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# STUDY ON ACCOUNT BLOCKING IN THE REPUBLIC OF MACEDONIA AND ITS IMPACT ON FINANCIAL RESTRUCTURING AND REORGANISATION

## MACEDONIA


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## 1. Executive Summary[1]

Under Macedonian law, there are three (3) enforceable instruments that incorporate cash sweeping and account blocking capacities: (i) an enforceable document (such as notarised bills of exchange); (ii) a decision by a competent governmental authority; and (iii) a court decision or court settlement on enforcement.

Bills of exchange are the only instruments out of the three above that are regularly offered as collateral to creditors. The other two instruments either: (i) require court proceedings prior to cash sweeping and account blocking (i.e., court decisions within enforcement proceedings); or (ii) require prior involvement of the competent authorities (Public Revenue Office, Customs Administration of the Republic of Macedonia, Ministry of Finance, local self-government bodies, Water Management Fund).

In fact, due to their direct cash sweeping and account blocking capabilities, bills of exchange have become the most popular security instrument among creditors in the Western Balkans and are widely used in every day commerce and financial transactions. If duly notarised, bills of exchange can be directly enforced by a bailiff without initiating court proceedings.

Cash sweeping is a two-stage process. First, the proceeds on the debtor's bank account held at the bank to which bills of exchange are presented for enforcement are transferred to the creditor. If such proceeds are not sufficient to cover the creditor's claim in full, proceeds up to the value of the claim are transferred to the enforcing creditor form any other bank accounts of the debtor.

Account blocking is activated only if cash sweeping does not satisfy a creditor's claim in full. It consists of blocking of all payments from the debtor's bank accounts and transfer of all proceeds from such bank accounts to the enforcing creditor until the creditor's claim is satisfied in full.

In comparison to the neighbouring countries legislation – where the respective National Banks have retained their centralised cash sweeping and account blocking role, the account blocking procedure in Macedonia does not provide for registration of bills of exchange, nor a centralised account blocking mechanism.

In addition to Slovenia, Montenegro has recently outlawed direct enforcement of bills of exchange. Namely, the strength of bills of exchange as an enforcement mechanism in Montenegro has been significantly reduced by a recent decision of the Montenegrin Constitutional Court which abolished provisions of the Montenegrin Enforcement Act that gave bills of exchange direct cash sweeping and account blocking powers. The Montenegrin Constitutional Court found direct enforcement of bills of exchange to be contrary to the Montenegrin Constitution, on a number of grounds including that it violated the debtor’s basic right to property. The decision effectively requires bills of exchange to be enforced through court proceedings thus the Montenegrin Constitutional Court rendered enforcement of bills of exchange to be on equal footing with enforcement of any other monetary claim.

[1] Terms are defined in Appendix 3 on pages 55 and 56.

The debtor's resulting illiquidity may also impact its counterparties, if their income relies on revenue generated from doing business with the debtor. Besides, the enforcement of bills of exchange could also trigger a downward spiral for the debtor's business, as other creditors may try to enforce their own bills of exchange before the debtor's cash reserves are depleted.

The chances of successful work-outs are also considerably hindered (if not rendered impossible) by the effects of enforcement of bills of exchange. For a debtor's business to be restructured, it must be viable in the first place. No viability is possible once bills of exchange have been enforced.

As opposed to out-of-court restructuring, court reorganisation based on a plan or arrangement with creditors is less exposed to unilateral creditor action. The entire reorganisation process is carried out within formal bankruptcy proceedings, during which a moratorium (i.e., automatic stay) halts actions by creditors to collect their claims from the debtor.

In contrast, voluntary out-of-court restructurings are not protected against unilateral creditor action throughout the process. Due to their voluntary nature, such restructurings are only obligatory for creditors wishing to participate, leaving the non-participating creditors free to enforce the bills of exchange they hold.

Pre-packaged reorganisations based on pre-packaged plans are exposed to the devastating effects of bills of exchange only during the preparatory and negotiation phases, unless a stay is granted by the bankruptcy judge upon the debtor's request.

Therefore, in order to create a framework friendlier to out-of-court restructuring and reorganisation, the powers and capabilities attached to bills of exchange must be reduced and/or gradually removed.

Due to the vast popularity[2] of bills of exchange among Macedonian creditors, any attempt to transition to a system where bills of exchange would not be capable of direct cash sweeping and account blocking should be undertaken in several phases, in order to avoid excessive market disturbance that may be caused by an abrupt change such as recently has occurred in Montenegro[3].

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[2] Market research evidences that over 90% of market participants request bills of exchange from their debtors. For further information, please see Section 4.11.1 below.

[3] Since September 2017, direct enforcement of bills of exchange is no longer possible in Montenegro due to such enforcement being declared unconstitutional. Further, all on-going proceedings before Central Bank of Montenegro (in charge for centralised cash sweeping and account blocking) were terminated and creditors were referred to enforcement before courts/bailiffs.

- **Phase 1** – Elimination of direct account blocking and strengthening of other cash collateral instruments[4]

  In phase 1, account blocking would, through legislative reform, be eliminated as an inherent characteristic of bills of exchange, leaving bills of exchange as a tool that only has cash sweeping capabilities.

  Given (i) the cumbersome perfection of account pledge (in comparison to bills of exchange which do not have extra perfection requirements); (ii) the lack of a concept of a floating charge over accounts meaning future cash balances are not captured; (iii) the lack of immunity of pledged accounts from other creditors e.g. presenting bills of exchange; and (iv) legal uncertainties regarding the existence and enforcement of account pledge, the current legislation should be amended to provide for a functional bank account pledge, which creditors may view as a suitable alternative to the existing bills of exchange.

- **Phase 2** – Limitation of the capability of bills of exchange to directly sweep cash from a specific bank account only[5]

  Within 12 - 18 months of the introduction of a functional account pledge through legislative reform, the power of bills of exchange may be further reduced by limiting their cash sweeping capabilities to the debtor's account kept within the bank to which bills of exchange are submitted for enforcement, instead of cash sweeping across all debtor's bank accounts.

- **Phase 3** – Removal of the capability of bills of exchange to directly sweep cash from any bank account of the debtor[6]

  The final phase, to be implemented 12 - 18 months after the implementation of phase 2 and in parallel with extending the Financial Collateral Act to mid and small size corporates as well as capacity building regarding financial collateral arrangements to encourage greater market use, would consist of entirely eliminating the direct cash sweeping capabilities of bills of exchange. This would be achieved through the introduction of a requirement that bills of exchange only be enforced through a court ruling, rather than directly. Effectively, this change would place bills of exchange on an equal footing with other monetary claims (e.g., claims arising out of ordinary commercial agreements).

  Deadlines for implementation of phases 2 and 3 are only suggested periods and are to be discussed with the regulators taking into account the duration of the legislative reform process, the immense popularity of bills of exchange, and the time required for account pledges to become market practice.

  Defined terms are in Appendix 3 on pages 55 and 56.

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4 For further details, please see Section 7.1 below.

5 For further details, please see Section 7.2.1 below.

6 For further details, please see Section 7.2.2 below.

## 2. Study Background and Methodology

Moravčević, Vojnović and partners AOD in cooperation with Schönherr (the "**Legal Consultant**") has been engaged by the European Bank for Reconstruction and Development ("EBRD") to prepare a study on the impact of bills of exchange (in particular, their cash sweeping and account blocking capabilities) on out-of-court work-outs (i.e. voluntary restructuring and consensual financial restructuring) and reorganisation of corporate debtors in Macedonia, Republic of Serbia, Montenegro, Federation of Bosnia and Herzegovina as well as in the Republic of Srpska.

The main objective of this study is to analyse the impact of cash sweeping and account blocking on out-of-court restructuring and reorganisation in Macedonia, with a view to identifying ways to improve the environment for, and remove obstacles that the existing powers of bills of exchange pose to out-of-court restructuring and reorganisation, and making specific recommendations on how to tackle the identified shortcomings and impediments.

The study also incorporates feedback from key market participants (i.e., commercial banks and companies operating in Macedonia that responded to a questionnaire attached at Appendix 2, see pages 45 to 55). The study has been prepared with a view to further discussions with the regulators, primarily the National Bank, Clearing House KIBS AD Skopje and the Ministry of Finance, involving potential cooperation on the gradual removal of cash sweeping and account blocking in relation to bills of exchange from the current legislation.

## 3. Legal Framework

This section provides an overview of the legal framework relevant for the purpose of this study.

### 3.1 Legislation on cash sweeping and account blocking

The legal framework governing cash sweeping and account blocking is not encapsulated in a single law, but is spread over several statutes, bylaws and regulations. These are, specifically, the following:

- The **Payment Operations Act** (*Закон за платниот промет*) regulates the collection within enforcement proceedings and therefore represents the key piece of legislation governing cash sweeping and account blocking. The Act regulates and establishes, among others, the legal requirements for account blocking which must be satisfied by creditors before enforcement of monetary claims.

  In particular, the Act regulates the following aspects of cash sweeping and account blocking:

- the instruments capable of cash sweeping and account blocking;
- the rights and obligations of the parties involved in proceedings for the enforcement of the instruments capable of cash sweeping and account blocking;
- the legal requirements for proceedings for the enforcement of the instruments capable of cash sweeping and account blocking; and
- the collection process within proceedings for the enforcement of the instruments capable of cash sweeping and account blocking.

- Bills of exchange are regulated by the **Bills of Exchange Act** (*Закон за меница*). Since 2002, bills of exchange are defined as means of payment and instruments for securing payments. They represent unconditional instructions given by the issuer to a third party, to pay a certain amount of cash to the holder of the instrument (*трасирана меница*), in accordance with the amount specified on the bill of exchange, or to the issuer (*сопствена меница*).

  The Bills of Exchange Act regulates:

  - different types of bills of exchange;
  - the manner in which they are used; and
  - formal requirements necessary for their validity.

- The **Enforcement Act** (*Закон за извршување*) regulates the process of enforcement of bills of exchange and other legal basis such as enforcement court decisions, including the process resulting in account blocking[7].

3.2 Out-of-court restructuring legislation

Companies facing bankruptcy or financial difficulty have various work out procedures available to them, which vary in terms of the level of regulation (ranging from voluntary, informal processes to those that are formal, regulated and supervised).

The informal work-out method has its legal basis in general civil law. Namely, the **Obligations Act** (*Закон за облигационите односи*), underpinned by the freedom of contract, serves as the legal basis for contractual parties to both agree and amend their respective rights and obligations. Thus, parties wishing to rearrange their contractual rights and obligations may do so at any time, in accordance with the Obligations Act and within the boundaries of the Macedonian legislation applicable to their relations (e.g., foreign exchange transactions).

The recently adopted **Out-of-Court Settlement Act** (*Закон за вонсудско спогодување*) sets out an incentive based legal framework to support consensual financial restructuring by regulating the conditions for initiating out-of-court settlement, the method and procedure of out-of-court settlement and the legal consequences of its opening and implementation.

[7] Enforcement of notarised bills of exchange in Macedonia is not subject to court procedure; instead it is performed directly through a bailiff and KIBS.

The Out-of-Court Settlement Act incorporates certain internationally accepted financial restructuring principles or practices, such as sharing of information, creditor cooperation and acting in good faith, as well as a range of measures through which creditor-debtor relations can be redefined (e.g. debt-to-equity swap, claim/debt assignment).

3.3 Court reorganisation legislation

Reorganisation is a court supervised process that may be undertaken in the two forms available under the **Bankruptcy Act** (З*акон за стечајот*). The Bankruptcy Act provides that reorganisation may be undertaken either through reorganisation plans which are part of formal bankruptcy proceedings and enforceable by court; and pre-packaged reorganisation plans, which involve a mixed procedure consisting of out-of-court negotiations and judicial approval of the plan.

## 4. Bills of exchange

4.1 Introduction

The Bills of Exchange Act defines bills of exchange as payment instruments and payment security instruments. In particular, bills of exchange represent unconditional orders given by the issuer to the drawee to repay the specified amount to the drawee or a third party payee. They represent a form of security granted by the debtor of repayment for creditor's goods/services in the future.

Properly issued bills of exchange represent sufficient evidence of the debtor's intention to pay the creditor at a certain point in the future and are used as such in enforcement procedures in order to obtain the notarisation necessary for the instrument to become enforceable.

The most common type of bill of exchange on the market is the notarised blank bill of exchange. Its popularity is attributed to the flexibility it provides to the creditor. As their name suggests, blank bills of exchange do not include any information regarding the debt on the face of the document. Such information, and other information required by the Bills of Exchange Act to ensure the validity and enforceability of the bill of exchange is filled in by the authorised creditor at the moment of its enforcement. The authorisation is proved by the authorisation letter issued by the debtor to the creditor at the time of issue of the blank bill of exchange.

The process is further automatically taken over by the bailiff and the debtor's bank. Bills of exchange and their enforcement are currently within the remit of the Clearing House KIBS AD Skopje ("**KIBS**") which holds the Unique Register of Transaction Accounts, in cooperation with the National Bank.

Prior to further elaborating on bills of exchange, it is important to explain why they are more relevant for this study than the other two enforceable instruments that have cash sweeping and account blocking capabilities (i.e. court decisions on enforcement and tax and competent authority decisions), and to further describe these features.

4.2 Bills of exchange in comparison to other instruments capable of cash sweeping and account blocking

Although cash sweeping and account blocking are inherent features of court decisions on enforcement and competent authority decisions as well, bills of exchange are the only instruments authorising regular creditors to perform direct cash sweeping and account blocking.

In contrast to court decisions on enforcement, which are also available to regular creditors, bills of exchange do not require prior court proceedings. Instead they authorise the creditor to sweep cash and block the debtor's bank accounts immediately through a bailiff.

On the other hand, while cash sweeping and account blocking are inherent features of competent authority decisions[8] as well, they are not readily available to regular creditors, but require an act issued by the authorities for enforcement purposes.

Therefore, compared to the other two instruments, bills of exchange have the greatest impact on out-of-court restructuring and/or reorganisation, as they constitute a direct and common practice and are available to all creditors.

4.3 Key features of bills of exchange - cash sweeping and account blocking

4.3.1 Cash sweeping

Cash sweeping is the first measure applied by the debtor's bank against the debtor's cash assets when the bailiff enforces the creditor's bills of exchange. Cash sweeping is a two-stage process.

Firstly, all funds held in the debtor's bank accounts kept with the bank to which bills of exchange are submitted for enforcement are transferred to the benefit of the enforcing creditor.

Secondly, and only if the first step does not cover the entire creditor's claim, all funds held in all the debtor's bank accounts at the time of commencement of the enforced collection are transferred to the account of the enforcing creditor.

4.3.2 Account blocking

Where cash sweeping fails to satisfy in full the claim under the bill of exchange, the National Bank activates the account blocking measure, which involves (i) prohibiting the debtor from disposing of any future income transferred to its bank accounts; and (ii) automatic transfer of such proceeds to the enforcing creditor.

4.3.3 A breakdown of cash sweeping and account blocking

Cash sweeping and account blocking may be broken down into the following key components:

[8] Public Revenue Office, Customs Administration of the Republic of Macedonia, Ministry of Finance, local self-government bodies, Water Management Fund.

| | Cash Sweeping | Account Blocking |
|---|---|---|
| Legal basis for implementation | Both cash sweeping and account blocking are implemented based on the enforcement of bills of exchange. | |
| Form | Transfer of all funds held in a particular bank account (i.e. bank account kept with the commercial bank to which bills of exchange are submitted for enforcement), if collected funds are insufficient for satisfaction of the entire claim; transfer of all funds held in all debtor's bank accounts to the account of the enforcing creditor. | Debtor prohibited from disposing of any future proceeds paid into his bank accounts; and<br><br>Automatic transfer of any future proceeds paid into the debtor's bank accounts to the enforcing creditor. |
| Implementation | Automatic implementation by the account bank of the debtor when enforcing bills of exchange. | Automatically implemented by the account bank of the debtor through KIBS if cash sweeping fails to satisfy in full the claim under the bills of exchange. |
| Termination | Automatically terminated when:<br><br>(i) claims covered by the bills of exchange have been satisfied in full; or<br><br>(ii) all funds held in all bank accounts of the debtor have been transferred to the enforcing creditor to satisfy the claims under the bills of exchange, and the enforcement process has transitioned to the account blocking phase due to the insufficiency of the swept funds to cover the entire claim under | In ordinary circumstances, automatically terminated where the claim under the bills of exchange being enforced has been satisfied in full.<br><br>Alternatively, the debtor can apply for the court to terminate account blocking, by presenting proof that all claims towards creditors which were due to be settled from the blocked account have been satisfied. In reorganisation conducted alongside bankruptcy, account blocking can be terminated when the trustee in bankruptcy takes over control over the accounts of |

| | | |
|---|---|---|
| | the bills of exchange. | the debtor. |

4.4 Applications of bills of exchange

The legal regime regulating bills of exchange and the efficiency of their enforcement have led to their use as:

- *payment instruments* – bills of exchange are easily enforced and transferred; thus market participants often use them as payment instruments. A creditor holding bills of exchange may transfer them to its own creditors instead of payment.
- credit instruments akin to "I owe you" documents – the bill of exchange binds its issuer, or a third party drawee to pay the amount stipulated on the bill of exchange, as a result of which it is often used as a substitute to immediate payment. In particular, the issued bills of exchange compel the debtor to repay to the creditor the monetary claim evidenced by them.
- collateral – Macedonian legal regime sets out simple perfection requirements, efficient enforcement and independence of bills of exchange from the underlying legal grounds applicable to secured claims. Due to this, bills of exchange are most commonly used as collateral for securing monetary receivables.

4.5 Bills of exchange as collateral

The principle that bills of exchange are independent from the underlying legal ground of the claim by them[9] prescribed by the Bills of Exchange Act, as well as their above referenced qualities regarding perfection and efficient enforcement, have greatly contributed to the widespread use of bills of exchange as collateral in Macedonia.

The use of bills of exchange as collateral is also attributed to their comparable advantage over other collateral instruments (i.e., considerably greater efficiency of enforcement compared to other types of collateral, such as pledges).

In addition, bills of exchange are the only form of collateral which allow creditors to enforce payment from all assets of the debtor. Enforcement of bills of exchange is not limited to the debtor's accounts, i.e. the creditor can enforce his claim from all assets of the debtor, including those not initially pledged in favour of the creditor. No court proceedings are necessary for the enforcement of bills of exchange from all assets of a debtor. The creditor can define the preferred source / method of enforcement with the bailiff, once an enforcement order based on the bills of exchange is issued by the notary.

Other types of collateral typically involve higher costs, greater uncertainties and longer enforcement periods. On the contrary, the enforcement of notarised bills of exchange in Macedonia is a straightforward process, which requires very limited involvement on the part of either the creditor or the debtor.

[9] A principle also applicable to instruments such as bank guarantees.

Their widespread use as collateral is evidenced by 90% of banks demanding bills of exchange as the instrument for securing their claims.

In particular, out of the 5 banks and 10 companies that completed the questionnaire, 100% of the banks surveyed stated that they required bills of exchange from their debtors/counterparties as collateral. However, bills of exchange are only required by approximately 50% of the surveyed companies.

4.6 Inoperability of account pledge contributing to the use of bills of exchange as collateral

The absence of other reliable security instruments for cash assets under Macedonian law is another factor that significantly contributes to the widespread use of bills of exchange.

While it could be argued that the concept of account pledge exists in Macedonia, account pledges are practically never used due to, inter alia, the following reasons:

- *Creation and perfection* – while the account pledge is created and perfected in the same manner as any other type of pledge (i.e. by way of registration in the Pledge Register), its perfection is more cumbersome, costly and time consuming in comparison with bills of exchange, which do not require any perfection formalities and costs associated therewith.
- *Life cycle of account pledge* – the concept of a floating charge over the debtor's bank accounts as a security instrument does not exist in Macedonia. Further, according to the unofficial position of the Macedonian Pledge Register, the account pledge captures only cash assets which were deposited on the account at the moment of pledge perfection (i.e. registration in the Pledge Register), thus, any account balance top-up(s) are not considered to be pledged. In addition, the unofficial position of the Macedonian Pledge Register is that current accounts may not be pledged making the account pledge an impractical instrument since it requires the debtor to set aside "cash reserves" which cannot be used in the ordinary course of the debtor's business. This substantially deviates from the bills of exchange which capture all cash found on all debtor's accounts at the moment of enforcement of the bills of exchange.
- *Enforcement* – The enforcement procedure envisaged under the Pledge Act is time consuming and complicated. Namely, the Pledge Act envisages that a pledge is enforced by liquidation of pledged assets through an auction process. The auction process dictates that auctions must be undertaken prior to the pledgee being entitled to retain the ownership over the pledged assets as compensation for secured liabilities. Furthermore, the concept of liquidation is not harmonised with cash collateral. Due to lack of clear regulation regarding enforcement against cash, the whole concept of account pledge is to certain degree questionable.
- *No immunity from other enforcements* - creditors do not deem account pledges to be a solid security instrument because the pledged accounts are not immune from enforcement over the debtor's cash assets by third parties.

Therefore, enforcement against debtor's cash assets by other creditors e.g. through a bill of exchange could render the account pledge to be economically worthless. In this respect, explicit provisions ring fencing the pledged accounts from enforcement should be considered.

As a result of the above, market participants are unaware and uncertain of the option to use account pledges to secure claims. Out of the 15 interviewed market participants, 80% of banks and only 15% of companies have stated that they find account pledges to be inferior/less efficient than bills of exchange as security instruments over the debtor's bank accounts.

4.7 Enforcement of bills of exchange

As bills of exchange are independent from the underlying legal ground of the claim, the notarisation process does not require the participation of the debtor.

The notarisation of a bill of exchange is obtained immediately prior to initiation of its enforcement. The enforcement of bills of exchange is initiated by a creditor presenting a completed and notarised bill of exchange to a bailiff, who verifies that all procedural requirements have been complied with. If satisfied, the bailiff then presents the bill of exchange to the debtor's bank with which the debtor maintains a bank account. Thereupon, the enforcement process is undertaken by the bank and no further action is required of the creditor or the debtor.

Once a completed and notarised bill of exchange is presented before a debtor's bank, the bank verifies its validity and immediately sweeps the specified amount of cash from the debtor's bank account and transfers it to the creditor.

The enforcement process is completed within minutes if the funds the debtor holds in its account at the bank to which the bills of exchange are presented for enforcement are sufficient to cover the amount stipulated under the bills of exchange being enforced.

However, if there are insufficient funds in the debtor's bank account to satisfy a creditor's claim in full, the bank first sweeps the required amount from the debtor's Macedonian Denar accounts (MKD accounts), kept with the bank which is subject to enforcement. If the balance is insufficient, cash is then swept from the debtor's foreign currency accounts.

If the funds available in all the debtor's accounts with the bank managing the enforcement are insufficient to cover the enforcing creditor's claim, the bank notifies KIBS, which maintains the Unique Register of Transaction Accounts. With its assistance, repayment is realised from all bank accounts of the debtor kept in Macedonia.

The duration of the repayment process depends solely on the amount of funds available on the debtor's account at the time of enforcement. If there are sufficient funds to repay the claim of the creditor the repayment process is completed on the same day. If however cash sweeping of the debtor's accounts is unsuccessful to completely cover the amount of the claim, the repayment process will be prolonged until sufficient funds have been placed on the debtor's accounts.

If full repayment has not been achieved after all cash has been swept from all of the debtor's bank accounts, the bank managing the enforcement notifies all banks with which the debtor has an account via KIBS to block all the debtor's bank accounts in Macedonia.

The debtor and its affiliates are prohibited from opening any new bank accounts until their existing ones have been unblocked (i.e., all the enforcing creditors have been satisfied in full).

The ranking of other types of collateral, such as pledges and mortgages, is determined based on the time of collateral perfection (i.e., registration in the relevant collateral register). In contrast, bills of exchange are ranked according to the time of enforcement initiation.

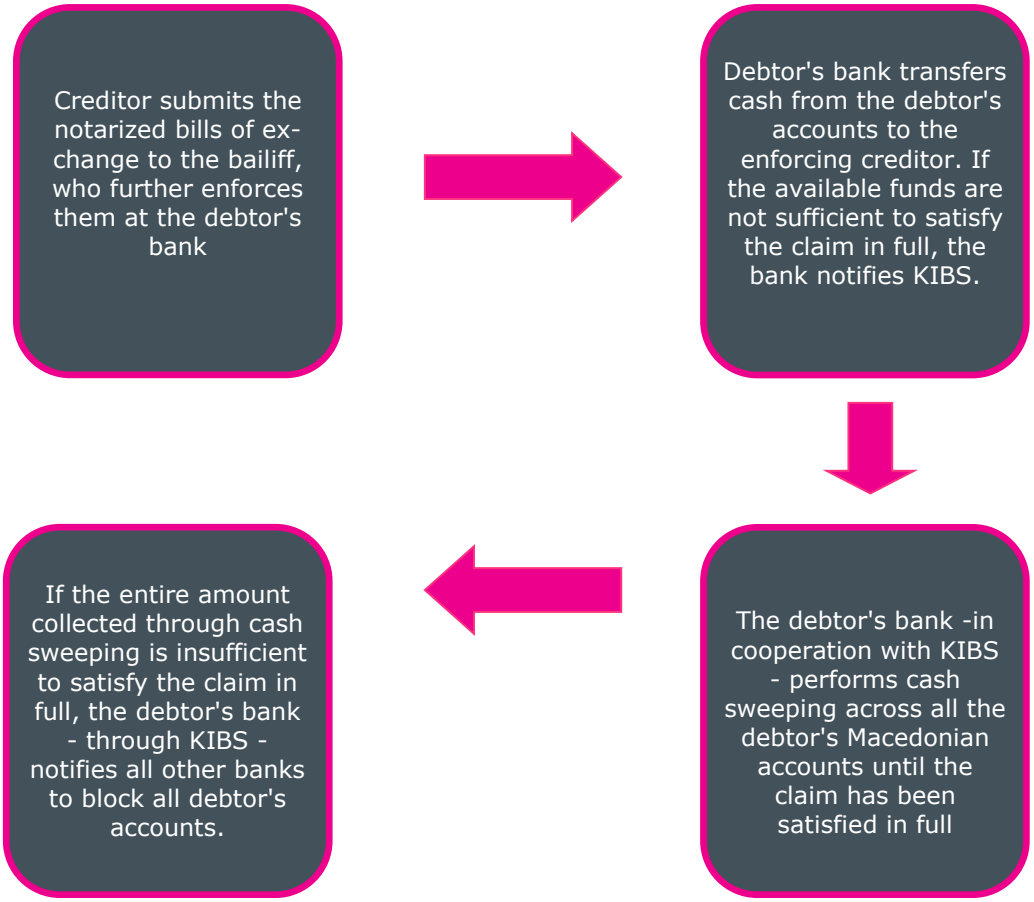
Provided there is sufficient cash available to satisfy in full the enforcing creditor's claim, the priority of claims between creditors with regard to the balance in a specific bank account is determined according to the time of submission of the bills of exchange to the debtor's bank.

Such priority is only exercised where the funds in the debtor's bank account against which the bills of exchange have been submitted are sufficient to cover the claim in full. Otherwise, the debtor's bank notifies KIBS of the submitted bills of exchange and informs all other banks holding accounts for the debtor to sweep all cash from the debtor's Macedonian accounts.

Therefore, where several creditors submit bills of exchange to different banks in which the debtor keeps its bank accounts, and such accounts hold insufficient funds to repay the respective amounts claimed by such creditors, priority is afforded to the bank that was the first to notify KIBS of the bills of exchange presented to it for payment.

The aforementioned priority ranking is purely theoretical, due to the KIBS's centralised system. In practice, priority is most likely afforded to the creditor that was the first to present the bills of exchange to any of the debtor's banks.

4.8 Bill of exchange enforcement process




4.9 Comparative overview of bills of exchange in Macedonia and in certain European Union Member States

In contrast to the Macedonian legal regime, the Austrian, German and Slovenian legal regimes governing bills of exchange and their enforcement do not allow for direct cash sweeping across all bank accounts of a debtor, or equip bills of exchange with account blocking powers.

The enforcement of bills of exchange in the above-referenced jurisdictions does not result in the blocking of all the debtor's bank accounts, nor does it prevent the disposal of any future income or allow automatic transfer of such incoming cash flows to the enforcing creditor.

Austrian law provides for the enforcement of bills of exchange in a two-step court procedure, which may be followed by cash sweeping.

The enforcing creditor must seek the competent court to issue a payment order based on the bills of exchange. Once the payment order has become final and binding, the creditor obtains an enforcement title, which may then be enforced through the competent enforcement court. Priority over cash assets is afforded to the creditor which first obtains a court seizure order based on the enforcement title.

If the funds available in the debtor's account are insufficient to satisfy the full amount indicated in the court order, unlike in Macedonia, this does not give rise to account blocking. The debtor is not barred from disposing of the available funds in his accounts and no automatic transfer of debtor's future income is available to the enforcing creditor.

The court may issue an attachment order and instruct the transfer of the debtor's receivables to the account of the enforcing creditor, resulting in direct cash sweeping or account blocking. But the enforcement of bills of exchange under Austrian law does not in and of itself allow for direct cash sweeping or account blocking.

Similarly, Germany does not have a centralised system that permits direct enforcement of bills of exchange resulting in cash sweeping or account blocking. Instead, the enforcement of bills of exchange is secured through a court ruling or a comparable title, such as a court settlement, writ of execution or notarial certification with submission under immediate execution.

A judgement or comparable title is required for the competent government authorities to implement any enforcement measure, including the freezing of debtor's bank accounts and the transfer of debtor's receivables to an enforcing creditor.

Account blocking is also possible. However, after receiving a judgment in court proceedings, the creditor must first apply to the court for a temporary freezing of debtor's accounts to ensure non-depletion of cash assets; once this has been granted, the creditor may apply for attachment and the transfer of the debtor's cash receivables to the creditor's account.

In contrast to Austria and Germany, Slovenia recognises some of the legal concepts applicable in Macedonia. Specifically, under Slovenian law, bills of exchange that indicate the place of payment and the payee (domiciled bills of exchange) are deemed to include the debtor's authorisation to the creditor to issue a payment order to the debtor's bank and debit a specific bank account.

A Slovenian bank receiving bills of exchange from an enforcing creditor is only authorised and obliged to sweep cash from the debtor's account if the account holds sufficient funds to settle the full claim covered by the bill of exchange.

However, any further enforcement of bills of exchange under Slovenian law requires the enforcing creditor to initiate and conduct prior court proceedings.

4.10 Recent changes in the Montenegrin legal framework

Until recently the Montenegrin legal framework for enforcement of bills of exchange permitted direct cash sweeping and account blocking based on bills of exchange.

On 29 September 2017[10], the Montenegrin Constitutional Court ruled that direct cash sweeping and account blocking based on bills of exchange is contrary to the fundamental principle of enjoyment of private property as direct enforcement (instead of regular enforcement through the court system) cannot be justified on the

[10] Adopted on a session held on 29 September 2017, published in the Official Gazette of Montenegro no. 76/2017 on 17 November 2017.

grounds of public interest. Furthermore, the Constitutional Court found that direct enforcement does not provide sufficient protection for the debtor, due to the lack of legal remedies available to the debtor.

On, *inter alia*, the above grounds, the Constitutional Court of Montenegro abolished provisions of the Montenegrin Enforcement Act which allowed for direct enforcement based on bills of exchange. Such decision renders the enforcement of bills of exchange to be the same as enforcement of any other monetary claim and requires the creditor to enforce its claims through the court/bailiff system.

In addition, on-going proceedings before the Central Bank of Montenegro (in charge of centralised cash sweeping and account blocking) were terminated and creditors were referred to enforcement before the courts/bailiffs.

4.11 Summary of key features of bills of exchange and their realisation

The table below describes and explains the key features of bills of exchange under Macedonian law.

| Key Feature | Comment |
|---|---|
| Simple perfection steps | A notarised bill of exchange and any accompanying authorisation letter are submitted to the bailiff, which verifies compliance with procedural steps of presentation of the bills of exchange.<br>If the bailiff is satisfied that the bill of exchange has been issued properly, the bill of exchange is considered a valid enforcement document. |
| Efficient tool for sweeping cash from a particular bank account | If there is sufficient cash in the debtor's bank account against which the bills of exchange have been submitted, the account bank performs cash sweeping from such account within minutes of the bills of exchange being submitted for enforcement. |
| Efficient tool for cash sweeping across all debtor's bank accounts | If there is not sufficient cash in the debtor's bank account against which bills of exchange have been submitted to cover in full the claim under the bills of exchange, the account bank automatically sweeps cash from all of the debtor's bank accounts in Macedonia within 24 hours of being notified of the submitted bills of exchange. |
| Limited involvement required of the creditor in the enforcement process | The creditor is only required to fill in the notarised blank bills of exchange and submit them for enforcement to a bailiff. |

| | |
|---|---|
| Account blocking capability | In case the total amount collected through cash sweeping across all debtor's bank accounts in Macedonia is not sufficient for repayment of the entire amount stipulated in the bills of exchange, all bank accounts of the debtor are blocked until the enforcing creditor's claim has been satisfied in full. Any amount credited to the debtor's account will be automatically transferred to the enforcing creditor and applied towards repayment of its claim |
| Safe and reliable form of collateral | The creditor is not required to prove the existence of a valid underlying obligation prior to enforcing a bill of exchange, nor can the debtor challenge the existence of such obligation. No court involvement is required |
| Priority between creditors is determined based on the time of submission of bills of exchange for enforcement | In practice, priority between enforcing creditors of the same debtor is determined according to the time of commencement of their respective enforcement proceedings (i.e., according to the time of submission of bills of exchange to the bank) |

4.12 The effects of bills of exchange

4.12.1 Race between creditors and chain reaction

The ranking of creditors according to the time of enforcement of bills of exchange, cash sweeping and account blocking may combine to trigger a race between creditors to submit their respective bills of exchange in order to ensure better prospects of satisfying their respective claims.

Payment priority ranking may encourage first movers to race for the cash available in the debtor's bank accounts in Macedonia. In addition, first movers may also reserve all future cash receivables of the debtor until satisfaction of their claims in full via account blocking.

The issues associated with first movers among creditors in submitting bills of exchange are not prevalent in Austria, Germany and Slovenia, since the legal regimes of these countries do not equip bills of exchange with the power of direct (i.e. without court proceedings) cash sweeping across all debtor's bank accounts, and/or account blocking.

Besides triggering a race between creditors, the payment priority ranking and the account blocking capability of bills of exchange also lead to creditor chain reactions: Once a creditor has enforced its bills of exchange, other creditors typically follow suit and initiate enforcement in order to reserve as much of the future cash flows to the debtor's account as possible.

4.12.2 Potential bankruptcy of a debtor

The chances of bankruptcy proceedings being initiated are increased once bills of exchange have been enforced and accounts have been blocked, as all payments from these accounts are hence prohibited, except those made in favour of the creditors enforcing their bills of exchange.

Grounds for opening bankruptcy proceedings will be satisfied in the event of non-payment of monetary claims within 45 days of their maturity, or if the debtor's actions create a likelihood that he will not be able to meet such payments.

Pursuant to the Out-of-Court Settlement Act, illiquidity may arise if the debtor fails to settle any Recognised Monetary Claims within 30 days after becoming due, or if the amount of his estate is insufficient to meet his liabilities. The debtor will be obliged to initiate out-of-court settlement if illiquidity continues for more than 30 days. The debtor can undertake consensual financial restructuring as a measure to avoid or remedy illiquidity.

Based on the feedback received from the questionnaires, over 80% of market participants are reluctant to initiate bankruptcy proceedings against a debtor whose accounts were blocked.

4.12.3 Deterioration of the debtor's business and businesses of its transacting counterparties

Due to the account blocking feature of bills of exchange, all payments from the debtor's bank accounts, other than those made in favour of the enforcing creditor, are suspended, which may have adverse effects on the debtor's business.

The discontinuation of the debtor's payments inevitably leads to his inability to acquire goods and services for its day-to-day business, as most suppliers are reluctant to supply goods/services where there is a risk of not being paid.

In most cases, businesses also cease operating due to employee work stoppages stemming from increasing uncertainty associated with account blocking.

In addition, suspension of payments by the debtor may also adversely affect the financial standing of the debtor's transacting counterparties, including the creditors who have not enforced their bills of exchange.

Furthermore, account blocking may lead to the debtor's transacting parties being unable to service their own debts, especially if their income heavily relies on revenue generated from doing business with the debtor.

While the surveyed market participants concur that enforcement of bills of exchange has adverse effects on the debtor's business, they fail to acknowledge that enforcement of such instruments also negatively impacts

the prospect of achieving successful out-of-court restructuring and/or reorganisation of the debtor.

4.12.4 Fraudulent behaviour

A debtor whose bank accounts are blocked is prohibited from assigning its claims/debt or setting off its rights and liabilities.

In practice, this prohibition leads to fraudulent behaviour by debtors, which devise various schemes to diminish the effects of account blocking. These schemes include, amongst others, debtors redirecting their cash receivables/liabilities to their affiliates through claim/debt assignment in order to circumvent the restrictions imposed on their bank accounts[11] or debtors operating through the bank accounts of related parties.

Such fraudulent behaviour of the debtors is frequently accompanied by a reluctance to share business-related information with their creditors as such information sharing could reveal the fraud.

4.13 Facts and figures

4.13.1 Questionnaires

A research conducted among market participants - 5 banks and 10 companies, i.e. members of the Chamber of Commerce currently operating in the Macedonian market - revealed the following:

- Over 90% of banks require their potential debtors to provide bills of exchange as collateral, failing which they are unwilling to provide financing. Banks find bills of exchange to be a solid collateral as it allows them to enforce payments from the debtor's assets which were not initially pledged.
- The payment of existing and future proceeds from the debtors' bank accounts contributes to better recovery, although 30% of companies disagree with this view, as they find the process may provide for significant delays in recovery.
- Bills of exchange are convenient and efficient security instruments, whose enforcement allows for collection against all assets of the debtor, whichever method of enforcement the creditor chooses.
- The enforcement of bills of exchange generally secures a good rate of recovery. In particular, approximately 60% of market participants find that enforcement of bills of exchange successfully secure 60% or more of their initial claim.
- Commercial banks maintain a cooperative policy towards their debtors, whereby they tend to attempt to impose fiscal policies to the debtor prior to enforcement of bills of exchange. Commercial banks do not generally enforce bills of exchange at the first sign of financial distress of the debtor. In comparison, 60% of companies as lenders would enforce bills of exchange at the first sign of financial distress of the debtor.

[11] Prohibiting the debtor from disposing of any future proceeds paid into its bank account; and automatic transfer of such proceeds to the creditor enforcing its cash sweeping/account blocking instrument.

- 80% of commercial banks and 55% of companies would enforce their bills of exchange as a result of other creditors enforcing in order to secure their place in the recovery race.
- Initiating initiate bankruptcy proceedings on the ground of the debtor's accounts being blocked by enforcement of bills of exchange is only exercised in exceptional circumstances, when it is considered to contribute to speedy collection and/or protection of the debtor's property.

## 5. Out-of-Court Restructuring and Reorganisation

Before analysing the impact of bills of exchange and account blocking on out-of-court restructuring and reorganisation in greater detail, we will attempt to explain the importance of these procedures and provide some background in form of the Macedonian legislation regulating them and the internationally recognised standards applicable to such procedures, provided by:

- the World Bank's 'Principles for Effective Insolvency and Creditor/Debtor Regimes'[12];
- the European Commission's Recommendation 'On a new approach to business failure and insolvency'[13]; and
- the proposal for a Directive of the European Parliament and of the Council on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency and Discharge Procedure and Amending Directive 2012/30/EU[14].

### 5.1 Importance of out-of-court restructuring and reorganisation

The purpose of out-of-court restructuring and court reorganisation (in particular, based on the pre-packaged reorganisation plans) is to ensure that viable enterprises in financial difficulty are able to restructure at an early stage, with a view to preventing their liquidation in bankruptcy and thereby maximising the overall value to creditors, employees, owners and public revenue authorities.

In contrast to bankruptcy, where the debtor's estate is sold or realised to satisfy the creditors' claims, the maximisation of value to creditors is achieved at an early stage of financial difficulty in out-of-court restructuring and/or reorganisation, by giving the debtor a chance to generate revenue by continuing to carry on its business.

This fundamental difference also ensures a positive impact on employment, the debtor's transacting counterparties and public revenue, which all benefit from the debtor remaining in business.

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12 http://pubdocs.worldbank.org/en/919511468425523509/ICR-Principles-Insolvency-Creditor-Debtor-Regimes-2016.pdf

13 http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf

14 http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016PC0723&from=EN

Therefore, the continuation of the debtor's business, which is a key characteristic of out-of-court restructuring and reorganisation, is beneficial to the economy as a whole, as it leads to:

(i) no or limited employee redundancies;

(ii) continued contribution to public revenues (e.g. through taxes);

(iii) benefits for debtor's suppliers and customers; and

(iv) reduced pressure on the judicial system, which is overburdened with bankruptcy proceedings.

These characteristics distinguish out-of-court restructuring and reorganisation from bankruptcy, and underpin the importance of the former two.

5.2 Consensual financial restructuring in Macedonia

In Macedonia, financial restructuring may be carried out under two statutes: the Obligations Act and the Out-of-Court Settlement Act.

Voluntary restructuring is performed based on the fundamental principle of contracting freedom under the Obligations Act. Specifically, parties are free to choose their contractual counterparties; decide whether to enter into a contract; and include suitable provisions to regulate their contractual relations, provided such provisions are in line with mandatory rules of law (e.g. foreign exchange rules).

By the same token, the parties that have already entered into contracts are free to amend their terms and conditions without the intervention of any governmental or judicial authority.

It is important to note that, pursuant to the Obligations Act, agreements are only binding *inter partes* and will have no legal effect on any third party. As a result, a voluntary restructuring plan would not be binding on any creditor that has not agreed to, for example, a standstill agreement.

However, while voluntary restructuring is performed on voluntary basis, the debtor is obliged to undergo consensual financial restructuring within 30 days of illiquidity or within 21 days of becoming insolvent. Furthermore, if the attempt to achieve solvency and liquidity through voluntary restructuring is unsuccessful, the debtor is obliged to initiate consensual financial restructuring.

The Out-of-Court Settlement Act defines consensual financial restructuring as a 'process initiated by the debtor, carried out based on a financial restructuring plan, aiming at achieving liquidity and solvency of an indebted company and creating better repayment conditions for the creditors than they would have received had the debtor gone into Bankruptcy'. The designated institutional mediator for consensual financial restructuring is the three member settlement council, appointed by the Ministry of Economy.

The restructuring plan containing details regarding the state of the business and the intended terms and measures to be undertaken must be approved by the settlement council. If satisfied with the restructuring plan, the settlement council issues a Resolution of approval of the plan. The settlement council also registers a standstill

on all creditors' actions until the completion of the consensual financial restructuring with the Central Register.

Consensual financial restructuring must be finalised within 120 days as of approval of the restructuring plan. The parties may however agree on postponement of debt or dividing payments in instalments to be performed after the expiration of the 120 day period. Furthermore, the creditors will only be able to recover the amount allocated in the restructuring plan, rather than the amount of the initial debt.

In an effort to simplify the procedure for both debtors and creditors, consensual financial restructuring may also be performed through a simplified procedure where the debt is below MKD 1m and the debtor employs less than 10 people.

The Out-of-Court Settlement Act could be characterised as a piece of legislation facilitating financial restructuring and providing consensual financial restructuring parties with a range of tools, including:

- Reduction and postponement of due obligations, repayment in instalments and postponement of maturity, interest rates, loans or other claims;
- Increase of share capital;
- Debt and interest write offs and change of interest rates;
- Realisation, substitution or waiver of collateral;
- Provision of collateral by the debtor or third parties;
- Debt to equity swaps; and
- Working with strategic partners and recapitalisation by strategic partners.

In accordance with best international practice, the Out-of-Court Settlement Act envisages standstills as crucial requirements for a successful financial restructuring.

Standstills represent restrictions imposed on the creditors and third parties for enforcement of recognised monetary claims against the debtor for a specified period of time (including with respect to claims under bills of exchange). The aim of standstills is allowing the debtor sufficient time to repair its finances without fear of creditors bringing enforcement or collection actions.

Based on the Out-of-Court Settlement Act, standstills cannot provide for retrospective termination (i.e., termination of enforcement actions already undertaken that have not been completed). Therefore, if a creditor has successfully submitted his bills of exchange and received repayment on that basis, it is entitled to retain any received amount.

According to the Out-of-Court Settlement Act, consensual financial restructuring is underpinned by the following core principles:

- *Voluntariness* - The conclusion of out-of-court settlement and the financial restructuring plan is only possible if interested parties holding 51% majority of the total determined debt have voluntarily approached financial restructuring.
- *Equal treatment of creditors* – During consensual financial restructuring the debtor is prohibited by the Out-of-Court Settlement Act from taking any

measures which may result in unequal treatment of the creditors. Examples of unequal treatment include preference or disregard of creditors from the same rank.

- *Acting in good faith* – The debtor and its creditors are prohibited from taking any actions that may harm the financial restructuring process.
- *Access to information* – The debtor is obliged to provide timely and unrestricted access to information and documentation regarding his property, capital, liabilities, business activities and business plans to all parties involved in the financial restructuring, including the creditors and the settlement council so as to ensure correct evaluation of the debtor's financial situation and the option for implementing Out-of-Court Restructuring.

5.3 Court reorganisation in Macedonia

Under the Bankruptcy Act, one of the outcomes of bankruptcy proceedings is court reorganisation. Bankruptcy proceedings are conducted by the competent court, with the aim of reorganisation or liquidation of the debtor. As defined in the Bankruptcy Act, liquidation in bankruptcy is the process of satisfying creditors' claims by liquidating the debtor's assets or dividing the debtor's property among the creditors.

Reorganisation (*реорганизација*) is a process implemented when the financial health and economic viability of the business of the debtor are capable of being restored. During the reorganisation, the business of the debtor continues operating primarily through (i) debt relief; (ii) postponing debt repayments; (iii) conversion of debt into company shares; and (iv) selling the company as whole or in part.

The Bankruptcy Act provides for two forms of reorganisation, i.e. reorganisation carried out based on a pre-packaged reorganisation plan submitted at the same time as filing for bankruptcy by the debtor or a creditor, or a reorganisation plan submitted by a creditor or the bankruptcy administrator in accordance with the assembly of creditors, after bankruptcy proceedings have commenced.

The stage at which either form of reorganisation plan is prepared and negotiated represents the crucial difference between the two forms of reorganisation.

The preparation and negotiation of both pre-packaged reorganisation plan and reorganisation plan may be protected from unilateral action by creditors if a temporary stay on creditors' actions is granted by the bankruptcy judge. The temporary stay can be granted either on the basis of a request from the person initiating bankruptcy proceedings, or at the discretion of the bankruptcy judge.

Reorganisation based on a pre-packaged reorganisation plan falls under the category of so-called 'hybrid work-out procedures'. Such reorganisation attempts to combine the advantages of both formal proceedings (i.e. reorganisation) and consensual financial restructuring. The pre-packaged reorganisation plans are negotiated prior to the formal bankruptcy proceedings in which they are submitted and adopted.

The process of adoption of a pre-packaged reorganisation plan involves two hearings. The initial hearing serves to evaluate the situation of the debtor and confirm that reorganisation is feasible; and a subsequent hearing where the creditors discuss and

vote on the reorganisation plan. Both hearings can be held at the same time. Otherwise, the initial hearing must be held first.

Debtors and creditors alike increasingly recognise the benefits of the hybrid nature of pre-packaged reorganisation plans. For them, if a temporary stay is awarded, these plans eliminate the pressure of negotiation failure due to creditors' actions and cram-down options afforded to hold-out creditors, while also providing the security of judicial approval for intended activities.

5.4 Implementation of internationally accepted standards for functional out-of-court restructuring and reorganisation in Macedonian legislation

The fact that Macedonian out-of-court and reorganisation legislation could be characterised as legislation enabling such work-out procedures further substantiates the claim that bills of exchange undermine successful implementation of work-outs.

The implementation in Macedonian legislation of internationally accepted standards for functional out-of-court restructuring and reorganisation, provided by the World Bank's 'Principles for Effective Insolvency and Creditor/Debtor Regimes' and the European Commission's Recommendation 'On a new approach to business failure and insolvency' is detailed in Appendix 1.

## 6. Ramifications of bills of exchange on the various stages of reorganisation and out-of-court restructuring

The following sections describe the impact of the bill of exchange enforcement on the prospect of achieving a successful reorganisation and/or out-of-court restructuring by reference to the critical stages of these proceedings.

6.1 Assessing the feasibility of reorganisation and out-of-court restructuring

The preparation to commence with reorganisation or out-of-court restructuring entails an assessment of the viability of the debtor's business, a statutory precondition for both proceedings under both the Out-of-Court Settlement Act and the Bankruptcy Act[15].

Out-of-court restructuring and reorganisation proceedings are an option only if a debtor's business is viable. Otherwise, any attempt to maximise value for creditors through redefining debtor-creditor relations would only delay an inevitable liquidation in bankruptcy.

Cash sweeping and account blocking capabilities of bills of exchange diminish the prospect of a successful outcome for reorganisation and out-of-court restructuring as they negatively affect the viability of a debtor's business in a number of ways.

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[15] This precondition is also envisaged in the European Commission Recommendation 'On a new approach to business failure and insolvency'; the World Bank's 'Principles for Effective Insolvency and Creditor/Debtor Regimes'; and the proposal for a Directive of the European Parliament and of the Council on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency and Discharge Procedure and Amending Directive 2012/30/EU.

6.1.1 Adverse effect on debtor's business

Cash sweeping and account blocking represent a major uncertainty for the business of a financially distressed debtor, which may at any time come to a halt if payments are discontinued as a result of the enforcement of bills of exchange.

6.1.2 Possible bankruptcy

As mentioned in Section 4.10.2 above, the viability of a debtor's business is also diminished by the high prospects of bankruptcy (and its effects), which could occur as a consequence of illiquidity caused by the enforcement of bills of exchange.

6.2 Negotiation of pre-packaged reorganisation plan/out-of-court restructuring plan

Amongst other elements, the stability of the debtor's business and the availability to creditors of complete and accurate information on the debtor and its business are essential for successful negotiation of pre-packaged reorganisation plans and out-of-court restructuring plans.

6.2.1 Stability of the debtor's business

The existence of a standstill in the context of an out-of-court restructuring or a stay on creditor action as part of reorganisation is critical for stabilising a debtor's business.

A standstill ensures that the viability of the debtor's business is not exposed to the risk of creditors' enforcement actions[16], and that assets required for successful reorganisation are not depleted by creditors' enforcement of bills of exchange.

Bills of exchange could be an obstacle to out-of-court restructuring negotiations, as they prompt their holders to enforce them, thereby discouraging other creditors from participating.

The benefit of claim recovery from cash available in all the debtor's bank accounts through cash sweeping and the reservation of all future cash flows into the debtor's bank accounts through account blocking afforded to the first enforcing creditor incentivises the enforcement of bills of exchange, rather than the participation in the negotiations of out-of-court restructurings.

Creditors are also motivated to enforce their bills of exchange by the fear that another creditor may do so, and that they will reduce/forfeit their chance of recovery by choosing not to enforce. Such risk leads to runs on the debtor, triggering a further downward spiral for its business and financial position.

Such behaviour is particularly common among commercial banks, as evidenced by the questionnaires. They show that, while commercial banks would not typically enforce at the first sign of debtor's financial distress, over

[16] Please see Section 5.2 above.

60% of commercial banks would attempt to increase their chance of recovery through enforcement, which could be jeopardised by other creditors' enforcing their bills of exchange in case of limited availability of funds in the debtor's accounts.

The implementation of pre-packaged reorganisation plans may also, to some degree, be affected by bills of exchange. Mainly, creditors holding bills of exchange might be inclined to vote against the plan.

In addition, if the bankruptcy judge does not grant a temporary stay on enforcement, the negotiations for a pre-packaged reorganisation plan are, much like those for the out-of-court restructuring plan, exposed to unilateral enforcement of bills of exchange.

On the other hand, reorganisation plans are not affected by bills of exchange, as negotiations are always protected by an automatic stay, triggered by the initiation of bankruptcy proceedings (reorganisation plans being negotiated within bankruptcy proceedings).

Furthermore, unlike the pre-packaged reorganisation plan, failure to adopt a reorganisation plan does not lift the automatic stay. Thus creditors holding bills of exchange are not inclined to vote against the reorganisation plan, tempted by the prospect of enforcing their bills of exchange after the lifting of the automatic stay as a result of failure to adopt a reorganisation plan.

6.2.2 Information sharing

Both out-of-court restructuring plans and pre-packaged reorganisation plans must be based on complete and accurate information about the debtor and its business in order to be viable. Namely, a plan based on inaccurate or incomplete information is susceptible to fail, as the forecasts and measures envisaged therein would be inappropriate and incapable of achieving the intended outcome of the work-out.

Debtors whose bank accounts have been blocked typically devise and implement schemes consisting of the re-directing of cash receivables/liabilities, in order to minimise the negative effects of account blocking on their business.

The above-referenced schemes are in direct contravention to the provisions of the Internal Payment Operations Act, which prohibits claim/debt assignment, and are classified as criminal offencec under the Criminal Code.

It cannot be reasonably expected that debtors who have engaged in such schemes and thereby violated statutory rules have fully and accurately disclosed all information to their creditors.

6.3 Implementation of out-of-court restructuring measures

The World Bank and the European Commission, as well as Macedonian legislation, all dictate that a functional work-out or restructuring and reorganisation in a bankruptcy environment requires an enabling framework.

A framework is considered to be enabling if, *inter alia*, it provides for a wide range of measures for re-defining debtor-creditor relationships. Such measures typically include debt/claim assignment and set-off.

Considering that claim/debt assignment is prohibited, as is the set-off of rights and liabilities of a debtor whose accounts are blocked[17], once account blocking is in place, out-of-court restructuring plans may envisage neither claim/debt assignment nor set-off as a measure for re-defining debtor-creditor relationships.

Therefore, unless supported by all creditors, some measures typically used for redefining debtor-creditor relationships will not be available as part of an out-of-court restructuring once account blocking has been put in place.

6.4 Adoption of the pre-packaged reorganisation plan/out-of-court restructuring plan

The adoption of an out-of-court restructuring or pre-packaged reorganisation plan is correlated to the participation of the key creditors in out-of-court restructuring/reorganisation negotiations.

The question whether creditors holding bills of exchange will vote for adoption of the out-of-court restructuring plan is redundant, since such plans are not binding on them without their consent (unless they have been outvoted by creditors holding 51% of the claims), while incentives presented by bills of exchange encourage them to take unilateral action (i.e. enforcement), rather than participate in collective action (i.e. out-of-court restructuring).

In addition, creditors holding bills of exchange are not incentivised to vote against reorganisation plans, as non-adoption of a reorganisation plan does not lead to the lifting of the automatic stay, but to the debtor's liquidation in bankruptcy**.**

6.5 Facts and figures

As confirmed by the questionnaire results[18], market participants are generally willing to participate in pre-packaged reorganisation plans/out-of-court restructuring plans with their debtors.

The general feel among market participants is that bills of exchange are held as leverage during restructuring negotiations, and are unlikely to commence enforcement prior to participating in the negotiations.

Over 90% of banks and approximately 55% of creditors are willing to participate in both bilateral and out-of-court restructuring with other creditors. The market participants have shown a great interest however, in supporting a reform of the legal regime for bills of exchange which would strengthen out-of-court restructuring and reorganisation.

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[17] In accordance with the Payments Transactions Act.

[18] The statistics have been developed based on a questionnaire completed by 5 banks and 10 companies.

## 7. Key recommendations for mitigating the impacts of bills of exchange on the various stages of reorganisation and out-of-court restructuring

Having in mind all of the foregoing obstacles posed by the bill of exchange enforcement in various stages of reorganisation and out-of-court restructuring proceedings in Macedonia, we consider it advisable to remove the immediate pay-out capabilities which bills of exchange possess.

However, the relatively recent Bills of Exchange Act introduced the requirement of a bailiff's approval prior to enforcement of bills of exchange. As such, it is more in line with European legislation compared to some neighbouring countries. This may cause delays in implementation of the following phases.

Therefore, the improvement of the out-of-court restructuring and reorganisation environment by eliminating obstacles arising from the unique features of bills of exchange must be carefully structured and gradually implemented.

At the same time, account pledges should be brought in line with their European counterparts, and other cash collateral used to secure trade finance receivables should be considered in order to "weaken" bills of exchange and generally promote more secured credit. In respect of the requirement and need to align Macedonian legislation with EU legislation and to the importance of gradual transition, please note that the Financial Collateral Act[19] currently excludes mid and small size corporates from financial collateral arrangements, despite the fact that these account for the vast proportion of businesses in Macedonia. The extension of the financial collateral regime to mid and small size corporates could provide banks with an easily enforceable security interest over cash assets in an important banking market segment of commercial loan transactions, further reducing the dependency of the market on directly enforceable bills of exchange with account blocking and cash sweeping powers and extending the possibility for mid and small size corporate to access the loan market. In addition, capacity building regarding financial collateral and its purposes and uses should also be considered as the market seems to be unaware of the possibility to use financial collateral arrangements. The extension of the Financial Collateral Act would align Macedonia with implementation of the EU Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (the "**EU Directive**") by EU Member States. Among EU Member States only Austria exercised the full opt out to exclude legal persons referred to in Article 1(2)(e) of the EU Directive from their implementing legislation. Many EU countries instead modified this or only partially implemented this provision. This includes Germany which partially implemented Article 1(2)(e) of the EU Directive to cover a collateral provider which is an undertaking, provided the financial collateral is used to secure specifically defined financial obligations (excluding mainly long-term cash loans).

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[19] Adopted by the Macedonian Parliament in 2008 and published in the Official Gazette of Macedonia, no. 84/2008.

The following three phases are suggested to achieve this goal.

7.1 Initial Phase

7.1.1 Phase 1 – Removal of the direct account blocking capability of bills of exchange

Considering that the direct account blocking capability of bills of exchange, more than their cash sweeping capability, represents a significant obstacle to the prospect of achieving a successful outcome in reorganisation/out-of-court restructuring, it is recommended that the direct account blocking feature be eliminated leaving bills of exchange as a tool that only has cash sweeping capabilities, as a first step towards mitigating the issues raised by bills of exchange.

7.1.2 Potential benefits

Removal of the direct account blocking capability from the bill of exchange enforcement mechanics would reduce the ramifications of account blocking on the viability of the debtor's business[20]. Namely, although in such a scenario bills of exchange would still be able to sweep cash across all debtor's bank accounts, they would not have the ability to "reserve" future inbound proceeds to such accounts for the benefit of a single creditor. Instead, future proceeds could be freely disposed of to meet the debtor's day-to-day business obligations and thus bills of exchange would not bring a debtor's business to a halt.

The chances of stabilising a debtor's business during the preparation and negotiation of a pre-packaged reorganisation plan/out-of-court restructuring plan would be significantly improved if creditors were not incentivised to take unilateral action by "reserving" the debtor's future cash receivables for their benefit.

In other words, the elimination of the account blocking capability would make creditors holding bills of exchange less incentivised to enforce them, as they would have to carefully balance whether a work-out would yield a higher repayment rate versus cash currently in the debtor's account (available to them through the cash sweeping measure).

Considering that the prohibition of claim/debt assignment is triggered by account blocking, the removal of the account blocking capability of bills of exchange would eliminate the ramifications of the prohibition on out-of-court restructuring (i.e., debt/claim assignment would remain available to creditors as a measure for re-defining debtor-creditor relations)[21]. Furthermore, information sharing would not be an issue since debtors would no longer be violating the statutory prohibition on debt/claim assignment[22].

7.1.3 Method

The direct account blocking capability of bills of exchange could be abolished by amending the Payment Operations Act, whereby any cash sweeping instrument

[20] Please see Section 6.1 above.

would trigger cash sweeping, but where only a competent authority decision or a court decision on enforcement would trigger account blocking.

Such amendments would effectively render account blocking contingent on a prior court ruling to that effect by removing the direct account blocking capability of bills of exchange.

#### 7.1.4 Result

Under this solution, bills of exchange should remain a tool capable of direct and accelerated one-off cash sweeping across all debtor's accounts on creditors' request. At the same time, the solution limits the negative ramifications of bills of exchange on the prospect of achieving a successful outcome to reorganisation/out-of-court restructuring. This would bring the Macedonian legal regime governing bills of exchange closer to that of Austria, Germany and Slovenia.

#### 7.1.5 Parallel actions

In parallel to any limitation of the enforcement powers of bills of exchange, including removal of their account blocking capability, appropriate amendments to the account pledge legislation should be introduced in order to render account pledges operable.

Therefore, it is recommended that the Pledges Act which regulates account pledges is amended so as to (i) define and explicitly regulate account pledge, (ii) provide for attachment of floating cash balances on pledge accounts up to the maximum secured amount (i.e. account balance top-up(s)) and (iii) explicitly regulate swift enforcement of account pledge and set-off of account balance against secured obligation.

In addition, consideration should be given to extending the Financial Collateral Act to mid and small size corporates as well as capacity building for the market regarding financial collateral arrangements to encourage greater market use. This would bring Macedonian legislation in line with other EU countries which have implemented the EU Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.

### 7.2 Further Phases

#### 7.2.1 Phase 2 – Removal of the capability of bills of exchange to sweep cash across all debtor's accounts

At a later stage, further consideration should be given to aligning Macedonian legislation with that of Slovenia by preventing cash sweeping across all of the debtor’s accounts.

The mechanism of direct cash sweeping across all accounts of a debtor should be limited to cash sweeping from a specific debtor account (i.e., the account to which the bills of exchange are linked).

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[21] Please see Section 4.10.4 above.

[22] Please see **Error! Reference source not found.** above.

The reason to consider this solution is that, under the present arrangements, cash sweeping deprives the debtor of all current working capital, which also has ramifications on the prospect of achieving a successful outcome of out-of-court restructuring/reorganisation.

The proposed timeline for the implementation of changes in Macedonian legislation is currently estimated at 12 to 18 months from the introduction of functional account pledges.

This is mainly due to the difficulties expected to arise as a result of reduction of the powers of bills of exchange, as described by market participants in their response to our questionnaire, detailed in Section 4.11 of this study.

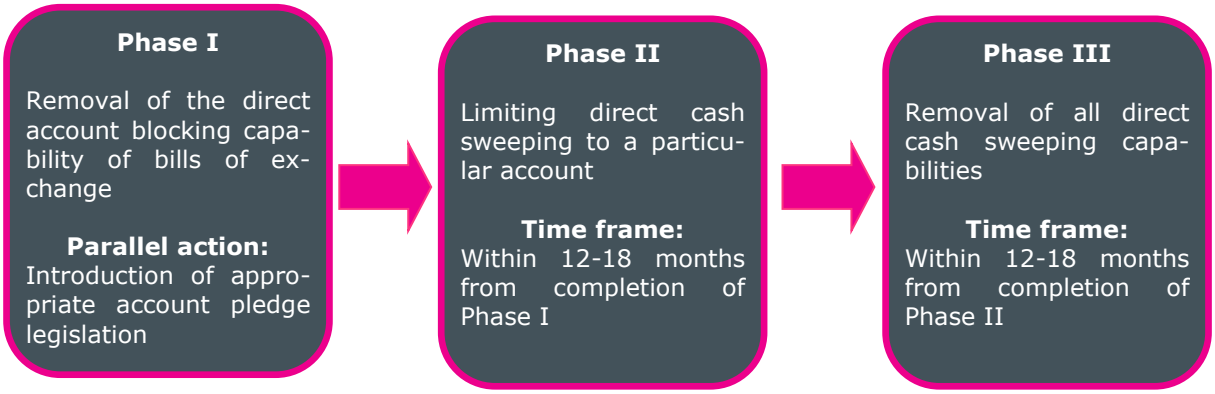
The Legal Consultant considers the introduction of a functional account pledge a necessary pre-condition, which must be met prior to initiating any amendments of the current legislation governing bills of exchange.

#### 7.2.2 Phase 3 –Removal of the capability of bills of exchange to sweep cash from any account of a debtor

The final phase in mitigating the effects of bills of exchange would involve the removal of all their direct cash sweeping capabilities, by way of introduction of a requirement that bills of exchange may only be enforced through/based on a court ruling, rather than directly. The vast popularity of bills of exchange as enforcement instruments, afforded by quick and effective enforcement, would thus be significantly reduced, however, if timed correctly with extending the financial collateral arrangements to mid and small size corporates as well as capacity building for market regarding such arrangements to encourage greater market use, the latter would provide banks with an easily enforceable alternative security interest over financial (cash) collateral.

The Legal Consultant expects that amending the relatively recent Bills of Exchange Act may require up to a further 12 to 18 months following the limitation of the cash sweeping powers of bills of exchange. It is expected that this step i.e. the second amendment of the legislation will be more readily accepted, and therefore this phase 3 is more likely to be implemented more swiftly than Phase 2.

Phases diagram:



In addition to the above recommendations, which aim to minimise the adverse impact of bills of exchange and their enforcement mechanism on the prospect of achieving successful out-of-court restructuring and/or reorganisation, it is also strongly recommended that the EBRD and the Legal Consultant discuss the availability of statistical data with the regulators (in particular KIBS); the discussion may serve as empirical confirmation of the legal analysis made and conclusions reached in this study.

Such data could include historical data concerning companies with blocked bank accounts, such as the number of companies currently blocked; the number of companies where the block was lifted; the total number of companies that were blocked in the past; and, in regard to the type of bankruptcy proceedings initiated, the number of companies that were blocked and subsequently went through out-of-court restructuring and/or reorganisation.

## Appendix 1 – Implementation of internationally accepted standards for functional out-of-court restructuring and reorganisation in Macedonian legislation

Prior to assessing the implementation of internationally accepted standards for functional out-of-court restructuring and reorganisation in Macedonian legislation, it is important to first explain the elements that are, according to such standards, considered to characterise the functional framework that enables work-out procedures.

### Elements characterising functional framework that enables work-out procedures

### 1. Enabling framework

A functional framework should facilitate out-of-court restructuring and reorganisation by providing various measures available to creditors and debtors, and enable achievement of out-of-court restructuring and reorganisation through their application. Such measures should include debt-to-equity swaps, debt write-off, set-off, amendment of debt obligations and priority for new financing providers.

In addition to introducing these measures, a functional framework should also incentivise both debtors and creditors to accept them. Such incentives should range from the relaxing of bad debt provisioning for banks to tax benefits.

Finally, regardless of the functionality of out-of-court restructuring and reorganisation legislation, other legislation should also incentivise out-of-court restructuring and reorganisation rather than hinder these work-out procedures.

### 2. Neutral forum

A functional out-of-court restructuring and reorganisation legal environment should facilitate these work-out procedures by providing for a neutral forum where both creditors and debtors can negotiate, explore arrangements and overcome their opposing interests with a view to implementing out-of-court restructuring and reorganisation.

### 3. Participants

Out-of-court restructuring and reorganisation both have in common the indebtedness of the debtor towards numerous creditors of varying financial and risk profiles. It is therefore paramount that the key creditors, whose collateral could lead to the debtor's liquidation in bankruptcy, or affect restructuring measures, be involved in negotiations and included in the out-of-court restructuring plan or reorganisation plan. The feasibility of such plans is contingent on the creditors' not jeopardising work-out by exercising the rights arising out of their arrangements with the debtor.

### 4. Coordination

Typically, a debtor has numerous creditors, whose actions tend to be disorganised and contradictory; this can frustrate the out-of-court restructuring and reorganisation process. Thus, for a functional work-out, it is essential that the actions of creditors be coordinated and uniform. Such coordination could be achieved through the creation of coordinating bodies with delegated authority from groups of creditors having a common denominator.

**5. Stabilisation**

In order to prevent unilateral action by creditors intending to realise their individual interests, triggered by the debtor's financial difficulties, a functional out-of-court restructuring and reorganisation environment must provide for a contractual or statutory stay of action against the debtor. This step should have a stabilising effect on the debtor and his creditors, as it ensures that the debtor's assets will not be subject to enforcement during negotiation of the work-out plan, and will be included in the process once the plan is adopted.

**6. Access to new money**

Most unsuccessful out-of-court restructurings and reorganisations fail due to a lack of liquidity, which is crucial for implementing the necessary measures. The parties to the process are unwilling to inject further cash into a financially distressed debtor, and so are new investors. A functional legal framework should provide incentives for injecting new money into financially distressed companies.

Such incentives could be in the form of priority payment, collateral ranking or deferral of outstanding liabilities. In particular, the debtor may offer his creditors to repay, in the long term, more than they were originally entitled to, in return for their agreement to extend the maturity of their claims and maintain their business relationship with the debtor.

**7. Information**

The out-of-court restructuring and reorganisation process can only be effective if all key participants have access to key information regarding the debtor's affairs. Otherwise, the plan would be based on unconfirmed or false presumptions, making it susceptible to failure.

**8. Legal effects**

Ideally, the out-of-court restructuring plan and reorganisation plan should be binding on all constituencies whose actions could result in liquidation in bankruptcy of a financially distressed debtor. Where there are creditors not bound by the plan, out-of-court restructuring and reorganisation envisaged thereunder may be at a risk of the debtor's liquidation in bankruptcy resulting from unilateral action by such creditors.

| Elements of a functional environment[23] | Voluntary Restructuring | Consensual Financial Restructuring | Reorganisation | Comments |
|---|---|---|---|---|
| **Enabling Framework** | √ | √ | √ | **Voluntary Restructuring**<br><br>While voluntary restructuring is not institutionalised in a separate piece of legislation (i.e., voluntary restructuring is not codified), general provisions of civil and corporate law may be used as the legal basis for the implementation of work-out measures. For example, debt/claim assignment may be agreed pursuant to the Obligations Act, while debt-to-equity swap may be stipulated in line with the Companies Act.<br><br>**Consensual Financial Restructuring**<br><br>The Consensual Financial Restructuring Act provides a wide range of restructuring measures for redefining debtor-creditor relations.<br><br>Please see Section 5.2 of this Study for consensual financial restructuring measures.<br><br>**Reorganisation**<br><br>The Bankruptcy Act contains a wide range of measures available to creditors and debtors to agree upon and redefine their relations accordingly. |

[23] Please see Appendix 1 for explanation of elements of a functional Reorganisation/Out-of-Court Restructuring environment.

| Elements of a functional environment[23] | Voluntary Restructuring | Consensual Financial Restructuring | Reorganisation | Comments |
|---|---|---|---|---|
| | | | | Such measures include, *inter alia*:<br>• management or disposal of the debtor's property, or transfer of the debtor's property to one or more legal entities that exist or will be founded;<br>• mergers of debtors with legal entities;<br>• disposal of debtor's property, with or without the rights to separate settlement;<br>• division of the debtor's property among creditors;<br>• determining the manner of settlement of the creditors;<br>• settling or changing the rights to separate settlement;<br>• reducing or postponing the payments of the debtor's liabilities;<br>• turning the debtor's liabilities into a credit/loan;<br>• settling all or part of the debt of the creditor with shares held by shareholders;<br>• undertaking a guarantee or providing other forms of security for the fulfilment of debtor's liabilities;<br>• turning all or part of the debt into shares in the reorganised debtor;<br>• additional investments; and<br>• permitting the increase of the initial share capital through issuing new shares or eq- |

| Elements of a functional environment[23] | Voluntary Restructuring | Consensual Financial Restructuring | Reorganisation | Comments |
|---|---|---|---|---|
| | | | | uity for the creditors or new investors. |
| **Neutral Forum** | √ | √ | x | **Voluntary Restructuring**<br><br>Given that voluntary restructuring is not codified, there are no explicit provisions governing the forum for such work-outs. However, there are no obstacles for parties to agree on a forum in which work-out will be performed based on general rules of civil law.<br><br>**Consensual Financial Restructuring**<br><br>The Ministry of Economy in Macedonia and the settlement council appointed by it are the neutral forums appointed to facilitate negotiations and mediate between opposing interests of the parties.<br><br>**Reorganisation**<br><br>The role of the bankruptcy court is opposite to that of the mediator appointed in consensual financial restructuring, as it is not involved in the preparation of the reorganisation plan. Its role is limited to verifying the legality of the reorganisation plan; and supervising/facilitating voting. |
| **Ensured Participation of** | | | | **Voluntary Restructuring**<br><br>As voluntary restructuring is binding only on its participants and there is no legislation |

| Elements of a functional environment[23] | Voluntary Restructuring | Consensual Financial Restructuring | Reorganisation | Comments |
|---|---|---|---|---|
| **Key Constituencies** | x | ✓ | ✓ | prescribing other mechanisms to ensure the participation of all creditors (e.g., the Bankruptcy Act), voluntary restructuring is undertaken and effective only between parties willing to engage in it.<br>**Consensual Financial Restructuring**<br>Initial participation is obligatory on a debtor which has become illiquid, however the creditors must vote out the restructuring plan by 51% majority of the total determined debt.<br>If the Resolution for commencement is passed, an automatic stay on all creditors actions is posed by the settlement council to ensure participation of all creditors.<br>**Reorganisation**<br>All parties wishing to realise their claims must participate in the bankruptcy proceedings; the reorganisation plan must include all claims; and its terms are imposed on each creditor, regardless of whether the creditor is for or against such plan (i.e., cram-down). |
| **Coordination / organisation of creditors** | | | | **Voluntary Restructuring**<br>No explicit provisions regulate creditors' coordination/organisation. However, the parties may agree on the manner of coordination and |

| Elements of a functional environment[23] | Voluntary Restructuring | Consensual Financial Restructuring | Reorganisation | Comments |
|---|---|---|---|---|
| | x | √ | x | delegate authority by power of attorney under general civil law.<br>**Consensual Financial Restructuring**<br>The Out-of-Court Settlement Act proclaims the principle of creditor cooperation and envisages their duty to cooperate. It also provides for a settlement council constituted by the Ministry of Economy, which oversees the implementation of the restructuring plan.<br>**Reorganisation**<br>The Bankruptcy Act does not explicitly regulate the coordination of creditors in respect of the preparation and negotiation of the reorganisation plan. |
| **Stabilisation** | x | √ | √ | **Voluntary Restructuring**<br>Given the inter-party legal effect of contractual obligations, standstill agreements reached in voluntary restructuring are binding only on their signatories.<br>**Consensual Financial Restructuring**<br>The Out-of-Court Settlement Act envisages standstill agreements with legal consequences in accordance with best international practice.<br>**Reorganisation** |

| Elements of a functional environment[23] | Voluntary Restructuring | Consensual Financial Restructuring | Reorganisation | Comments |
|---|---|---|---|---|
| | | | | Reorganisation based on a reorganisation plan, is protected from hold-out creditors' unilateral actions by way of an automatic stay on such actions, triggered on initiation of bankruptcy proceedings.<br><br>The same protection is also available reorganisation based on pre-packaged reorganisation plan, if the bankruptcy judge approves it upon a debtor's request. |
| **Information** | √ | √ | x | **Voluntary Restructuring**<br><br>Based on the Obligations Act, contracting parties must act in good faith and with due care during negotiations. The Obligations Act also prescribes the prohibition to cause damage and obligation to compensate for damage occurring as a result of breach of good faith negotiations.<br><br>**Consensual Financial Restructuring**<br><br>The Out-of-Court Settlement Act obliges a debtor to share business information with the participants in the restructuring process.<br><br>**Reorganisation**<br><br>There is an obligation on the debtor to share information regarding the state of the business during the implementation of the reorganisation plan. There is no obligation to share information |

| Elements of a functional environment[23] | Voluntary Restructuring | Consensual Financial Restructuring | Reorganisation | Comments |
|---|---|---|---|---|
| | | | | in the course of preparation of the pre-packaged reorganisation plan. |
| **Legally**<br>**Binding on all Creditors** | x | x | ✓ | **Voluntary Restructuring**<br>Agreements concluded in voluntary restructuring are binding only on their signatories.<br>**Consensual Financial Restructuring**<br>If approved by the creditors, the restructuring plan is binding on all creditors.<br>**Reorganisation**<br>The Bankruptcy Act obliges all creditors to participate in bankruptcy proceedings, thus ensuring the participation of all creditors in reorganisation as a method of conducting bankruptcy proceedings. The Bankruptcy Act provides for a cram-down of dissenting creditors by stipulating that reorganisation is binding on all creditors if adopted by a simple majority of 51% in all groups of creditors of the total amount of the claims of creditors present at the voting meeting. The reorganisation plan can envisage a larger majority. |

## Appendix 2 – Questionnaires completed by market participants

### Background

This questionnaire is provided to you within the context of a study conducted by the European Bank for Reconstruction and Development together with its consultants Moravčević, Vojnović i partneri AOD in cooperation with Schönherr on account blocking and its impact on debtor-creditor relations in the Western Balkans (i.e. Republic of Macedonia, Republic of Serbia, Montenegro, Federation of Bosnia and Herzegovina as well as in the Republic of Srpska).

The ability to restructure or reorganise financial obligations is immensely important for debtors and creditors and for the wider economy, particularly in financially challenging times. Both out-of-court restructuring and court-led reorganisation can maximise value to creditors by ensuring that viable debtors in financial difficulty continue operations rather than enter into unplanned liquidation in bankruptcy. They can also preserve employment of the debtor's staff and ensure continuation of the business of the debtor's business partners and suppliers, as well as the debtor's ability to pay taxes and contribute to the public revenue.

Cash sweeping and account blocking on the basis of bills of exchange have existed as an effective means of quasi-security for creditors in Macedonia for a long time and are perceived to be important in the absence of effective account pledge security instruments. Nevertheless preliminary evidence suggests that this practice can reduce the incentives for creditors (and their debtors) to cooperate on out-of-court restructuring and court-led reorganisation in bankruptcy (*стечај*), since it gives rise to a 'first to act' advantage[24].

The purpose of this questionnaire is to gather stakeholder feedback on the effects of account blocking on out-of-court restructuring and court-led reorganisation in bankruptcy (*стечај*) and to obtain stakeholder views on whether any changes are needed to the existing legal framework for account blocking to support out-of-court restructuring and/or court-led reorganisation.

**Please note that this questionnaire is voluntary and you are not obliged to answer every question. If you do not know the answer to a particular question or do not wish to answer, please leave this blank.**

[24] First movers benefit from (i) any available cash balance on the debtor's accounts at the moment of enforcement, through the ability of bills of exchange to sweep cash from all of the debtor's accounts in the jurisdiction and (ii) "reserving" all future cash receivables of the debtor by the account blocking mechanism.

## Questionnaire – Association of Banks

Questions - Bills of Exchange

1.1 Does your financial institution typically require bills of exchange from borrowers as a form of collateral for providing financing? Please tick one box as applicable.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

1.2 Do you consider bills of exchange to be essential collateral, without which your financial institution is not willing to provide financing? Please tick one box as applicable.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

1.3 If your answer to the above question 1.2 is positive, please briefly explain why you consider bills of exchange to be essential collateral for providing financing.

_____

1.4 The account pledge is not popular in Macedonia due to difficulties in creating effective security over a debtor's bank account(s). If the account pledge were fully effective, would you be willing to rely on the account pledge rather than bills of exchange as collateral? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

1.5 In your experience, does the enforcement of bills of exchange by your financial institution secure a good rate of recovery i.e. 60% or above of the original debt? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

1.6 Do you agree with the following statement "The cash sweep and the payment of existing proceeds from the debtor's accounts are important for the overall recoveries of my financial institution"? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

1.7 Do you agree with the following statement "Account blocking and the payment of future proceeds from the debtor's accounts are important for the overall recoveries of my financial institution"? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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1.8 Does your financial institution typically enforce bills of exchange at the first sign of financial distress of the debtor? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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1.9 Does your financial institution typically enforce bills of exchange as a result of other creditors enforcing or threatening to enforce their bills of exchange? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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1.10 Does your financial institution initiate insolvency proceedings in respect of a debtor on the grounds of the debtor's accounts being blocked? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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Questions - Out-of-Court Restructuring / Reorganisation

2.1 Does your financial institution ever participate in bilateral out-of-court restructuring of a debtor? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

---

2.2 Does your financial institution ever participate in out-of-court restructuring of a debtor with other creditors (including under the Out-of-Court Settlement Act (*Закон за вонсудско спогодување*))? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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2.3 When your financial institution participates in an out-of-court restructuring and hold bills of exchange which can enforce, does it typically:

☐ enforce any bill(s) of exchange first and then engage in out-of-court restructuring (including negotiation of a standstill agreement);

☐ engage in negotiation of a standstill agreement first but hold onto bills of exchange as a leverage tool for the negotiations; or

☐ other/ none of the above.

Please tick one box above as applicable and provide any additional comments below.

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2.4 In your opinion, does the possession of bills of exchange by creditors undermine negotiations on a standstill and/or out-of-court restructuring? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

2.5 Does your financial institution typically participate in out-of-court restructuring even if bills of exchange by creditors (including your financial institution) have been enforced? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

2.6 Do bills of exchange in any other way effect your decision whether to participate in out-of-court restructuring / court-led reorganisation process and why? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

2.7 Does existence of bills of exchange in any way affect negotiations or voting of creditors on pre-packaged reorganisation plans? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

2.8 If the answer to the above question 2.7 is positive, could you please elaborate on how bills of exchange affect negotiations or voting of pre-packaged reorganisation plan?

_____

2.9 If you see bills of exchange and the effects of their enforcement (i.e. account blocking) as an obstacle for achieving successful out-of-court restructuring / court-led reorganisation, could you please suggest any potential solutions to overcoming this obstacle?

_____

2.10 Would you generally support a reform of the legal regime for bills of exchange which would strengthen out-of-court restructuring and court-led reorganisation? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

## Questionnaire – Chamber of Commerce and Industry

Questions - Bills of Exchange

*When in capacity of the creditor*

1.1 Do your typically require bills of exchange from your business partners as a form of collateral for your monetary claims against your business partners? Please tick one box as applicable.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

*When in capacity of the debtor*

1.2 Do your business partners typically require bills of exchange from you as a form of collateral, for their monetary claims against you? Please tick one box as applicable.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

*When in capacity of the creditor*

1.3 Do you consider bills of exchange to be essential collateral, without which you are not willing to provide your business partners with a loan/trade credit? Please tick one box as applicable.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

*When in capacity of the creditor*

1.4 If your answer to the above question 1.3 is positive, please briefly explain why you consider bills of exchange to be essential collateral for providing loan/trade credit.

_____

*When in capacity of the debtor*

1.5 Do your business partners/creditors consider bills of exchange to be essential collateral, without which they are not willing to provide you with a loan/trade credit? Please tick one box as applicable.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

*When in capacity of the debtor*

1.6 If your answer to the above question 1.5 is positive, please briefly explain why you consider bills of exchange to be essential collateral for providing loan/trade credit.

_____

*General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)*

1.7 The account pledge is not popular in Macedonia due to difficulties in creating effective security over a debtor's bank account(s). If the account pledge were fully effective, would you be willing to rely on the account pledge rather than bills of exchange as collateral? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

---

*General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)*

1.8 In your experience, does the enforcement of bills of exchange secure a good rate of recovery i.e. 60% or above of the original debt? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

---

*General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)*

1.9 Do you agree with the following statement "The cash sweep and the payment of existing proceeds from the debtor's accounts are important for overall recoveries"? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

---

*General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)*

1.10 Do you agree with the following statement "Account blocking and the payment of future proceeds from the debtor's accounts are important for overall recoveries"? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

---

*When in capacity of the creditor*

1.11 Do you typically enforce bills of exchange at the first sign of financial distress of the debtor? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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*When in capacity of the debtor*

1.12 Do your creditors typically enforce bills of exchange at the first sign of your financial distress? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

---

*When in capacity of the creditor*

1.13 Do you typically enforce bills of exchange as a result of other creditors enforcing or threatening to enforce their respective bills of exchange? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

*When in capacity of the debtor*

1.14 Do your creditors enforce bills of exchange as a result of other creditors enforcing or threatening to enforce their respective bills of exchange? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

*When in capacity of the creditor*

1.15 Do you initiate insolvency proceedings in respect of a debtor on the grounds of the debtor's accounts being blocked? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

*When in capacity of the debtor*

1.16 In case your account was ever blocked, have any of your creditors initiated insolvency proceedings on the grounds of your accounts being blocked? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

**Questions - Out-of-Court Restructuring / Reorganisation**

*When in capacity of the creditor*

2.1 Do you ever participate in bilateral out-of-court restructuring of a debtor? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

*When in capacity of the debtor*

2.2 If you were in situation of financial distress, have you ever engaged in bilateral out-of-court restructuring with your creditors? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

*When in capacity of the creditor*

2.3 Do you ever participate in out-of-court restructuring of a debtor with other creditors (including under the Out-of-Court Settlement Act (*Закон за вонсудско спогодување*))? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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*When in capacity of the debtor*

2.4 If you were in situation of financial distress, would you invite your creditors to join out-of-court restructuring (including under the Out-of-Court Settlement Act (*Закон за вонсудско спогодување*))? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

---

*When in capacity of the creditor*

2.5 When you participates in an out-of-court restructuring and hold bills of exchange, do you typically:

☐ enforce any bill(s) of exchange first and then engage in out-of-court restructuring (including negotiation of a standstill agreement);

☐ engage in negotiation of a standstill agreement first but hold onto bills of exchange as a leverage tool for the negotiations; or

☐ other/ none of the above.

Please tick one box above as applicable and provide any additional comments below.

---

*When in capacity of the debtor*

2.6 In case you have ever been subject of out-of-court restructuring, did your creditors holding bills of exchange:

☐ enforce bill(s) of exchange first and then engage in out-of-court restructuring (including negotiation of a standstill agreement);

☐ engage in negotiation of a standstill agreement first but held onto bills of exchange as a leverage tool for the negotiations; or

☐ other/ none of the above.

Please tick one box above as applicable and provide any additional comments below.

---

*General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)*

2.7 In your opinion, does the possession of bills of exchange by creditors undermine negotiations on a standstill and/or out-of-court restructuring? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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*When in capacity of the creditor*

2.8 Do you typically participate in out-of-court restructuring even if bills of exchange by creditors (including yourself) have been enforced? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

*When in capacity of the debtor*

2.9 In case you have ever been subject of out-of-court restructuring, did your creditors participate in out-of-court restructuring even if bills of exchange by other creditors have been enforced? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

---

*When in capacity of the creditor/debtor*

2.10 Do bills of exchange in any other way effect your decision whether to participate in out-of-court restructuring / court-led reorganisation process and why? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

---

*General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)*

2.11 Does existence of bills of exchange in any way affect negotiations or voting of creditors on pre-packaged reorganisation plans (план за реорганизација пред отварање на стечајна постапка)? Please tick one box above as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

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*General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)*

2.12 If the answer to the above question 2.11 is positive, could you please elaborate on how bills of exchange affect negotiations or voting of pre-packaged reorganisation plan?

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*General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)*

2.13 If you see bills of exchange and the effects of their enforcement (i.e. cash sweeping / account blocking) as an obstacle for achieving successful out-of-court

restructuring / court-led reorganisation, could you please suggest any potential solutions to overcoming this obstacle?

_____

*General question (i.e. regardless of whether you are in capacity of the creditor or the debtor)*

2.14 Would you generally support a reform of the legal regime for bills of exchange which would strengthen out-of-court restructuring and court-led reorganisation? Please tick one box as applicable and provide any additional comments below.

☐Yes ☐Yes, with reservations ☐No ☐No, with reservations

_____

## Appendix 3 – Definitions and Abbreviations

| | |
|---|---|
| **Account Blocking** | Measure prescribed under the Payment Operations Act and implemented by KIBS via the debtor's account banks, consisting in prohibiting the debtor from disposing of any future proceeds paid into his bank account, and automatically transferring such proceeds to the creditor enforcing his account blocking instrument, if the amount of available proceeds at the time of enforcement of the claim is insufficient to repay the entire creditor's claim in full; |
| **Bankruptcy** | Bankruptcy (*стечај*) is a term defined in the Bankruptcy Act as incapacity of a debtor to make any payments based on recognised monetary claims within 45 days of falling due; |
| **Bankruptcy Act** | Bankruptcy Act (З*акон за стечај*) (Official Gazette of the Republic of Macedonia, No. 34/06, 126/06, 84/07, 3/08, 122/09, 47/11, 79/13, 164/2013 and 29/2014); |
| **Bills of Exchange Act** | Bills of Exchange Act (*Закон за меница*) (Official Gazette of the Republic of Macedonia, Noc. 3/02, 67/10 and 145/2015); |
| **Cash Sweeping** | Measure prescribed under the Payment Operations Act and implemented by the debtor's account bank, which entails the transfer of all funds held in all debtor's bank accounts at the moment of commencement of the enforced collection of a cash sweeping instrument to the benefit of the enforcing creditor; |
| **Chamber of Commerce** | Chamber of Commerce of Macedonia (*Стопанска комора на Македонија*) |
| **Consensual Financial Restructuring** | Out-of-court financial restructuring carried out under the Out-of-Court Settlement Act with the assistance of the Macedonian Ministry of Economy; |
| **Consensual Financial Restructuring Act** | Out-of-Court Settlement Act (*Закон за вонсудско спогодување*) (Official Gazette of the Republic of Macedonia, No. 12/2014); |
| **EBRD** | European Bank for Reconstruction and Development; |
| **Enforcement Act** | Enforcement Act (*Закон за извршување*) (Official Gazette of the Republic of Macedonia, No. 72/2016 and 142/2016); |
| **Financial Collateral Act** | Financial Collateral Act (*Закон за финансиско обезбедување*) (Official Gazette of the Republic of Macedonia, No. 84/2008); |
| **Illiquidity** | non-payment of Recognised Monetary Claims within 30 days |

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| | after becoming due or over-indebtedness of the debtor, if the amount of his estate is not sufficient to cover the debtor's liabilities; |
| **Legal Consultant** | Moravčević, Vojnović and partners AOD in cooperation with Schönherr; |
| **Market Participants** | 5 commercial banks and 10 members of the Macedonian Chamber of Commerce in their capacity as creditors, comprising the representatives of market participants; |
| **Obligations Act** | Obligations Act (*Закон за облигационите односи*) (Official Gazette of the Republic of Macedonia, No. 18/2001, 78/2001, 4/2002, 59/2002, 5/2003, 84/2008, 81/2009, 161/2009 and 123/2013); |
| **Out-of-Court Restructuring** | Voluntary restructuring and/or (depending on the context) consensual financial restructuring; |
| **Payment Operations Act** | Payment Operations Act (*Закон за платниот промет*) (Official Gazette of the Republic of Macedonia, No. 113/07, 22/08, 159/08, 133/09, 145/10, 35/11, 11/12, 59/12, 166/12, 170/13, 153/15 and 199/15); |
| **Pledge Act** | |
| **Recognised Monetary Claim** | a court decision or court settlement on enforcement, a decision by a competent authority (Public Revenue Office, Customs Administration of the Republic of Macedonia, Ministry of Finance, local self-government bodies, Water Management Fund) or a notarised enforcement document (e.g. bill of exchange); |
| **Reorganisation** | process whereby the financial health and economic viability of the business of the debtor may be restored and whereby the business of the debtor continues operating, through the use of resources provided for in the Bankruptcy Act, and primarily through (i) debt relief; (ii) postponing debt repayments; (iii) conversion of debt into company shares; and (iv) selling the company as whole or in part; |
| **Voluntary Restructuring** | Out-of-court voluntary restructuring between parties on a voluntary basis, which takes place outside of a formal statutory framework, subject to general rules and conditions established by the Obligations Act. |