy settlement is binding on the debtor and its creditors, regardless of whether they participated in the procedure or not.

Pre-bankruptcy settlement proceedings are classed as urgent proceedings and must be completed within 120 days from the day when the decision commencing pre-bankruptcy settlement proceedings was published. In respect of certain debtors, expedited pre-bankruptcy settlement proceedings must be used and these must be completed within 100 days from the day when the decision commencing pre-bankruptcy settlement proceedings was published. Practice has shown that this period is rarely complied with; therefore the provisions of the Bankruptcy Act allow, at the request of the debtor, for an extension of up to 90 days.

If the pre-bankruptcy settlement proceedings are successful, the debtor emerges as a solvent and liquid company. If no restructuring plan is accepted, the pre-bankruptcy settlement proceedings are terminated. After the termination of any unsuccessful pre-bankruptcy settlement proceedings, bankruptcy proceedings will usually follow since the court is

authorised, in certain events, to continue the proceedings as if a proposal for the initiation of bankruptcy proceedings had been submitted.

Voluntary winding-up proceedings

Voluntary winding-up proceedings are regulated by the Companies Act. Voluntary winding-up proceedings are initiated by the shareholders of the solvent company. In voluntary winding-up proceedings the remaining assets of the company are distributed among the shareholders after the company's creditors have been fully satisfied. If it is ascertained, in the course of voluntary winding-up proceedings, that the assets of the company will not cover the existing liabilities, the company's management must initiate bankruptcy proceedings. Filing for bankruptcy proceedings during the voluntary winding-up proceedings is permitted only before the debtor's assets have been divided among its creditors.

European Insolvency Regulation

The EU Regulation on Insolvency Proceedings 2015 (Regulation (EU) 2015/848) (the **Recast Regulation**) applies to all proceedings opened on or after 26 June 2017. Its predecessor, the EC Regulation on Insolvency Proceedings 2000 (Regulation (EC) 1346/2000) (the **Original Regulation**) continues to apply to all proceedings opened after Croatia's accession to the European Union on 1 July 2013 and before 26 June 2017. One of the key changes in the Recast Regulation is that it brings into scope certain pre-insolvency "rescue" proceedings and these are now listed alongside the traditional insolvency procedures in Annex A to the Recast Regulation. The Recast Regulation retains the split between main and secondary/territorial proceedings but secondary proceedings are no longer restricted to a separate list of winding up proceedings - secondary proceedings can now be any of those listed in Annex A. By contrast, the Original Regulation listed main proceedings in Annex A and secondary proceedings (which were confined to terminal proceedings) in Annex B.

Of the above restructuring and insolvency regimes, only bankruptcy proceedings (*stečajni postupak*) was available a main proceeding under the Original Regulation.

Bankruptcy proceedings (*stečajni postupak*) was also available as a secondary proceeding under the Original Regulation.

Under the Recast Regulation, only bankruptcy proceedings (*stečajni postupak*) was listed in Annex A however, given the wider scope of proceedings under the Recast Regulation, is it expected that pre-bankruptcy settlement proceedings (*postupak predstečajne nagodbe*) will be added to Annex A in the future.

Further Information

For further information on Croatian restructuring and insolvency procedures, we would refer you to the Sweet & Maxwell book "European Cross Border Insolvency" edited by Allen & Overy. To purchase a copy of this book, please visit www.sweetandmaxwell.co.uk

This fact sheet has been prepared with the assistance of Divjak, Topic & Bahtijarevic d.o.o..

Allen & Overy has launched an online service for clients focusing on debt restructurings and insolvency issues.

Developed by Allen & Overy's market-leading Restructuring group, "Restructuring Across Borders" is an easy to use website that provides information and guidance on all key practical aspects of restructuring and insolvency in Europe and the US.

To request access for your organisation, please contact your usual Allen & Overy contact, or email rab@allenovery.com

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