

CROATIA



Legislative framework

Legislative framework for insolvency proceedings

The Bankruptcy Act¹ (BA) is the main law governing the insolvency of businesses (including individual entrepreneurs) in Croatia. The newly adopted BA now also incorporates the pre-bankruptcy settlement procedure, previously regulated in the Act on Financial Operations and Pre-Bankruptcy Settlement Proceedings² (as amended).

Legislative framework for insolvency office holders

In addition to the BA, other legislation regulating the insolvency office holder (IOH) profession includes: the Decision on Establishing the List of Bankruptcy Administrators;³ the Rulebook on Establishing the List of Bankruptcy Administrators;⁴ the Rulebook on the Expert Exam Programme for Bankruptcy Administrators;⁵ the Rulebook on Conditions and Method of Random Selection of Bankruptcy Administrators;⁶ and the Regulation on the Criteria and Calculation of Payments to the Bankruptcy Administrators.⁷

Types of insolvency procedures

There are two separate regimes in Croatia under the BA for businesses that are illiquid and/or insolvent – the pre-bankruptcy settlement procedure and bankruptcy procedure.

Pre-bankruptcy settlement proceedings must generally be initiated by illiquid or insolvent debtors within the early stages of illiquidity or insolvency and are aimed at restructuring the debtor's financial obligations and restoring its solvency by means of a restructuring plan.⁸ This stage is intended to be the first voluntary route for most struggling businesses, with formal bankruptcy proceedings under the BA reserved for those businesses which fail to

¹ Official Gazette No. 71/2015

² Official Gazette Nos. 108/2012, 144/2012, 81/2013, 112/2013 78/2015, 71/2015.

³ Official Gazette Nos. 84/2015, 87/2015, 93/2015, 93/2015

⁴ Official Gazette No. 104/2015

⁵ Official Gazette No. 104/2015

⁶ Official Gazette No. 105/2015

⁷ Based on Article 25 of the IA, the debtor and the creditor with debtor's consent can initiate this procedure

⁸ Since the introduction of PSP in 2012, commercial bankruptcy proceedings under the IA play a minor role compared with pre-bankruptcy settlement proceedings

reach an agreement with their creditors. However, the BA is available for businesses that are threatened with illiquidity and/or insolvency.⁹ BA proceedings can result either in liquidation of the debtor or restructuring pursuant to a plan agreed with majority creditors.

Institutional framework

Pre-Bankruptcy Procedure

The key players in pre-bankruptcy settlement proceedings are the debtor (it is a debtor-in-possession procedure), the court (and the insolvency judge), the IOH, the relevant financial agency (FINA) and creditors.

Upon receiving the motion for pre-bankruptcy settlement proceedings, the competent court (being the commercial court where the debtor's headquarter is registered) decides on initiation of such proceeding. The court conducts and oversees all the procedure phases, while FINA assist the court in receiving and processing the filed claims of creditors. When opening the procedure, the court appoints an IOH, known as the pre-bankruptcy trustee or insolvency trustee, from a list of certified IOHs to co-manage the debtor and supervise its disbursements.

The debtor is required to prepare and submit an initial draft of the restructuring plan. During the procedure the debtor is required to adjust the plan in accordance with the accepted and challenged claims of the creditors. For the purpose of voting on the plan the creditors are divided into groups of higher (preferential), lower (ordinary) ranking claims, and those creditors with a right of separate settlement. Upon receiving the majority of creditors' votes, the court confirms the plan. Creditors with a right of separate settlement vote for the plan in case they waived their right of separate settlement.

Bankruptcy Procedure

The key players in bankruptcy proceedings are the commercial court (and the commercial judge), the IOH and creditors (acting as a general body at the creditors' assembly and, to the extent applicable, as represented by the creditors' committee).

In Croatia BA proceedings are overseen by the competent court (being the commercial court where the debtor's headquarter is registered). The court directs and controls the proceedings from opening to closure. It decides, among other matters, on the initiation and termination of the insolvency proceedings and the appointment or replacement of an IOH. The court supervises the activities of the IOH and the creditors' committee.

The IOH, known as the insolvency trustee, is appointed by the court in its decision on opening of the insolvency proceedings. The creditors (acting through the assembly of creditors) are, however, entitled to elect a replacement insolvency trustee. The insolvency trustee, inter alia, exercises the rights of the debtor's management body, manages the debtor's business and represents the debtor. The activities of the insolvency trustee are supervised by the court and the creditors.

⁹ The initiator of proceeding and debtor file reports before the court in pre-bankruptcy proceedings and the IOH only comments on such reports at hearings

The assembly of creditors is the general body of creditors convened and chaired by the judge. It has the power to decide on the establishment of a creditors' committee (if not already established by the court) and the appointment of a new insolvency trustee. The assembly may ask the insolvency trustee to report on the status of the proceeding and the management and performance of the debtor's business. Creditors as a whole may vote on any reorganisation plan.

The creditors' committee is established by the first assembly of creditors. It, among other matters, supervises the insolvency trustee and assists him in the conduct of the proceeding. The creditors' committee may file a complaint with the court regarding the conduct of the insolvency trustee and is entitled to inspect the books and records of the debtor.

Assessment overview/strengths and weaknesses

Based on the results of the assessment, a partially developed legal framework appears to exist for the IOH profession in Croatia, which prima facie displays certain strengths. Nevertheless, such a framework would benefit from further improvement to address important areas of weaknesses and thereby improve IOH capacity and performance.

Benchmarks	Strengths of the Croatian IOH professional framework	Weaknesses of the Croatian IOH professional framework
Licensing and registration:	<ul style="list-style-type: none"> • IOHs are required to obtain a licence; Licensed IOHs are determined and divided into two lists: A and B.¹⁰ • An official list of authorised IOHs is easily accessible and published on the web site of the Ministry of Justice (and in the official gazette). 	
Regulation, supervision and discipline:		<ul style="list-style-type: none"> • There is no single dedicated body for the regulation, supervision and discipline of IOHs. The Ministry of Justice is the official regulator, but the court plays the main role in supervision and discipline of IOHs, with creditor assistance, within the context of specific insolvency proceedings. • There is no legal

¹⁰ The division into two lists was part of transitional arrangements following introduction of the new bankruptcy legislation. To be listed in the A list IOHs need to have a formal education, pass the professional exam, have a good reputation in the society and undergo a professional education within one year after passing the exam. B list IOHs have to meet the same criteria, besides the one-year professional education. IOHs from the B list are entitled to manage only the shortened and simpler insolvency proceedings envisaged in the IA, while A list IOHs are entitled to participate in regular and simpler insolvency proceedings

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		<p>requirement for regular monitoring of IOH activities by a dedicated body: the BA stipulates that the insolvency judge, assembly of creditors and creditors' committee shall supervise the IOH's work.</p> <ul style="list-style-type: none"> • There is no separate complaints procedure, although complaints regarding an IOH's conduct can be filed with the court. • A full range of sanctions for IOH misconduct is not available (court sanctions are limited to dismissal or revocation of licence).
Qualification and training:	<ul style="list-style-type: none"> • IOHs are required to pass a specific examination for entry into the IOH profession. • A list IOHs are required to undertake practical "work-based" training. • Criminal checks are carried out and persons convicted of certain offences on a non-appealable basis cannot be licensed as IOHs. Persons who were deleted from the list of IOHs or dismissed also cannot be licensed as IOHs for 3 years, as well as persons who have been declared bankrupt. • IOHs are required to participate twice a year in professional education and training organised by the Ministry of Justice and deliver proof of completion of such training to the Ministry of Justice every two years. 	<ul style="list-style-type: none"> • Although IOHs need to have obtained a higher-education degree, such a degree does not need to be in a relevant discipline. • Prospective B list IOHs are not required to undertake any practical "work-based" training with a licensed IOH. • Continuing training is not required for licensed IOHs.
Appointment system:	<ul style="list-style-type: none"> • Although the appointment of the initial IOH in 	<ul style="list-style-type: none"> • The court appoints the pre-bankruptcy trustee without

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	<p>insolvency proceedings is primarily a matter of judicial discretion, a majority of creditors by value voting at the assembly of creditors are entitled to select a different IOH. Such an IOH shall be appointed by the judge provided s/he meets the legislative requirements.</p> <ul style="list-style-type: none"> The IOHs are appointed by a method of random selection from the list, which prevents potential manipulations with appointments. Moreover, judicial control is guaranteed by giving court the authority to appoint another IOH, if the one randomly selected does not have required expertise for concrete proceeding. 	<p>stakeholder input.</p>
Work standards and ethics:	<ul style="list-style-type: none"> Prior to their appointment, IOHs are required to give statement before the court, promising that they will obey Croatian constitution, laws and legal system in performing their duties. 	<ul style="list-style-type: none"> There is no code of conduct governing work standards and/or ethics for the IOH profession.
Legal powers and duties:	<ul style="list-style-type: none"> In pre-bankruptcy proceedings, IOHs have strong powers of management oversight, but cannot sell the debtor's assets. In insolvency proceedings IOHs have strong powers to manage the debtor's property in an autonomous way; however, the IOH is required to comply with the decision of creditors regarding the sale of assets. IOHs in insolvency proceedings are required to provide reports on a regular (three-month) basis and otherwise at the request of the court and/or the creditors. 	<ul style="list-style-type: none"> Although the debtor (and parties connected to the debtor) are required to cooperate with the IOH and provide information in pre-bankruptcy and insolvency proceedings (and are subject to significant sanctions for non-cooperation), creditors and third parties do not have this obligation and the IOH needs to apply to the court to ensure cooperation by third parties.

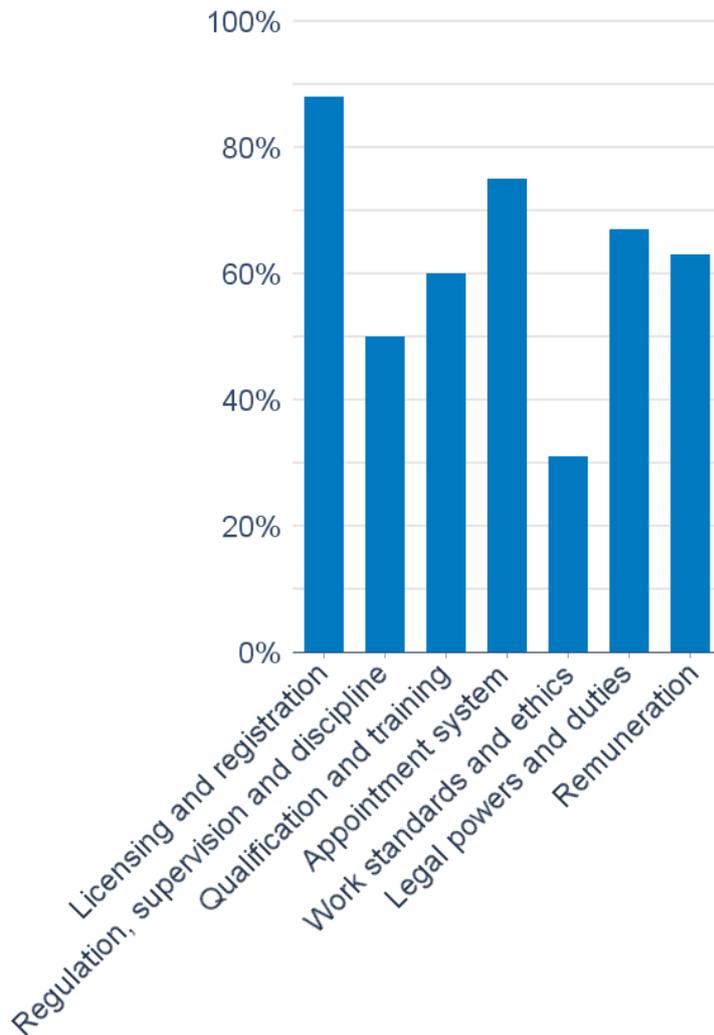
Benchmarks	Strengths of the Croatian IOH professional framework	Weaknesses of the Croatian IOH professional framework
Remuneration:	<ul style="list-style-type: none"> • There is a clear legislative framework for IOH remuneration covering both pre-bankruptcy trustees and insolvency trustees, which prescribes a fixed fee subject to overall cap/limits.¹¹ • IOH remuneration forms part of the procedural costs and therefore enjoys priority in liquidation over unsecured claims and generally over preferential claims, including tax and employees; however unpaid salaries will rank equally with IOH remuneration in certain circumstances.¹² 	<ul style="list-style-type: none"> • IOHs are not required to explain to creditors the costs and fees incurred during the course of insolvency proceedings.

The following chart shows us the quality of legal framework related to IOHs in the key areas as listed below.

¹¹ The pre-bankruptcy trustee fee can vary between HRK 3,000 and HRK 20,000, final amount of which is set by the court. The bankruptcy trustee fee is limited to maximum of HRK 795,000. When deciding on these amounts, the court takes into account the complexity of each proceeding and the amount of work.

¹² Employee claims for unpaid salary which exceed three unpaid salaries will have the same priority as IOH remuneration, but only up to the amount of three minimum salaries in Croatia.

Croatia



Key recommendations

As illustrated in the chart above, Croatia appears to have a legal framework for the IOH profession which covers only some of the key elements of the profession. There are certain areas where reforms are particularly needed including: regulation, supervision and discipline; qualification and training; and work standards and ethics; and legal powers and duties.

- Further consideration should be given to the creation of a dedicated regulatory body for IOHs. Experience demonstrates that an active regulatory body is more effective at enhancing IOH professional standing and performance. Such a regulatory body could

monitor the activities of IOHs on a regular basis. In this regard, the establishment of a formal complaints procedure (operated by a dedicated regulatory body) should be considered.

- Relevant professional education as well as practical work experience for prospective IOHs should be introduced in order to enhance the performance of IOHs and the status of the profession
- A comprehensive and publicly available code of professional conduct for IOHs of a binding nature should be adopted to provide useful guidelines and principles for IOH professional activities.
- Additional requirements for cooperation by third parties with IOHs would enhance the investigation powers of the IOH and may facilitate the successful recovery of assets belonging to the debtor's estate.
- Greater oversight and transparency with respect to IOH costs and expenses would be beneficial to protect stakeholder interest.