

New bankruptcy law in Croatia

Prof. Dr. Jasnica Garasic reviews the new law



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The modern development of Croatian bankruptcy law started with the Bankruptcy Act¹ of 1996 which entered into force on 1st January 1997. The Act was drafted along the lines of the German Insolvency Act².

The Bankruptcy Act 1996 provided for uniform (integrative) procedures that served the purpose of collective satisfaction of a debtor's creditors by liquidation of the debtor's assets and by distribution of the proceeds, or by reaching an arrangement in a bankruptcy plan, particularly in order to maintain the enterprise. The reorganisation of the insolvent debtor i.e. restructuring of the business was possible only within the opened bankruptcy proceedings by means of a bankruptcy plan. This Act also provided for personal management of the debtor as well as the possible discharge of the residual debt of a natural person. Bankruptcy proceedings were permitted only against legal persons or natural persons who were merchants within the meaning of the Companies Act, or³ craftsmen.

Most of bankruptcy (insolvency) proceedings in the practice were liquidation (winding up) proceedings. Due to different reasons, bankruptcy plans (reorganisation plans) were very rare as petitions to open them were often filed too late, costs of proceedings were too high for creditors, bankruptcy administrators (trustees) usually did not have enough knowledge about preparing bankruptcy plans, etc.

Therefore, the Croatian Government decided in 2012 that the reorganisation and restructuring proceedings were to take place outside of the bankruptcy proceedings. As a result of this decision, the Ministry of Finance prepared the Financial Operations and Pre-bankruptcy Settlement Act⁴ which came into force on 1st October 2012. The main idea of this Act was that every insolvent

debtor and his or her creditors had to try to achieve a pre-bankruptcy settlement in the administrative procedure under the strong supervision of the Ministry of Finance and the Financial Agency before filing a petition for the opening of bankruptcy proceedings. At the same time the Act on Changes and Amendments to the Bankruptcy Act of 2012⁵ abolished the rules on



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bankruptcy plans regulating the reorganisation of the insolvent debtor i.e. restructuring of his or her business. In other words, the reorganisation of the debtor's company and the restructure of his or her business became possible only within the administrative proceedings based on pre-bankruptcy settlements. Unfortunately, the rules of proceedings based on pre-bankruptcy settlements were written within a very short time and without the participation of the Croatian bankruptcy law experts. These rules so deficiently drafted provided an opportunity for misuse in practice. The public perception of the reached pre-bankruptcy settlements and of the whole administrative procedure was negative.

In consequence, the Croatian Government decided to transform pre-bankruptcy proceedings from the

administrative procedures into court procedures and to adapt the rules on a pre-bankruptcy settlement in accordance with the ideas expressed in the European Commission Recommendation of 12th March 2014 on a new approach to business failure and insolvency⁶. The competence for drafting all legislation in connection with bankruptcy law lies with the Ministry of Justice of the Republic of Croatia. It was entrusted with the task of preparing a new bankruptcy law. The new Bankruptcy Act⁷ came into force on 1st September 2015.

The new Bankruptcy Act of 2015 follows the basic structure of the old Bankruptcy Act of 1996. Consequently, many solutions of the Croatian bankruptcy law are furthermore similar to those under the German Insolvency Act. The rules on bankruptcy plans

regulating the reorganisation of the insolvent debtor i.e. restructuring of his or her business were taken over in the new Act. This new Act abolished the rules on a pre-bankruptcy settlement contained in the Financial Operations and Pre-bankruptcy Settlement Act and introduced provisions on the new court pre-bankruptcy proceedings into its own text.

The aim of the new pre-bankruptcy court proceedings is the same as that of the abolished administrative proceedings on a pre-bankruptcy settlement: to reach a pre-bankruptcy agreement between the debtor and his or her creditors outside of bankruptcy proceedings, which will enable the reorganisation of the debtor i.e. the restructuring of his or her business. Most of the rules, which were misused in the administrative proceedings on pre-bankruptcy settlement have been abolished. As a result, the public has much more trust in the commercial courts which now conduct pre-bankruptcy proceedings.

According to the new Bankruptcy Act the pre-bankruptcy proceedings presents only one possibility. The debtor is no longer under the obligation to initiate pre-bankruptcy proceedings before filing for a petition to open bankruptcy proceedings. The creditors may initiate the pre-bankruptcy proceedings only with the consent of the debtor. In any case, the pre-bankruptcy proceeding can be conducted only if the debtor is faced with imminent insolvency. If the insolvency of the debtor has already occurred or in case of overindebtedness of the debtor, the debtor or any of his or her creditors may file only the petition to open bankruptcy proceedings and not the petition to open pre-bankruptcy proceedings. The reorganisation of the debtor, i.e. the restructuring of his or her business is possible in such a case only within the bankruptcy proceedings by means of a

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THE AIM OF THE NEW COURT PRE-BANKRUPTCY PROCEEDINGS IS TO REACH A PRE-BANKRUPTCY AGREEMENT OF THE DEBTOR AND HIS/HER CREDITORS OUTSIDE OF BANKRUPTCY PROCEEDINGS

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**BOTH ACTS
WERE WRITTEN
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bankruptcy plan.

The new Bankruptcy Act rendered more stringent rules on directors' liability for insolvency-related duties, i.e. for a timely filing of the petition to open bankruptcy proceedings.

An accepted bankruptcy plan which has been confirmed by the bankruptcy court can limit the security rights of the creditors. Unfortunately, provisions on effects of a pre-bankruptcy agreement on security rights are not sufficiently clear, so that it is questionable whether these rights can be limited by an accepted and confirmed pre-bankruptcy agreement.

A pre-bankruptcy agreement can not affect the claims of the employees. Their claims are the only privileged claims in the bankruptcy proceedings. These claims are in the first payment rank.

Fraudulent (detrimental) transactions and omissions of the debtor made prior to the opening of the bankruptcy proceedings may be avoided not only by a bankruptcy administrator (trustee) but also by a debtor's creditor. The new Bankruptcy Act contains detailed provisions on the conditions and circumstances in which a creditor instead of the bankruptcy administrator may avoid debtor's fraudulent (detrimental) transactions.

According to the new Bankruptcy Act all submissions in pre-bankruptcy proceedings as well as those in bankruptcy proceedings may be exclusively filed by means of standard forms. As a rule, communications of the court shall be served upon participants in pre-bankruptcy proceedings and in bankruptcy proceedings by means of publication on the website Electronic Notice Board of Courts (<https://e-oglasna.pravosudje.hr>).

It should be emphasised that differently from the previous Bankruptcy Act, the new Bankruptcy Act provides for a continuous professional training and professional improvement for bankruptcy administrators even

after they have passed the state exam for bankruptcy administrators, have been listed as bankruptcy administrators and have obtained a permission to be appointed in pre-bankruptcy and bankruptcy proceedings. This permanent education of bankruptcy administrators should contribute to the increasing of the number of the bankruptcy cases where bankruptcy plans (reorganisation plans) would have been made.

Since 1996 Croatia has very detailed and modern rules on international bankruptcy (insolvency) that regulate *inter alia* the international jurisdiction for the opening of bankruptcy proceedings, presumptions and procedure for the recognition of foreign decisions on opening bankruptcy proceedings, the applicable law, the opening of secondary and particular bankruptcy proceedings, as well as cooperation between main and secondary bankruptcy proceedings. All these rules are taken over in the new Bankruptcy Act. These rules of the Croatian autonomous international bankruptcy law shall be applied towards the countries that are not Member States of the European Union. The European Regulation on Insolvency Proceedings⁸ shall be applied between the Member States.

The number of citizens who were unable to pay their due debts would steadily grow and, as a result, the Croatian legislator took the decision to draft a special Consumer Bankruptcy Act⁹ in 2015, which entered into force on 1st January 2016. The purpose of this Act is to allow an honest consumer to be discharged of all obligations remaining after his or her assets had been encashed (liquidated), the obtained proceeds had been distributed to his or her creditors and a period of good conduct has elapsed. A judge determines the length of the period of good conduct which can be between 1 to 5 years. It is important to emphasise that a debtor must seek an out-of-court settlement with his/her creditors. For this

reason, out-of-court proceedings shall always be carried out before the initiation of consumer bankruptcy proceedings. Croatian consumer bankruptcy proceedings are in many aspects similar to German consumer insolvency proceedings.

The Bankruptcy Act and the Consumer Bankruptcy Act 2015 are currently the main sources of bankruptcy law in the Republic of Croatia. Unfortunately, both Acts were written in a hurry before the elections. In my opinion, they leave much room for further elaboration and improvement, especially provisions on pre-bankruptcy proceedings and consumer bankruptcy proceedings. ■

Footnotes:

- 1 Bankruptcy Act, *Stečajni zakon*, Official Gazette Narodne novine nos. 44/1996, 29/1999, 129/2000, 123/2003, 82/2006, 116/2010, 25/2012, 133/2012.
- 2 Insolvency Act, *Insolvenzordnung*, Official Gazette Bundesgesetzblatt I, no. 1994, p. 2866, entered into force on 1st January 1999, last amendment on 20th November 2015.
- 3 Companies Act, *Zakon o trgovačkim društvima*, Official Gazette Narodne novine nos. 111/1193, 34/1999, 52/2000, 118/2003, 107/2007, 146/2008, 137/2009, 125/2011, 152/2011, 111/2012, 68/2013, 110/2015.
- 4 Financial Operations and Pre-bankruptcy Settlement Act, *Zakon o financijskoj nagodbi i predstečajnoj nagodbi*, Official Gazette Narodne novine nos. 108/2012, 144/2012, 81/2013, 112/2013, 78/2015.
- 5 Act on Changes and Amendments to the Bankruptcy Act, *Zakon o izmjenama i dopunama Stečajnog zakona*, Official Gazette Narodne novine no. 133/2012.
- 6 C(2014) 1500 final.
- 7 Bankruptcy Act, *Stečajni zakon*, Official Gazette Narodne novine no. 71/2015.
- 8 Council Regulation (EC) No 1346/2000 of 29 May 2000, Official Journal of the European Communities, L 160/1. The reformed Regulation shall be applied from 26 June 2017: Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast), Official Journal of the European Union, L 141/19.
- 9 Consumer Bankruptcy Act, *Zakon o stečajju potrošača*, Official Gazette Narodne novine no. 100/2015.