

Faster, more orderly exit

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Winding up a failed Serbian enterprise could take 10 years or more. The entire bankruptcy process was susceptible to corruption by bankruptcy administrators and judges—including an infamous group known as the “bankruptcy mafia.” After aggressive reforms, the average duration is now less than 3 years, and the procedure itself enjoys greater transparency and professionalism.

The new government that took power in January 2001, led by reformist Prime Minister Zoran Đinđić, faced a daunting task. Since the breakup of Yugoslavia in 1991-92, Serbia had become embroiled in one regional military conflict after another. These conflicts ravaged an economy already weakened by general government mismanagement. By 2000 Serbia’s gross domestic product (GDP) was half that of 1989, public debt was 130% of GDP, and inflation hit 113%. Between 1994 and 2000 the Yugoslav dinar lost 97% of its value.

The Đinđić government made the privatization of state-owned enterprises a cornerstone of its liberalization program. In January 2001 Minister of Economy Aleksandar Vlahović announced that “4 years from now socially owned capital will be completely eliminated”; in June, Parliament passed a privatization law. But it soon became clear that more than 50 years of state planning and neglect had left a legacy that no privatization law alone could fix.

A World Bank report observed that a “functioning bankruptcy law is required in Serbia to provide an efficient alternative to the methods of privatization of social and state capital set out in the Privatization Law.” The Ministry of Economy estimated that 3,000 enterprises were irretrievably inefficient and impossible to privatize through regular auctions and tenders. They would first have to be restructured and then privatized in bankruptcy proceedings. Bankruptcy reform in Serbia was thus closely linked to privatization.

The law then in effect—on forced settlement, bankruptcy, and liquidation—was not adequate. Courts applied it unevenly, opting in many cases for an unofficial and ad hoc “working bankruptcy” that prolonged the existence of uneconomical enterprises to prevent job losses. The law also failed to properly define the roles and responsibilities of bankruptcy administrators and creditors, and it contained no provision for reorganizing viable companies.

Drafting and passing the new law

Vlahović, whose vision and support of the reform process were crucial in launching the bankruptcy reform, decided to push forward with plans to privatize Serbia’s state and socially owned enterprises and introduce, in tandem, a new bankruptcy law at the republic level. He ordered a new law drafted in December 2001, delegating the task to an initial working group that included several commercial court judges, lawyers and law professors.

Progress on the new law was relatively slow until 2003, when donor pressure and the need to fit the law into the Serbian parliament’s schedule led Vlahović and Deputy

Minister Mirko Čvetković to demand an accelerated timeframe. At his request, a group of 4 Serbian and several foreign experts from the World Bank and U.S. Agency for International Development (USAID) produced a first draft within the time demanded.

The core group submitted the draft for public consultation with various Serbian legal authorities, including judges of the commercial courts, the high commercial courts, and the Supreme Court of Serbia, as well as chambers of commerce, attorneys, and law professors. In addition, the chambers of commerce organized forums and roundtables to promote and discuss the draft law.

The Ministry of Economy distributed the draft to the Ministries of Finance, Justice, and Labor (as well as the major trade unions) for review and comment. After the Ministry of Economy reviewed the comments and finalized the draft text, the government of Serbia approved the draft on 5 June 2003. The draft was then handed over to a legislative panel to polish the text and prepare it for reading by Parliament.

Three months earlier, however, the assassination of Prime Minister Đinđić plunged Serbia into a political crisis that stalled the law's passage. A further setback: the December 2003 elections brought to power a government that had no interest in the proposed law and that withdrew the bill from Parliament. Only in March 2004 did the government pick up the draft again. In July 2004, Parliament approved a version of the draft revised slightly to include the UNCITRAL Model Provisions on Cross-Border Insolvency. The Law on Bankruptcy Proceedings entered into force on 2 August 2004 and took effect on 2 February 2005.

Training administrators and judges

Training the administrators and judges was important in implementing the new law, which could work only if the parties with a direct hand in bankruptcy proceedings were familiar with the law. Serbia enlisted USAID and Germany's Gesellschaft für Technische Zusammenarbeit (GTZ) to put together training programs.

ADMINISTRATORS—VALUATIONS IN 22 MINUTES! USAID organized 6 seminars to train administrators. "The seminars focused on practical training," explains Milo Stevanović, the USAID consultant who assisted the committee in drafting the law. For example, the seminars tried to educate administrators on how to work within the new law's strict time limits. "Administrators thought it was impossible to perform a valuation in 30 days—they thought that 1 person would have to count every nut and bolt in the factory," Stevanović continues. "We brought in 1 professional trustee and asked him to give a valuation of the hotel where the conference was taking place. He came up with a valuation in 22 minutes—everyone was startled." Other seminars emphasized other practical issues, from demonstrating how many creditors' claims an administrator can evaluate in 1 hour, to how to conduct asset sales.

JUDGES—OBSERVING PROCEEDINGS FIRSTHAND IN LOS ANGELES. Soon after the release of the first draft, Serbian members of the original drafting group joined U.S. and German experts in touring the country's commercial courts to see the proposed changes.

USAID also sponsored 2 conferences for Serbian judges to discuss issues that arose in their practice, the first in Vršac, a town in the Vojvodina region near the Romanian border, and the second at Lepenski Vir, a significant archeological site in eastern Serbia. The new law met considerable resistance and skepticism at the Vršac conference, but the judges warmed to the law somewhat at Lepenski Vir, as they gradually became familiar with the reforms.

Some commercial court judges also had the opportunity to observe firsthand the workings of bankruptcy courts overseas. USAID consultant Stevanović led 3 groups of 8 commercial court judges on 1- or 2-week study tours to Los Angeles, to observe the U.S. Bankruptcy Court for the Central District of California in action. The judges saw how U.S. judges relied on attorneys to draft orders, used automation, and ran their back offices.

According to Stevanović, it was an “eye opener” for the judges to see the operational nuances of a court that works quickly, effectively, and efficiently: “One judge said she had thought the reforms were moving much too quickly, but once she saw how things worked in Los Angeles, she said she realized that ‘we were incredibly behind and had to move much faster.’ Another judge reported that, if he had had the clarity of what he saw in Los Angeles, he would never have opposed the changes in the law in the first place.” In Stevanović’s opinion, the study tours benefited the implementers of the reform as much as they benefited the judges: “For every dime we spent on [the tours], we saved time and effort on overcoming resistance from the judges. They were welcoming [the new law] instead of fighting it.” Stevanović said that the study tours also bolstered USAID’s credibility as reformers, as judges could “feel and taste and smell” for themselves that what they were being told was not just dry theory, but could be applied in their practice.

Training for judges did not end after Parliament passed the law. Beginning in June 2004 GTZ organized six 2-day seminars for Commercial Court judges, led by Judge Rudolf Voss, an experienced insolvency practitioner from Munich.

In 2006 GTZ organized 4 roundtables attended by 15–20 commercial court judges and representatives of the Privatization Agency and the Bankruptcy Supervision Agency. The roundtables allowed participants to discuss issues in implementing the new law, especially procedures involving socially owned enterprises. Based on the judges’ own evaluations, the sessions were a “comprehensive success.” Miloš Baltić, coordinator for GTZ, observes, “Although both sides were reluctant to open the dialogue at first, after the first half hour, it was difficult to get them to stop talking.”

Eliminating delays

Lawyers, administrators, judges on the High Commercial Court, and officials in the Bankruptcy Supervision Agency, while voicing some reservations, declared themselves satisfied with the reform. One attorney noted that bankruptcy procedures now move much faster and that there is no room for delays and uncertainties. Other improvements include the enhancement of the role of creditors and the more stringent qualifications required of bankruptcy administrators. According to Jay Allen, insolvency counsel at the European Bank for Reconstruction and Development (ERBD), the reform “leads the way in the region.” Meanwhile, the World Bank commended the law as being “designed to minimize the impact of existing institutional deficiencies in the judiciary and the trustee community.”

The Bankruptcy Supervision Agency is one of the real innovations of Serbia’s bankruptcy law, especially in the Balkans and continental Europe. An agency within the Ministry of Economy, it was created to regulate the bankruptcy administrator profession. Robert Gourley, one of the architects of the reform, says that his experience with the Canadian licensing system led him to promote a similar system in Serbia. The code of ethics and professional standards for bankruptcy administrators was another major step. So far 412 individuals have passed the licensing exam for bankruptcy administrators, 339 are licensed by the agency, and 237 are involved in bankruptcy cases.

The law measurably improved all the major areas it was intended to address

STRICT DEADLINES. The reforms set clear timeframes for completing particular parts of the bankruptcy procedure. The average time for a company to go through bankruptcy has fallen from 7.3 years to only 2.7. This shorter duration has also reduced the cost of bankruptcy and enhanced recovery for creditors. All wage, rent, and utility expenses incurred by the distressed company after the start of proceedings are considered bankruptcy costs and have priority over the claims of unsecured creditors.

CLEARLY DEFINED ROLES OF BANKRUPTCY ADMINISTRATORS. The new law requires the bankruptcy administrator to consult with creditors on most important decisions. For example, the bankruptcy administrator must now obtain creditors’ written consent before selling any assets, taking a loan, or granting a lien.

REDUCED CORRUPTION. Only time will tell whether the new law eliminates corruption. But the law puts in place several mechanisms that discourage collusion: the licensing of bankruptcy administrators; the separation of powers among judges, administrators, and creditors; and creditors’ greater ability to influence and determine outcomes. The new law also requires creditors’ written consent for assets to be sold through direct negotiations with a private buyer.

PRIORITY RANKINGS TO CREDITORS' BENEFIT. Secured creditors now enjoy a “super-secured” position that stands above and apart from the priority rankings granted to other categories of creditors and claims: (1) bankruptcy costs, including post-bankruptcy wages, rent and utilities; (2) pre-bankruptcy wages up to 1 year, and unpaid social security and health contributions for up to 2 years, before the opening of the bankruptcy proceedings; (3) tax claims up to 3 months before the opening of the case; (4) all other creditors. The time requirements reduce the claims related to bankruptcy costs and pre-bankruptcy wages, benefiting unsecured creditors.

HIGHER QUALIFICATIONS FOR BANKRUPTCY ADMINISTRATORS. Although many of the administrators who passed licensing exams were also administrators under the old system, Jovan Jovanović, director of the Bankruptcy Supervision Agency, reports that the licensing requirements have had a positive effect on administrators' sense of professionalism. The pass rate was only about 20–25% for the first exams, but 50% for the last exam. Jovanović said that this increase was due to administrators “taking their jobs more seriously.”

Buy-in is crucial

Obtaining the buy-in of the various stakeholders was crucial to the reform's success, but also an area with lessons for future reforms in Serbia and elsewhere. Meetings with union representatives to vet the law allowed the unions to feel that they could have their say. And in the end the unions came out for the law because they received a (capped) wage priority claim that nonetheless ranked near the top.

Not all stakeholders gave their unequivocal buy-in. Despite the apparent success of the training for judges, perceptions of judges' acceptance of the new law are mixed. Gourley, one of the key people behind the reform, explained that, by altering the balance of power between judges and creditors, the new law “undermined not only [judges'] independence but also their freedom of action.” That, of course, was precisely the point. As a result, the law was never widely accepted among all judges, and today a segment of the judiciary consists either of passive cooperators or judges who are actively trying to undermine the law.

One unique outcome of Serbia's bankruptcy reform is the emergence of an ad hoc committee that groups representatives from the Privatization Agency, USAID, and GTZ, as well as 2 supreme court judges, 2 high commercial court judges, and 6 commercial court judges. At its biweekly meetings, 20–25 people discuss issues in the day-to-day practice and implementation of the bankruptcy law. The issues raised—typically 5 or 6 per meeting—are tracked and recorded on a grid. The meetings help prevent misunderstanding and make it easier to get stakeholders' buy-in, since interested parties can voice their concerns and respond to real-life issues that crop up in implementing the law.

New bankruptcy supervisory agency—a great success, but...

The Bankruptcy Supervisory Agency is generally recognized as one of the great successes of the reform. But there is disagreement over whether it has assumed the full mantle of duties it was intended to take on. It has been very successful in training administrators, instituting professional standards, conducting examinations, and issuing licenses. But it has not yet assumed its intended supervisory and—especially—disciplinary functions, stymied by a nonbinding supreme court opinion limiting its regulatory functions.

One observer, to remain anonymous, says, “The agency was told, ‘You’re the regulator’ and the response was ‘What’s a regulator? You can’t expect someone to make fire if they haven’t seen fire before.’” That makes it easy for the agency to stray out of areas it was supposed to regulate into areas where it was not.

Overall, however, Serbia’s experience of bankruptcy reform appears to be an example of a generally successful reform that continues to inspire efforts to further improve the country’s bankruptcy law.