Bankruptcy of Socially Owned Enterprises in Republic of Serbia

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TABLE OF CONTENTS:

ABSTRACT

This work deals with insolvency and bankruptcy of socially and state-owned enterprises in Serbia[4], as well as laws, regulations and the ongoing privatization process. The majority of the analysis in this document is based upon information as at 1st October 2006.

This document is in 4 parts.

1. Part 1 provides an introduction to the transition process in Serbia, with short historical review of regulations of the insolvent socially and state-owned enterprises.
2. Part 2 summarizes the specific characteristics of the Serbian economy, introduces the concept of social property, and provides more detailed analysis of state property in Serbia, as well as an overview of the current privatization process, and previous privatization experiences.
3. Part 3 deals with the Bankruptcy Law in Serbia in general.
4. Part 4 deals with the application of Bankruptcy to Socially owned enterprises and in particular the experiences of Serbian Privatisation Agency Bankruptcy Unit

Key words: Serbia, privatization, bankruptcy, socially-owned enterprises.

Definitions:

The following definitions are used throughout this paper.

BSA	Bankruptcy Supervision Agency
LBP	Law on Bankruptcy Proceedings
New Law	Law on Bankruptcy Proceedings
PA	Privatization Agency
PABU	Privatization Agency Bankruptcy Unit
SOE	Socially owned enterprises
SSOE	State and Socially -owned enterprises

Disclaimer

The views and opinions expressed in this paper and likewise any mistakes, errors or omissions are those of the Author alone.

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[4] Kosovo and Metohija are excluded from data in document. These regions are officially an integral part of Serbia, however under international protectorate.

EXECUTIVE SUMMARY

- With the collapse of the Milosevic regime in 2000, Serbia officially started the path to transition. Economically, the most important aspect of this process has been privatization which it is hoped should be largely completed by 2007.

- In common with the experience of other transitional countries, Serbia has had to face the problem of how to dealing with a large number of insolvent enterprises with existing law and institutions not up to the task. In Serbia's case and particularly as a result of the former Yugoslavia economic model and the depredations connected with the countries isolation, has come the recognition that new institutions and law were needed to overcome this hopefully "one off" insolvency hurdle. At the same time, the solutions introduced could have long term benefit once the transition phase has been passed.

- Serbia's Law on Bankruptcy Proceedings ("LBP" or "New Law") implemented in February 2005 differs greatly from its predecessor. Primarily it provides a more active role for creditors in proceedings, formal licensing and regulation of Bankruptcy Administrators, shortened deadlines and significantly, includes provisions from the UNCITRAL model, a first in Central and Eastern Europe[5].

- Presently, there are approximately 1,300 open bankruptcy cases in Serbia; though the exact number is uncertain due to the fact that the Courts do not publish statistics. Some 900 of these cases are being conducted under the provisions of the LBP, including the oversight by the newly formed regulator Bankruptcy Supervision Agency ("BSA"). In the absence of any better information it is presumed that the remaining cases are being conducted by unlicensed parties, under the supervision of the Courts and under the provisions of the Old law.

- Under the terms of the new law, the Serbian Privatisation Agency ("PA") acting through its Bankruptcy Unit ("PABU") is appointed Bankruptcy Administrator in cases dealing with majority State or Socially Owned Enterprises ("SSOE"). Given that thus far the PABU has been appointed in 40% of bankruptcy proceedings supervised by BSA (which monitors cases being dealt with under the LBP), it is clear that the PABU's role in applying the new law and creating and developing the profession of Bankruptcy Administrators in Serbia is highly significant.

- Given that 60% of the PABU's portfolio of cases consists of proceedings opened under the old law ("old law cases") and the fact that liquidation is the predominant exit mechanism for such cases, are major indictments of the failures of both the SSOE model and the old law. If the SSOE model had been viable one might have expected more restructuring cases, while the old Bankruptcy Law was not capable of closing cases (either by liquidation or reorganisation).

- Results to date suggest that the solutions adopted are working. Insolvencies of SSOE's are being closed and slowly a cadre of skilled and motivated Licensed Bankruptcy Administrators is being built up. However challenges remain, in particular the continued existence of "old law" cases, which are being administered by unlicensed persons. As a result the process of Bankruptcy and particularly the new law is being undermined and

[5] The new Law is conventional, and follows for the most part the German model and affords three exit mechanisms: liquidation, reorganization and sale as a going concern. The law departs from the continental model by introducing an independent Regulator and Licensing Body.

certainly it contributes both to public confusion and engenders resistance and passivity to progress, which regrettably is widely encountered.

1 INTRODUCTION

Life in Serbia is highly exciting. Everyone keeps convincing you that you are on the right track, that you have achieved significant results. At the same time however, you feel that you are continuously watching the same TV channel, and that your remote control is not working. The moment when you realize that something truly is out of order is incredibly important. In Serbia we have recently lived through that moment, yet how aware we are of it remains an open question.

Life in Serbia is not easy. Chronic illiquidity and insolvency have been serious problems for the Serbian economy for a long time and this is especially true amongst the approximately 5,000 SSOE which used to dominate the economy. As one might have expected, over time their economic woes spread to the small and medium-sized enterprises[6]. Thus by the end of 2002, it was estimated that 34.000 commercial legal entities employing nearly 400.000 employees were illiquid and had unsettled liabilities in excess of 1 billion EUR[7]. Further, unemployment is rife, thus even today, it is estimated that 50% of those under the age of 30 do not have a job with an equivalent number who have never been outside the country. Against such a background it is perhaps no surprise that bankruptcy was historically used to maintain social peace and its implementation was under the influence of political decision makers.

Life in Serbia is complicated. By way of example until recently the constitution of the Republic of Serbia recognized three types of property[8], as follows:

- **Private Property.** Until the Second World War almost all property was privately owned but was expropriated under socialism. Private ownership was however, possible even during socialism. The quality of Cadastral registries is variable and they are now being reorganized. At the same time and to date there is no law on restitution, though claimants to property (or their descendants) are wide spread. A Restitution law is presently in preparation.
- **State property.** This is defined by the Law on Assets Owned by the Republic of Serbia, adopted in 1995, as well as other laws. State Property was extended on a number of occasions since the Second World War and now covers a wide variety of items, many of which are no longer appropriate. For example all municipal construction land is State owned.
- **Socially Owned property.** The simplest way to define social property is as a group-ownership category or the collective usage of property without being the titled owner. The concept was developed in the mid 1950's and since that time there was a transition of state property into social ownership. Social property as created was therefore largely a political instrument, and its fundamental flaw is the lack of motivation – the underlying objective isn't profit and property

[6] Estimated at that time to number as many as 50-60,000 enterprises

[7] Economist Magazine, No. 149, Illiquid Economy: Bankruptcy, March.2003 (National Bank of Serbia exchange rate on December 31, 2002 EUR=61.515 CSD)

[8] The Government of Serbia passed a draft constitution on September 30th 2006. At a referendum held on October 28 and 29, the adoption of the constitution was confirmed. The new constitution, unlike its predecessor, does not recognize social property, but instead emphasizes that it shall be transformed into private ownership in keeping with the conditions, manner and deadlines prescribed by law.

increase but rather distribution to the "owners". Indeed, the reality was that the so called "owners" looked to government to carry the real economic burdens of ownership such as making decisions on investment and support of inefficient and uneconomic enterprises.

Taken together life is Serbia is challenging. Today, as a result of our past, we are faced with a large number of insolvent and non-functioning enterprises with dilapidated and outdated facilities, equipment and technologies and excess personnel. The challenge that we face is how to release the capital locked up in such entities, so that it can be redeployed more productively. The solution to this problem is privatisation and the cases where conventional methods of privatisation are not able to succeed; for such enterprises to be placed into Bankruptcy proceedings, so that the assets therein can be returned to use and creditors can finally receive some return on their debts.

2 REFORMS OF THE SERBIAN ECONOMY

Following a lengthy period of isolation, conflict, political, social and economic crises, Serbia commenced its transition in 2000. The initial reforms encompassed the regulation of ownership relations, business environment, foreign trade regime, financial sector, labour market, education system. Since then the country has embarked on major program of privatisation which is scheduled to be completed in 2007 or there about.

2.1 Privatization

Privatization in Serbia can be split into two phases or experiences[9]:

- Prior to 2001 (4 waves starting at the end of 1980's) and
- Post 2001 according to Law on Privatization (adopted in 2001).

In what is a clear case of the first initiative not necessarily leading to first results, is the fact that although Yugoslavia was in the vanguard of former socialist countries to adopt privatization (towards the end of the 80's), the results of these early attempts were little more than a sham. The reasons for this were because the process was largely of a voluntary nature, which introduced no new money or owners and in that sense that period presents a decade of lost opportunities.

In reality therefore, 2001 represents the beginning of privatization in Serbia. The law introduced at that time differed from previous laws in that it was not only market orientated, but was created with the intention of attracting strategic investors, and had well developed models of sale. Essentially three methods are available: Public Auctions for small to medium sized companies, Public Tenders for larger entities and finally the sale of stakes in previously privatised companies, on the Belgrade Stock Exchange.

In addition to the above, the 2001 law established a government Privatization Agency which deals in promoting, initiating, implementing and monitoring the privatization procedure, as well as restructuring socially and state-owned enterprises, with the

[9] A more detailed summary of these waves is attached as an Annex to this paper.

intention of ensuring their successful privatization.

As the following table shows, the results speak for themselves.

Table 1: Privatization results in the period from 2002 to September 2006[10]:

Period 2002-2006	Enterprises offered for sale	Enterprises sold	% successful	Employees 000's	Sales Price Million €
Tenders	129	63	49%	57	948
Auctions	1,812	1,303	72%	124	625
Capital market	913	408	45%	92	377
Total	**2,854**	**1,774**	**62%**	**273**	**1,950**

With regards to the above, it is worth mentioning that there is only a handful of Companies which are majority state-owned- though they tend to be large- and are mostly in the utilities or public transport or communications sectors. For the most part no attempt has been yet been made to privatize such companies and therefore this paper does not address such companies any further.

After six years of reform an analysis of the Serbian Balance Sheet might be as follows[11]:

Facts

- Serbia has 7.5 million citizens[12] and has one of the fastest growing economies in Central and Southeast Europe (in 2005 GDP per capita was US $ 3.158 a more than doubling in 4 years (in 2001 GDP was US$ 1.375));
- Foreign direct investments in 2005 amounted to US$ 1.5 billion, and the same amount for the first ten months of 2006;
- Serbia has an educated and cheap labour force of approximately 3 Million, and has the largest English speaking population in Southeast Europe;
- The tax regime in Serbia is considered to be one of the most attractive ones in Southeast Europe (tax rate on company profit 10%);

Achievements

- In 2004 according to a World Bank report, Serbia was named top global performer for the year;
- In 2005 Serbia's S&P and Fitch credit rating improved to (BB);
- In 2005 EBRD proclaimed Serbia as the leader amongst the 27 countries undergoing transition in that year;
- In 2006 a Financial Times vote for the European Cities and Regions of the Future, named Belgrade the City of the Future of Southern Europe;
- Since 2004 and three years in a row, Serbia has been the winner of the OECD Investor of the Year award for the largest Greenfield investment in Southeast Europe;

Connections

[10] Source: PA database, Centre for the Support of Privatization, September 2006

[11] Doing Business in Serbia 2006, Serbia Investment and Export Promotion Agency (SIEPA), July 2006

[12] Census from 2002, without Kosovo and Metohija

- Serbia is a member of the South East European Free Trade Agreement – a market which consists of nearly 60 million people;
- Serbia is the only country outside the Commonwealth of Independent States which has signed a Free Trade Agreement with Russia (access to a market of 150 million people);
- Serbia has a preferential trade status with the EU and the US;
- Serbia commenced negotiations on accession to the EU in 2005;
- European corridors 10 and 7 travel through Serbia;

3 BANKRUPTCY IN SERBIA

3.1 Bankruptcy under the Old law

From 1989 until February 2005, the Law on Forced Settlement, Bankruptcy and Liquidation[13] ("the Old law") was in effect.

The Old law had a number of major weaknesses, foremost amongst which is that it afforded the protection of the debtor at the expense of creditors' interests. For example with an average duration of proceedings at 7.3 years[14], clearly no prospect of a timely repayment to creditors was being offered.

Further, the provisions and practice surrounding "forced settlement", which was intended to allow for reorganization, rarely led to enterprise revitalization. Indeed, due to poorly defined deadlines within the law, a large number of agreed settlements were never

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[13] The most important deficiencies of the Law on Compulsory Settlement, Bankruptcy and Liquidation were:

- Insufficient precisely defined criteria for: initiating bankruptcy and authorized persons – petitioners;
- The court passed judicial and operative decisions, the bankruptcy panel had the key function;
- The job of the bankruptcy administrator boiled down, in a large measure, to administration. There were insufficient criteria for the expertise of a bankruptcy administrator (there was no obligation to pass an expert exam nor to acquire a license) and with no personal liability and with compensation determined on a monthly basis, there was no incentive for administrators to conclude cases;
- It wasn't mandatory to establish a creditor's commission, nor did the aforesaid have any legally prescribed authorization to make decisions which were fundamental for the course of the bankruptcy proceedings. The creditors commission pursuant to this Law was determined to be an optional body with advisory characteristics;
- The bankruptcy proceedings were established as urgent, but for a large number of actions there was no fixed deadline, especially for court actions;
- Enforced settlement, often used in practice, did now provide flexible and wide ranging possibilities for reorganization;
- Insufficiently precise rules for the sale of assets;
- Employees were fired pursuant to the law on the day when bankruptcy is initiated.

[14] Doing Business in 2004 Serbia and Montenegro Country Profile Monitoring, Analysis and Policy Unit Investment Climate Department World Bank Group, page 4

implemented. And even those which attempted to do so, often found that they were not capable of rejoining normal business life, having been financially drained by the sheer length of the insolvency proceedings and as a consequence, they were once again candidates for bankruptcy.

Finally, a practice developed, the so-called "working bankruptcy" which though not regulated by law, afforded companies the opportunity of remaining in operation for the benefit of their employees, who continued to have a job and accrue pension and benefit rights and even possibly receive salaries, all paid from the realisation of the company's ever diminishing assets. In short "Working bankruptcy" was both "allowed" and indeed "supported" by Courts as their contribution to maintaining social peace in the country.

The length of proceedings, together with the failures of "forced settlement" and the practice of "working bankruptcies" delayed the development of more fundamental solutions for an insolvent enterprise and its creditors.[15]

3.2 Bankruptcy under the New Law

Given the need to carry out economic reforms in Serbia in a just and fundamental manner, as well as the need to revise the existing institutional framework dealing with insolvency, it was recognised early on that there was an opportunity to reform the old law. Indeed, such a step provided a number of opportunities; thus not only could new law be harmonized with best practice and relevant international standards, but it could also address insolvency issues standing in the way of privatization.

A draft new law existed from mid 2002 and was the topic of considerable expert and public debate and indeed was highly graded by the World Bank and EBRD[16].

Finally on August 2, 2004 the new law was adopted, although with implementation delayed until February 2, 2005. The reasons why it took such a long time for the LBP to be adopted, and its postponed implementation are various and include negative political and judicial reactions towards the new legal solutions therein including inter alia: protection of the creditors' interests; precisely defined deadlines, establishing and promoting the profession of Bankruptcy Administrator including their personal liability as well as new takes on reorganization etc.; many of these principles differed fundamentally from the Old law.

In addition time was needed to prepare and set up the necessary institutional framework to ensure that the new regime was in a position to succeed (the creation of the BSA and the PABU, as well as the preparation of more detailed sub legal acts which defined the

[15] Manual for Bankruptcy Administrators, Milo Stevanovic, USAID Commercial Courts Administration Strengthening Activity in Serbia (CCASA), Belgrade, 2005, page 24

[16] In a group of 27 transition countries, EBRD evaluated the LBP as superior (together with the Romanian one), Serbia Investment Climate Assessment, page 44, World Bank, December 2004.

bankruptcy proceedings and the status of the Bankruptcy Administrator. Amongst the later the following were adopted by the Ministry of Economy in 2005:

- National Standards for Managing a Bankruptcy Estate,
- Code of Ethics for the Bankruptcy Administrators and a
- Regulation on the Remuneration and Reimbursement of Costs of the Bankruptcy Administrators.

Unlike its predecessor the new law and associated regulations only deals with bankruptcy proceedings for enterprises[17] and entrepreneurs (though the new law does not recognize personal bankruptcy). Corporate solvent winding–ups or Liquidations, hitherto part of the old law, is now regulated by the Law on Commercial Entities while separate legislation applies to the insolvency of banks and insurance enterprises[18].

Solutions afforded by the new Law include bankruptcy (settlement of creditors- either by a sale of the assets of the bankruptcy debtor, or its sale as "a going concern" / "legal entity[19]") as well as reorganization (settlement of the debtors on the basis of an adopted reorganization plan).

3.3 Institutions Established by the New Law

With the objective of establishing a profession of Bankruptcy Administrators and creating and official regulatory body to supervise said administrators, two key institutions were established. They are the BSA[20] which was started in 2004 and the PABU which was started in January 2005.

The BSA carries out the following tasks:

- it issues, suspends, renews and revokes licenses
- it sets the professional exam which all candidates must pass as a precondition of acquiring a license,
- it maintains a directory of licensed Bankruptcy Administrators,
- it supervises the operations of Bankruptcy Administrators, and
- It collects and processes statistical and other data relating to bankruptcies etc.

As previously mentioned the PABU is the "specialized institution is to be appointed as a Bankruptcy Administrator" in the bankruptcies of SSOE's. More details concerning the role of the PABU and its case load is dealt with in Section 4 below.

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[17] Pursuant to Article 6 of the LBP, it is possible for a public company which is not exclusively financed from the budget of the Republic of Serbia to be bankrupted. To date however, no such proceedings have been opened.

[18] Law on Bankruptcy and Liquidation of Banks and Insurance Enterprises, Official Gazette of the Republic of Serbia No. 61/05

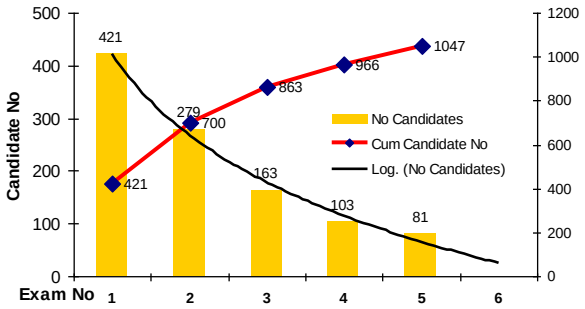
[19] The purchaser of an insolvent debtor sold by a Bankruptcy Administrator as a legal entity acquires the debtor clean of debt, but with all ownership rights and assets attached.

[20] Law on the Bankruptcy Supervisory Agency, from 2004.

3.4 Solutions introduced by the New Law

3.4.1 The Profession of a Bankruptcy Administrator

One of the most fundamental and far reaching reforms introduced was that for the first time Bankruptcy Administrators must meet clear and stringent criterion to be eligible to take appointments: specifically passing an expert exam set by the newly formed BSA and then acquiring a practice license from the BSA. The conditions for sitting an exam are:

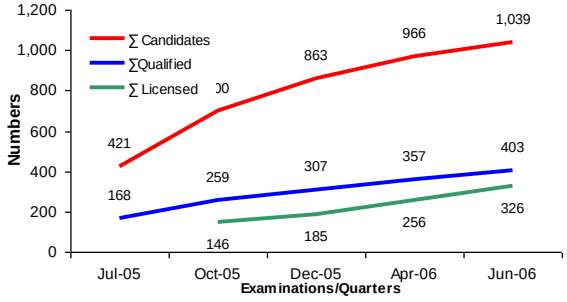


- University degree,
- 3 years of work experience.
- Entrepreneurship status (unlimited personal liability)

The exam consists of written and oral parts, and with 5 sessions to date some 326 licenses have been awarded, approximately 80% of all those who on the basis of passing the exams are eligible to apply for licenses.

The following tables show the take up of candidates for these licensing exams.

Source PABU



the exams to date is less than 40% of all
e time being at least, interest in taking the
recognition that an adequate population of
to have been established.

appointment and removal of Bankruptcy
for damages, remuneration for work,
compensation of costs and relations with the other bodies in the proceedings.

Bankruptcy Administrators are required to submit a report to the Court on the economic-financial standing of the bankruptcy debtor within 40 days from the date when bankruptcy was initiated, and then subsequently monthly reports to the bankruptcy panel, and judge, the Creditors' Committee and assembly and the BSA

In conclusion, relative to the "Old Law", the Bankruptcy Administrator has considerably more operational independence than previously, albeit with the requirement to gain sanctions for significant decisions. By the same token, accountability and reporting requirements mean that they are the subject of intensive oversight and while carrying out their duties (see Enhanced Protection of Creditors below). Collectively these ensure greater transparency of the Bankruptcy Administrators work and greater opportunities for supervision.

Given all of the above it is encouraging to note that already a professional association representing the interests of Licensed Bankruptcy has been formed[21].

3.4.2 Changed Roles for Court Bodies in Proceedings

The LBP have introduced changed roles for the bankruptcy panel and the bankruptcy judge, who now have a purely judicial role, rather than an operative one as well (as in the previous law). Yet another difference with regards to the previous law is the more pronounced role of the bankruptcy judge with regards to the bankruptcy panel.

3.4.3 Enhanced Protection of the Creditors

This has been significantly enhanced with an obligation to convene a Creditors' Assembly and establish a Creditors' Committee. The Creditors' Assembly is composed of all bankruptcy creditors who have the right to vote at the first creditors hearing, and they appoint and remove members of the Creditors' Committee and in theory at least, evaluate the reports of the Bankruptcy Administrator and the Creditors' Committee.

The Creditors' Committee has an executive oversight role in proceedings, and is established in order to protect the interests of bankruptcy creditors. They have three separate types of authorization as follows:

- **Providing Opinions** on the way assets are to be realised, on the continuation of business operations and on the costs and remuneration of the Bankruptcy Administrator etc.
- **Providing Consents** for matters of significance such as taking a credit, the sale of a significant portion of the assets, high value litigation and
- **Filing Complaints** to the bankruptcy panel and bankruptcy judge with regards to the operations of the Bankruptcy Administrator, as well as objections on Bankruptcy Judges' conclusions[22].

3.4.4 Improved Criteria to Initiate Proceedings

Criteria to initiate proceedings and the persons authorized to do so have been improved. Bankruptcy proceedings may now be opened in the event that insolvency is established, pending or presumed. Insolvency is

- **Established** when a bankruptcy debtor cannot meet his liabilities within 45 days of its due date or completely suspends all payments in the period of 30 days), or is
- **Impending** (prior to the date of maturity of the liabilities of the bankruptcy debtor it appears likely that he will not be able to meet his liabilities on the due date) or
- **Presumed** (when the creditor in the executive proceedings could not cash in his claims)[23].

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[21] The Association of Licensed Bankruptcy Administrators (ALBA), with seat in Belgrade, was established on June 9, 2006.

[22] New Legal Solutions in Bankruptcy Proceedings, Dragisa Slijepcevic, Legal Informer, October 2005

[23] Manual for Bankruptcy Administrators, PABU, Intermex 2006, page 160

3.4.5 Improved Reorganization Provisions

The new law provides a wide and flexible range for reorganizing a bankruptcy debtor, including the sale of part of its assets, conversion of debt into equity, taking out credit etc., with the plan capable of being proposed by the Debtor, the Bankruptcy Administrator, or Secured or Bankruptcy Creditors with at least 30% of such claims.

3.4.6 Clearer Provisions relating to Sale of Assets

The advantage of the new law is that it provides clear rules for the sale of assets. Three manners of selling property are allowed: Public Auction, Public Collection of Bids (Tenders) and Directly Negotiated Agreements.

Publicity of the sale is ensured by the following obligations:

- Publishing an announcement in a daily newspapers with a high circulation, domestic and foreign, 30 days prior to the sale, forwarding notification on the intended sale to the bodies of the proceedings, the secured creditors whose property is being sold and interested parties, as well as.
- Forwarding notification on the completed sale.

3.4.7 Rank of Bankruptcy Claim Satisfaction

As mentioned elsewhere the old law was extremely debtor-friendly (read protection of employee's), with claims for unpaid minimum wages ranking as a cost of Bankruptcy, ahead of all other claims (there were only two ranks of claims).

The new law has introduced **four rankings of bankruptcy creditors,** as follows:

1. Claims based on the costs of the bankruptcy proceeding;
2. Claims for up to one years arrears of unpaid net minimum wages, and up to two years unpaid contributions to the pension and disability fund;
3. Claims based on accrued public revenues apart from contributions from the 2nd rank of payment and.
4. Claims of the remaining bankruptcy creditors.

3.4.8 Position of the Employees

Under the LBP, employee contracts are no longer automatically terminated at the outset of a case, instead bankruptcy is merely a reason for the termination of employment contracts. Bearing in mind the emphasized urgency of the proceedings, the more stringent deadlines and the personal liability of the Bankruptcy Administrator, the possibility for the unprofitable engagement of employees has been diminished.

3.4.9 UNCITRAL and Other New Features

As previously mentioned, the new Law now incorporates provisions from the UNCITRAL model law, allowing for the recognition of cross border insolvency proceedings, personal management, bankruptcy of small value and bankruptcy of the entrepreneurs – none of which were legally regulated in Serbia before.

3.5 Bankruptcy in Serbia in General

As at 30th June, 2006 some 1,345 bankruptcy cases were on foot in the 17 Commercial Court in Serbia[24]. Of this amount, more than 50% of cases were with the Belgrade Commercial Court; this is in line with the fact that an equivalent percentage of all companies are registered in the capital city.

Of the total number of cases, some 770 "old law" cases were opened prior to the adoption of the new law, with more than half of them more than 2 years old. As to the 575 remaining "new law" cases opened since the adoption of the new law, more than 70% of them have been open for less than 6 months.

Given that only licensed Bankruptcy Administrators may be appointed to deal with "new" cases or transitioned "old law" cases, the BSA only has information on the 900 or so cases being dealt with by licensed Bankruptcy Administrators. According to the BSA, the PABU was the Bankruptcy Administrator in 40% of cases under their supervision, with the remainder private sector cases being dealt with by private sector practitioners.[25]

Given the above it would seem therefore that there continues to be several hundred "old law" cases still open. This is despite the fact that such cases must have been well advanced at the time of the expiry of the transitionary provisions in the new law, as otherwise they ought to have been transitioned to licensed Bankruptcy Administrators. Of course the fact that the cases are still open begs two questions: Why they were not transitioned, or why have they not been closed?

During 2005, 144 bankruptcy cases were opened, approximately 15 cases a month. In 2006 a higher activity was noted, thus for the first five months some 101 cases were opened equivalent to 20 cases per month, a 30% increase on 2005 figures. By the end of June however, 431 bankruptcies had been opened, with 330 in June alone. It is believed that the reason for the increased number of bankruptcies in general terms is the more active role of the creditors, primarily the banks, while the surge in June was a function of the fact that the newly formed Agency for Commercial Registers had set a deadline for registration of companies as at June 15, 2006[26]. Given that entities which failed to register within the given deadline were to be deemed inactive, it is thought that Bankruptcy petitions were being filed by creditors in order to protect their positions.

Little Reorganization to Date

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[24] BES - Baseline Assessment Report, USAID, July 2006

[25] The new law in its transitional and closing provisions regulates that bankruptcy proceedings, enforced settlements and liquidation initiated in accordance with the previous law and in which a decision was handed down to cash in the assets are to be continued pursuant to the provisions of the previous one, under the condition that within 6 months from the date when the new law came into effect not more than 50% of the book value of the assets has been sold (Article 185, paragraph 2 of the Law on Bankruptcy Proceedings).

[26] By-law on the state administration procedure, organization and legal entities towards inactive commercial subjects deleted from the Commercial Entities Register, Official Gazette of the Republic of Serbia No. 49/2006.

On the basis of information from the BSA there are few reorganizations occurring (less than 30) and of this, 7 are PABU cases. Given the flexibility of the law it is expected that in future that number should rise.

Seen from the perspective of the Bankruptcy Administrator who is in a position to formulate and lodge a plan, the reasons for the present low level of reorganizations include both technical/operational and financial reasons:

- The majority have not been operating for years,
- The markets where they used to place their products have moved on,
- They products they used to make are obsolete,
- Their equipment and technologies are 20-30 years out of date.

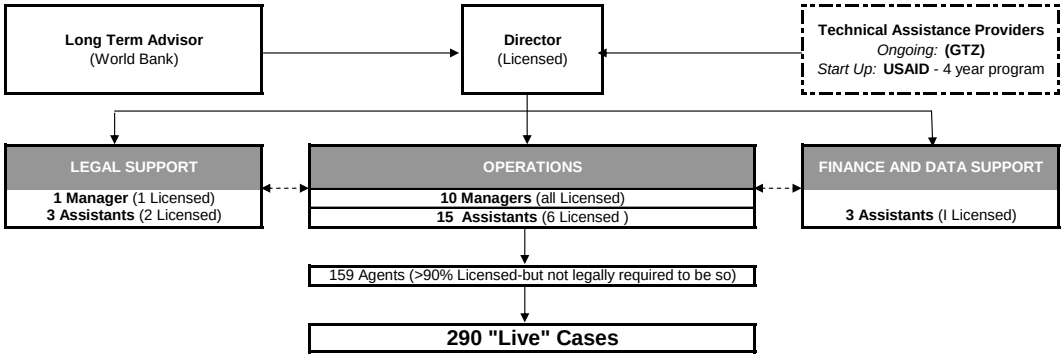
While creditors are themselves in a position to promote plans, it would be relatively unusual for such parties- except for employees- to have sufficient insight and information into the debtor's affairs to be able to formulate a plan.

Generally speaking however, it appears that creditors are still largely ignorant of the law. Experience to date also shows considerable creditor passivity, particularly from those who are themselves SSOE's. Perhaps this is because even though they are often the majority creditors, they are too preoccupied with their own problems of illiquidity and an uncertain future (privatization or bankruptcy).

4 SSOE Bankruptcy –Experience Thus Far

4.1 PABU a New Organisation

As previously mentioned the PABU was set in January 2005 expressly to act as the Bankruptcy Administrator of socially and state-owned enterprise. The following diagram shows the structure of the PABU



As the chart above shows, organisationally, the PABU is led by a Director who is supported by 8 operational teams (in total slightly more than 30 persons) each consisting of a project manager backed up by assistant managers. Each team is in charge of

bankruptcies initiated by one or more Commercial Courts in Serbia[27] (in total 17 commercial Courts) with each team managing slightly more than 30 cases on average. All project Managers and many of their supporting staff hold Bankruptcy Administrator licenses.

Technical support is afforded to the above by a 4 person in-house legal team as well as a Data Control and Processing department.

The PABU leverages its in-house capabilities by engaging agents – typically licensed Bankruptcy Administrators – to perform the day by day conduct of cases subject to the management and supervision of case managers and the PABU director. Thus far, PABU has contracted with 159 agents (nearly half of all licensed Administrators in Serbia). As the following table shows, the majority of Agents have two or less cases.

No of Cases per Agent	No of Agents	% of Total
1	84	53%
2	37	23%
3	25	16%
>3	13	8%
Total	**159**	**100%**

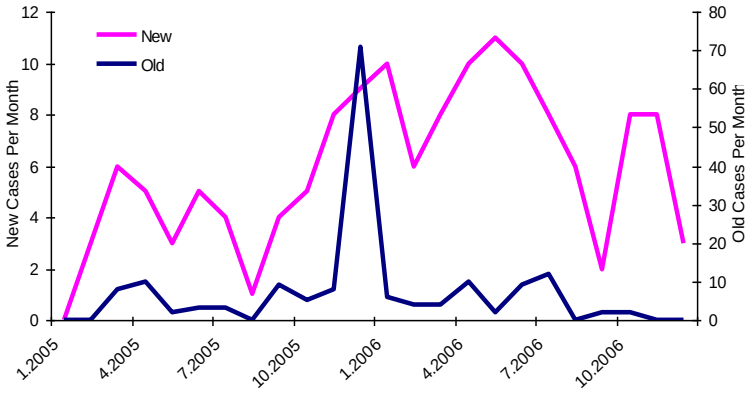
Other than agents referred to above, the PABU contracts out other professional expertise (legal, accounting and valuation etc) as may be required.

4.2 PABU Case Load Development

The PABU took its first case on February 21, 2005, and by October 2006, it had been appointed in 340 Bankruptcy proceedings (of which 293 are active) over Socially-owned enterprises and of this total portfolio some 57% are "old law" cases, transferred to the PABU under the transitionary provisions of the law.

As the chart below shows, with the exception of peak in November/December 2005, being the deadline by which the above mentioned transitionary provisions expired, PABU case load has increased at a fairly constant rate of 15-20 cases per month with mostly "new law" cases being now received.

[27] The Commercial Court in Pristina, Kosovo and Metohija, is not part of the judicial system of Serbia.



The majority of companies in the PABU's portfolio are not in operation; as a consequence, the majority of cases are purely asset sales, though the PABU is supervising 7 approved reorganizations. Purely by way of illustration as to the magnitude of social problems faced by the people in Serbia, the total number of employees who were engaged by such companies in their heydays was nearly 20,000.

As the following table shows, the spread of PABU cases is not significantly skewed towards cases in Belgrade, which is perhaps surprising, given that 50% of all Bankruptcy cases are in that city.

Table also reveals the number of PABU cases per court, and the number of Judges handling PABU cases at those courts.

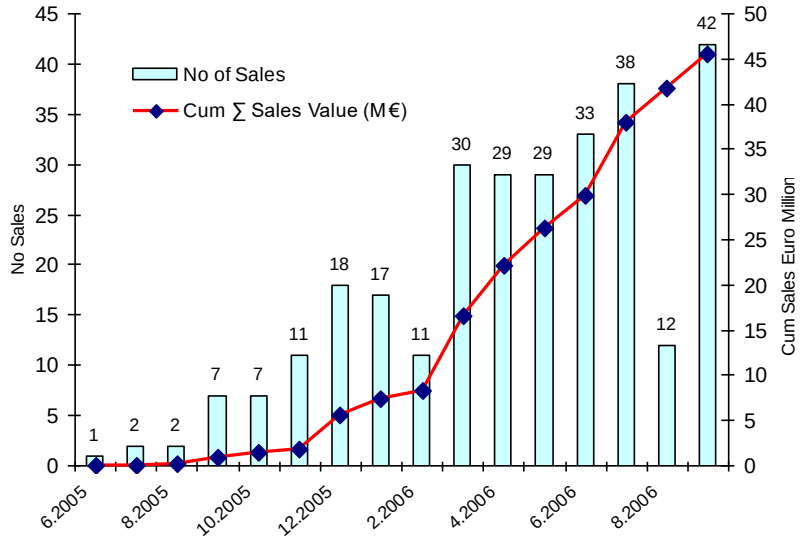
No	Court	No of Judges with PA BU Cases	Average No of PA BU cases per Judge	No of PABU Cases per Court
1	Beogradu	21	2	49
2	Čačku			
	Total	**87**		**293**

With a total of 193 Commercial Court Judges in Serbia, the above table shows that nearly half of all Judges are dealing with at least one PABU case.

More detailed analysis however reveals that 17 Judges or less than 10% of the total are presently handling more than 50% of all PABU cases. This implies that though at present specialist bankruptcy courts do not exist, specialisation in this field does appear to be occurring.

4.3 PABU Sales

As the following table shows within the first 16 months of its operations the PABU has successfully generated more than 50 Million Euro[28] from sales.



The methods used to achieve the above results are as follows:

Table: PABU Asset Realisations: June 2005 to October 2006.

Sales method	Income million EUR	%
Public bids (Auction)	35.7	66.
Public collection of offers (Tenders)	8.0	15
Direct agreement	10.3	19
Total	**54. 0**	**100**

During the aforementioned period some 301 sales were scheduled and of these 225 or 74% were successfully completed.

Table: Overview of organized and successful sales from June 2005 to October 2006.

Sales method	Number of organized sales	%	Number of successful sales	% successful
Public bids (Auction)	195	65.2	135	70
Public collection of offers (Tenders)	68	21.8	64	94
Direct agreement	38	13.0	26	68
Total	**301**	**100**	**225**	**74**

Despite the success to date, when considering the number of participants and sales price

[28] Sales are in Dinar, the above figures are calculated on the basis of the National Bank of Serbia exchange rate on October 1. 2006 EUR=80.3 CSD

achieved relative to estimated values it is clear that there is scope for improvement.

For example 784 legal entities or natural persons participated in the successful sales. However overall in more than half of such cases, less than one participant was involved. The situation was slightly better when one considers tenders, and indeed 94 % of tenders led to successful sales, a markedly better success rate than auctions. However, as is shown below, there was a price to pay for such success.

From a comparison of prices achieved versus estimated values, it appears that overall only in 17% of the 225 successful sales was the achieved purchase price higher than the evaluated value of the assets. In this regard, auctions were more successful than other means of sale, as in 25 % of cases sales prices were in excess of valuation estimates. By contrast only 8% of tenders achieved better than the valuation, with direct negotiations achieving slightly more at 10%.

Given that the legal requirements associated with public advertising and contacts with potential buyers were exceeded by the PABU, the above begs the question as to whether valuation estimates were realistic. Nonetheless it seems reasonable to suggest that more effort needs to be put into promoting and attracting potential buyers. Limiting factors to achieve this are:

- Limited funds are being sanctioned by the Courts for marketing purposes;
- There is a general resistance to use of professional agents to achieve sales (it is also equally true that there are not yet many credible specialists in this field)
- Potential buyers are ignorant of the fact that assets bought in bankruptcy from the PABU are without charges, obligations to maintain employment levels, or social and investment programs (as is the case with privatization);
- Experience and knowledge of how to apply successful marketing campaigns and other sales tools is still limited.

4.4 PABU Case Closures

As October 2006 15 bankruptcy proceedings had been concluded, of 9 which were “new law” cases and 6 were “old law” cases. In addition to this 20 PABU bankruptcies had been suspended.

It is an indictment of the old law, that most of these suspended cases were “old law” transitioned to the PABU, where it was then found that the costs of the administration of the bankruptcy had exceeded the value of the assets in the case, thereby depriving not only the original creditors of any prospect of repayment, but also creating further liabilities which will never be settled. By contrast, only a few “new law” cases have been suspended, and these have been because they were “no asset” cases.

In 47 cases all the assets have been sold and are in the process of being closed. Closure requires a number of matters to be resolved, thus

- 50% are in the phase (completed/execution/controversial/waiting until it becomes valid) of main distribution decisions.

- 25% are awaiting Court resolutions of disputes[29]
- 25% are awaiting the resolution of other issues.

4.5 Problems Faced by the PABU in Practice

As might be expected, issues arise when implementing new procedures in an environment in transition. These can be split into three different groups as follows:

1. **Problems of Inheritance:** These are issues associated with the failures of the past which cannot be resolved but instead must be dealt with
2. **Stakeholder Inertia:** These are issues associated with passivity, resistance and lack of familiarity by stakeholders of the law or willingness to recognise and accept change. These matters can be addressed over time
3. **Deficiencies in the law** – Addressing these requires creativity on the part of the Bankruptcy Administrator and flexibility on the part of the Judiciary; there may also be a need to amend the law, though experience suggests that this should be avoided unless that matter cannot be overcome in other ways.

4.5.1 Problems of Inheritance

Assets were not well maintained – bearing in mind the character of social ownership, one can say that negligence towards property existed. This perhaps should be expected given that those enterprises which are now the subject of bankruptcy did not functioned normally in years, salaries were not paid, illegal appropriation of assets was common place- and this was in most cases perpetrated by management or company personnel.

Records are deficient - The majority of PABU bankruptcy debtors did not use, nor have any computers. Further, updated bookkeeping and other records existed in only a small number of cases[30]. Worse, there are a number of cases – in particular "old law" bankruptcy cases where important bookkeeping documentation appears to have either been destroyed or perhaps never existed in the first place. Bearing in mind the state of property-legal regulations in Serbia, it fails to surprise that Debtors/ Bankruptcy Administrators often do not have adequate information on what they actually own or manage.

4.5.2 Stakeholder Inertia

Creditor Passivity – While increased activity on the part of the creditors has been noted, it is at a low level, and such activity as there is appears more rhetorical than based upon a sound grasp of the law and the rights and obligations which are available to them. To some extent this may be due to the fact that previously creditors were not in a position to influence bankruptcy proceedings. Significantly, State creditors (for example the tax administration) and other state and socially-owned enterprises are especially inactive.

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[29] it is extremely important that the courts start implementing more practical solutions of concluding the proceedings with regards to the disputes, to lower the costs of the proceedings and therefore to protect the interest of the creditors.

[30] International Accounting Standards have been in effect in Serbia since January 1, 2004

A lack of Interest Amongst Buyers – even though the PABU is in full compliance with the law in particular with regards to sales, and generally with regards to publicity of its work; for the most part buyers are still local and there still exists a negative stance towards the assets of bankruptcy debtors, such that competition for them and prices bid are still low.

Problems of Responsive Communications– The new law has redefined the role of bankruptcy judges, which has fundamentally changed such that greater powers (subject to authorization) are given to the Bankruptcy Administrators. At the same time Bankruptcy Administrators are bound by tight deadlines, and are subject to criminal and material liability and multilevel supervision and control by the Courts, Creditors' bodies and the BSA. However, if the system is to work more effectively, it is important that all components respond and communicate quickly, openly and in a straightforward and consistent fashion so that proceedings can proceed at a good pace.

4.5.3 Deficiencies in the law

Deficiencies in the law can be bridged in variety of ways, principally:

- Improving the creativity of the Bankruptcy Administrator through keeping good relations and contacts on different type of issues with creditors and judges and encouraging the Judiciary to be flexible and expeditious in solving the problems;
- Amending the law and associated sub-decrees unless that matter cannot be overcome in other ways, for example through guidelines from the Higher Commercial Court or regulator.

A need for amendments to the LBP and other laws – after almost two years of practice it is clear that amendments should to be made to the LBP, primarily with regards to the deadlines, which are in many cases too short, bearing in mind the limitative factors for fulfilling the said deadlines which appear in practice (for example the re-registration of the enterprises under bankruptcy, insufficient knowledge of the company which renders service of general interest for LBP, insufficient activities of the creditors, primarily state ones), especially in complex bankruptcy proceedings.

It is extremely important to determine the way in which judges should appoint Bankruptcy Administrators, either by methods of accidental appointment, or rotational appointment or other, since that issue isn't regulated at all.

Practice has demonstrated that certain provisions are not precisely worded, while more flexible and agile actions are needed by the judge, the panel, the creditors' assembly and the other participants in the proceedings.

The practice also shows that charges presented in Tariffs for Services Provided by BSA (Managing Board of BSA adopted it in 2005) are too high: presently they are 1% of realisation value of the Bankruptcy Estate and 3% of expenses on the monthly basis. They have to be at least revised.

It would be more useful to have guidelines before starting changing the law. Those guidelines would be of great help for different kind of situations in practice.

5 CONCLUSIONS AND THE LESSONS LEARNED

PABU's Role and Significance

PABU actively takes part in **creating and implementing new practices**, and primarily in **creating a new profession of Bankruptcy Administrators**. In that process, the role of BSA and PABU encompass creating the procedure, reports and raising the level of the publicity of the proceedings.

Bearing in mind that all participants in the proceedings still haven't completely adapted to the new legal solutions and that no significant judicial practice exists, the role of PABU becomes all the more significant in the sense of supporting the establishment of the profession of Bankruptcy Administrator which is still in the initial phase. In that way, standardization in dealing with the Courts, employees, creditors and other participants in the proceedings are enabled. Team solutions (economists, lawyers, advisors) with similar and specific problems within PABU have turned out to be very useful, while when working with a large number of bankruptcy debtors one arrives at an answer to the questions which will in time become practice. One more reason is that many Bankruptcy Administrators (half of all those licensed in Serbia) are also engaged as agents in PABU where they can make use of the stands, opinions and experience of the team managers, legal department of PABU, as well as consultants from the country and abroad: therefore, one can say that PABU also has an educational function.

It is more than apparent that a solid determination exists to eliminate the remaining social property by way of bankruptcy in Serbia, as well as that the deadlines to do so are tight. The benefit is manifold:

- Protection of the creditors, especially by the privileged SSOE;
- Creation and protection of a healthy credit relationship;
- Elimination of enterprises whose property is in a bad state, is not operative, has no market nor products, needed employees or technology and therefore no chance of rehabilitation;
- Reorganization and normal continuation of company operations where that is possible.

The advantages of LBP are more detailed, faster proceedings which depend on the decisions of the creditors and on the liability of the Bankruptcy Administrator. However, it is necessary to harmonize the other laws with any amendments to the LBP as well as resolving the problems noticed in practice.

Apart from illustration of situation and solutions being applied for almost two years from the beginning of the implementation of the "new" law, the prevailing feeling is that, although we chose the right path (finally), there are numerous challenges, and definitely great changes and adaptations to be experienced, yet. Seen from the professional corner there is a good basis of qualitative regulation and a will for carrying out SOE insolvencies. Serbian practices, experienced upon occasions of solving important issues in the past are the most significant pointer for the bankruptcies of SOE's and for the affirmation of the profession of bankruptcy practitioners. Serbian people have got used to changes, and that should be used in the most positive sense.

Minimizing political and individual influences (interference) has always been a problem, especially in countries which found themselves having to solve these issues behind time, and at the same time minimizing them should be the purpose of all of us.

The moment when the courts, regulatory bodies and bankruptcy administrators have to start to cooperate in order to form the best possible practice has started.

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Appendix

RESULTS OF THE PRIVATIZATION LAWS UP TO 2001

Waves	Period of implementation	Result[31]
1. Law on Social Capital (federal)	1990- 1991	33.17% transformed enterprises (out of 3.678). The method most often used was share capital increase (99% of those transformed). Without any fundamental change in the capital structure, since private capital in the transformed enterprises was minimal.
2. Law on the Conditions and Procedure of Changing Social Property into Other Property Types (republic)	1991 – 1994	Obligation of evaluating value for the first time, the method most often used was share capital increase, period of hyperinflation precipitated privatization.
3. Law on Revalorization (republic)	VIII 1994	Revalorization and the revocation of previous privatizations, privatization confirmed for only 3.52% of social capital, period of division of a number of large socially-owned enterprises into a larger number of entities. Result - 85% capital in state and social ownership.
4. Law on the Ownership Transformation.(republic)	1997 - 2001	Primary free of charge distribution of shares to the employees, by a government decision 70 large socially and state-owned enterprises were exempt from this law, obligations of re-evaluating capital value, out of 8.500 enterprises only.1.500 completed re-evaluation, and only 300 commenced privatization.

[31] Zec M., Mijatovic, B., Djuricin, D. Savic, M., Privatization-Necessity or Freedom of Choice, Jugoslovenska knjiga; Institute of Economics, 1994