

Review Article

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BUSINESS REORGANIZATION AS A WAY OF RESOLVING INSOLVENCY

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Abstract: *A long-term insolvency period usually precedes commencement of bankruptcy proceeding, by which time a debtor has already used up most of their assets. Such company has already lost its place on the market, been abandoned by the company's best workers, and has not maintained or renewed the equipment. These are all indicators of the company's need of fresh capital required for effective reorganization. Reorganization provides the debtor with an opportunity to "revive", provided that reorganization has to be cost-efficient for the creditors, who will make decision on the course of action, toward insolvency or bankruptcy. Bankruptcy proceeding should be completed with as low costs as possible, as soon as possible and as effective outcomes as possible in order to ensure a regular economic course. The legal system can generate fundamental risk factors for bankruptcy, whereby not only regulations but rather implementation of the law are involved. Duration and costs of a bankruptcy proceeding, and sometimes incompetent bankruptcy administrators and other people involved in the proceeding can add to the debtor's bad position and further deepen insolvency of the business entities involved. Bankruptcy reorganization also affects existing agreements between the debtor and creditors but measures affecting rights of the owner of all the debtor's assets may also apply, which essentially includes their private property. The aim is to sustain functioning of the business entity as a unit including all its business relationships and employees because this can assign the business entity the value higher than the value of individual sales of the debtor's assets.*

Key words: *reorganization plan, bankruptcy reorganization, legal system, adopted plan, satisfying creditors*

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REORGANIZACIJA POSLOVANJA KAO NAČIN REŠAVANJA INSOLVENTNOSTI

Sažetak: Dužnik je najčešće insolventan dugo pre pokretanja stečajnog postupka i obično je do tada već potrošio najveći deo svoje imovine. Takvo preduzeće je najčešće već izgubilo svoje mesto na tržištu, napustili su ga najbolji radnici, nije održavalo niti obnavljalo opremu. Svi pomenuti pokazatelji ukazuju na to da je ovakvom preduzeću potreban sveži kapital kako bi se sproveda uspešna reorganizacija. Reorganizacija nudi mogućnost stečajnom dužniku da „ponovo živi“, s tim da reorganizacija mora biti ekonomična za poverioce, koji će doneti odluku u kom smeru će se ići: stečaj ili bankrot. Cilj je da se postupak stečaja sprovede uz minimalne troškove, što brže i uz najbolje moguće rezultate, kako bi se obezbedili normalni privredni tokovi. Pravni sistem može generisati osnovne faktore rizika za stečaj i pri tome se ne misli samo na propise, već se znatno više misli na primenu prava. Vremenski raspon trajanja stečajnog postupka, troškovi koji su sa tim povezani, ponekad nedovoljna stručnost stečajnih upravnika i drugih aktera ovog postupka, mogu doprineti lošijoj finansijskoj poziciji stečajnih poverilaca i daljem produbljivanju insolventnosti privrednih učesnika. Stečajnom reorganizacijom se zadire i u postojeće ugovorne odnose između stečajnog dužnika i poverilaca, ali se mogu primeniti i mere koje zadiru u prava vlasništva stečajnog dužnika, čime se suštinski dotiče i njegova privatna svojina. Cilj je da se sačuva privredni subjekt kao celina, sa njegovim ukupnim poslovnim odnosima i zaposlenima, jer takav privredni subjekt vredi više u poređenju sa vrednošću koja bi se ostvarila pojedinačnom prodajom imovine stečajnog dužnika.

Ključne reči: plan reorganizacije, stečajna reorganizacija, pravni sistem, usvojeni plan, namirenje poverilaca

1. INTRODUCTION

The structure of a bankruptcy proceeding is determined by the goal of the bankruptcy proceeding: the bankruptcy system and the institutions involved are crucial in providing opportunities for the state to get benefits and avoid traps of integration (Falke, 2003), efforts to provide the required sale of goods and services and protection of all the participants in economic and legal fields. Achievement of the set goals leading to an efficient proceeding, practical and functional implementation of the reorganization plan with all the participants in the bankruptcy proceeding, requires minimum costs and time, and maximum satisfaction of the creditors. It is of the utmost importance to exclude from trade or to reorganize any legal entities that fail to resolve their debts on a regular basis.

From the economic-legal perspective of the bankruptcy proceeding, economic and legal effectiveness of the bankruptcy proceeding duration, claim costs, efficiency and payments, regulation of financial reporting and bankruptcy revising should be operationalized. Where any reasonable economic conditions can apply, the priority should be given to reorganization in order to maintain the debtor's assets, business relationships and the employed, with the restructured business entity provided with an opportunity to sustain its business operation after reorganization completion.

Bankruptcy legal framework has been reviewed in economy, law and broad social influences. Legislation should promote solutions to maintain economically efficient debtors. Continuous revision and reconciliation of all the bankruptcy regulations as well as search for novel and better solutions to bankruptcy issues provide a solid background for creating favorable business conditions in a country (Tribe, 2004). The model should be used to create a joint mechanism to provide creditors with an opportunity to identify and select the best option of recovering the debts owed to them.

Bankruptcy is an outstanding example of economic rationalization accompanied by interesting legal and bureaucratic phenomena. Still, what has remained throughout history is the fact that bankruptcy can maintain fragile, often instable interactions between legislation and individual interests, market rules and general (public) interests (Sgard, 2009).

2. NEW AGE – STRUCTURAL CHANGES IN BANKRUPTCY LAW

According to the available information, early bankruptcy law emerged in English legislation in 1813. The results of the transformation became visible as early as 1883, when the new Bankruptcy Act (1883) was enacted. The Bankruptcy Act 1883 including the amendments of 1890, 1913, 1914, 1926 and 1976 served as a base for bankruptcy proceedings until 1986, when the Insolvency Act was enacted in response to the Report of the Cork Committee (Radović, 2003). Concurrently with enacting of this Act, the Anglo-Saxon countries and countries on the continent simultaneously enacted other laws that were not updated until the late 1930s (Di Martino, 2008).

Similar circumstances that led to amendment requirements in bankruptcy law in some of the developed countries (only a few, England, France, Germany, Italy and the USA) resulted in similar legal solutions to the issue. The similarity was reflected in two key components: an attempt to reconcile conflicting interests of debtors and creditors, and a desire to make balance between agreements on debt

payment and asset sales to repay the debt. English bankruptcy law significantly changed in the 19th century (Di Martino, 2008).

The 20th century was marked by economic transformations, cultural changes and general institutional changes, which together largely contributed to development of bankruptcy law. Some Western countries witnessed global industrialization as well as inevitable changes in understanding the concept of debt. All the previous amendments of the Bankruptcy Act were clearly made in order to improve effectiveness of judicial, crediting and other authorities involved in bankruptcy proceeding. In changing conditions, ‘‘out-of-date law on bankruptcy’’ created during industrialization process and intended for undeveloped loan market turned out inappropriate. In general, the need of effective insolvency system was not actually considered and the issue was mostly disregarded.

3. PERIOD OF TRANSITION – A SHIFT TO THE MARKET ECONOMY

The 20th century was characterized by transitional changes in bankruptcy law. No previous process other than transition contributed that much to harmonization of European bankruptcy proceedings. Transition shaped the period of extremely unfavorable economic movement. In early transition stages in the 1990s, countries were left with numerous state-owned insolvent enterprises. Legislators responded to the issue in a different manner. Governments in some countries tried to protect large companies from bankruptcy by exempting them from bankruptcy proceedings and spending large funds to sustain their solvency (Campbell, 1993).

When Serbia entered the process of transition in the early 1990s, a new business environment and new institutional infrastructure were required. Appropriate macroeconomic prerequisites as well as processes associated with novel economic society were needed. Privatization of enterprises led to the development of financial markets that are the core of market economy. The transition was entered with good infrastructure conditions in comparison to any other former socialist country, however, we ended up as losers. Privatization brought no significant modifications in its structure because of the global crises in the first place, which attenuated to a large extent the effects of completed ownership transformations.

At its start, privatization in Serbia brought no expected economic growth based on the improvements in business operations but only a specific asset redistribution and individual economic power. From this perspective, it was

clear that privatization would produce negative effects because the entire approach was wrong; in the process of privatization, the state gave priority to its revenue at the expense of the economic growth and employment. Workers who lost their jobs and salaries were worst affected by privatization, with enterprises sold out for only one dinar. In this period of time, numerous enterprises went bankrupt due to bad privatization, wrong people in the leadership positions, theft, dispossession, appropriation of the public and state-owned assets with an implied approval from the state.

Legislation in the field of economy further deepened desperation because most of the regulations at the time were poor in nomothetic terms, which often allowed misuse and misinterpretations. Due to a lack of understanding but also (negative) mutual historical experience, most of the post-socialist countries emulated western models. It should be noted that modern western economies also underwent similar transition problems in the 1920s. Consider German and Austrian banks, insurance companies and their duty during the Nazi regime to purchase a large number of government securities that became worthless after the war. When the war came to an end, bankruptcy followed but the state could not afford collapse of the entire economy, which led to various forms of state interventions (Fialski, 1994).

Implementation of an effective system of general performance represents a key step in building a successful corporate post-communist economy management. The bankruptcy experience of Eastern and Central European countries to date clearly indicates that this step has still not been entirely successful (Bufford, 1996).

Since transition conditions can considerably differ from conditions in developed market economies, transition economies commonly develop their own resources for and methods of resolving these issues (Falke, 1993). Some supported a large number of bankruptcy proceedings such as the Czech Republic in 1993 (Hashi, Mladek, & Sinclair, 1998), whereas others tried to force programmes of reorganization such as Poland (Gray & Holle, 1998). The fundamental bankruptcy issue results from various goals emerging from filing bankruptcy but also from the fact that an effective bankruptcy proceeding is to lead to many goals that are often incompatible (Dika, 1998). Legislature tends to support certain parties in bankruptcy proceeding and it is obvious that insolvency should be resolved by balancing the rights and interests of both the debtor and the creditor. Therefore, a debate on finding an optimal procedure for achieving final goals is not an easy one. What matters is that some prefer various methods of achieving these goals.

The USA bankruptcy law is the most liberal law in the world whereas most of the European laws, on the other hand, have not even included any provisions on

debt discharge until recently (Niemi-Kiesilainen, 1999). In fact, even if the initial goal is the same, the initial intentions are certainly not (Tabb, 2005). Namely, American principles suggest that a liberal market has to absorb default payers through a system of generous debt discharge. On the other hand, the Europeans consider incapacity to pay a kind of economic insufficiency that may be treated by a long-term economic rehabilitation (Martin, 2005). The main principles in the European legislation include rehabilitation, earned initial amount with a payment plan, access to the bankruptcy proceeding at low costs, available debt counselling and preferred out-of-court procedures with relation to judicial procedures (Hulls et al., 1995).

In the SFRY, both the model of self-management and the model of central management of the business entities generated business difficulties associated with the policy decision-making, with all the failures of the state enterprises commonly compensated at the expense of tax payers. It was a period of counteracting unemployment, and these were the primary goals of the communist economic regime. Efforts directed toward preserving employment at any cost resulted in emergence of bankruptcy. It was quite common not to take any consequences of defaults after a fifty-year existence in the economic-political environment. The 1980s introduced some novel ideas and perspectives suggesting that business entities themselves were to take responsibilities for their success and failures.

In transition countries, the underside of bankruptcy law was a protective attitude toward the debtor. The attitude was primarily based on politics that is, on the need of preventing production and employment decline, which consistently led to dissatisfactory position of creditors. Participation of creditors was low due to financially uncertain market. This led to high rates of interest in comparison with the market economies in the Western world.

Early bankruptcy legal frameworks were designed to support and provide the most favorable method of satisfying creditors as well as collecting the debtor's assets, rather than to protect the debtor or discharge their debts that is, to offer them a new start. Our Law on Bankruptcy is based on the principle of ensuring the most favorable settlement of bankruptcy creditors (Bankruptcy law of the Republic of Serbia). The advantage of the Law in relation to earlier legislative solutions include precise criteria for filing for bankruptcy; identified roles of the court and arbiters; more rigorous criteria have been specified for bankruptcy administrators, responsibilities of bankruptcy administrators are at a much higher level, the Agency for Privatization has the role of a bankruptcy administrator in majority-socially-owned and state enterprises; position of creditors and their protection in bankruptcy proceeding are also provided for;

terms for taking actions are specified for all the participants in the proceeding; a novel institution of reorganization is introduced; status of the employed has been significantly altered i.e., bankruptcy does not necessarily imply termination of employment (Kozar, 2006).

Bankruptcy law, on the other hand, is protective of debtors in Western economies as well but the question was whether a transition country, which is yet to develop capital market, could afford being protective. Namely, it was not until the 19th century that western market-oriented economies started to give more importance to creditors. Only in the second half of the 20th century, when they developed their financial markets, they became debtor-oriented because such relationship provided them with more open market but also an opportunity to predict losses (IMF, 1999).

The dissolution of the former SFRY produced the need of new laws in all fields of economy including bankruptcy. In 2004, the Republic of Serbia enacted the Law on Bankruptcy Proceeding. The new order and the requirement for new legislation generated the Law on Bankruptcy that entered into force in 2009 and was amended in 2014, 2017 and 2018 (Dukić Mijatović & Kozar, 2019). The new order forced Serbia to structure the new bankruptcy law according to the early and advanced bankruptcy legislation such as German and American bankruptcy laws. Serbian Bankruptcy Law emerged as a combination of the two models, American and German bankruptcy laws. Extensive experience was required to enact this Law including wisely assuming certain parts of the laws from the countries with a long-lasting tradition in bankruptcy proceedings. Implementation of a complex law such as a bankruptcy law from a country with a long-lasting practice in the field is a challenging task, which means that some kind of intermediate method adjusted to our culture, mentality, level of development and legislative procedures and practice was required. All this indicates that some simplified effective solutions are more appropriate than legislation that would lead to legal uncertainty and hinder development of judiciary in a country such as ours. Bankruptcy proceeding is specific in that it is the only arbitrary procedure involving out-of-court bodies such as a bankruptcy administrator, the creditors' assembly and the creditors' committee.

The American model of reorganizations integrated in most contemporary bankruptcy laws due to its positive effects (Azar, 2008). European legislation has increasingly recognized options of a company reorganization through a bankruptcy plan and effective redistribution of assets, which is a prerequisite for faster and more successful recovery of the market in general and the maintenance of employment (Cvetković, 2004). With a collapse of communism, European leaders strived to create a competitive market, with a reorganization bankruptcy as one of the models (Falke, 2003).

French regulations on the bankruptcy plan (*Procédure de Sauvegarde* in French) are focused on the debtor, even to a greater extent than Chapter 11 of the USA Bankruptcy Code. The goal is not only a successful implementation of the reorganization procedure but also promotion of the reorganization procedure through early identification of difficulties in business operations, which can enable timely initiation of a rehabilitation bankruptcy procedure (Martin, 2002). Intervention as a component has been present in recent French history, which has also influenced the bankruptcy law. Eventually, the goal is to prevent redundancy at any cost (Koral & Sordino, 1996).

In Germany, the Insolvency Law entered into force in 1999, with one of the goals to promote resolutions and provide framework for the liquidation procedure. Previous bankruptcy law (*Konkursordnung*) allowed for entering into forced settlement in bankruptcy proceeding, very much alike *Vergleichsordnung*, an early bankruptcy act. Until recently, the concept of a rehabilitation bankruptcy plan did not come to life in German culture of bankruptcy/insolvency (Paulus, 1998). However, the doctrine indicates that German legislature together with business environment have come to understand that reorganization of a company is probably (the most) optimal solution to business problems.

4. CONCLUSION

Contemporary bankruptcy laws are not based on liquidation and removal of insolvent business entities but on reorganization and sustained business operation of a business entity (Britanica). From the legal-economic perspective, reorganization is a more favorable and acceptable option in most cases. Continuous legislative activities, and since the beginning of this century in particular have made practitioners to respond, to use their approaches and interpretations to bring these acts close to participants in bankruptcy proceeding and thus facilitate their implementation.

From the point of view of creditors, bankruptcy proceeding often seems more appropriate than reorganization, whereas the reorganization plan may not allow for a more adverse satisfaction of the creditors than the one they could achieve in bankruptcy proceeding.

Reorganization should prevent liquidation of a business entity if there is a possibility of its rehabilitation. In this procedure, social status of the employees, the capital owner and the management should not be overlooked and must be protected to the largest extent possible.

Current tendencies on the international stage have resulted in a considerably modified approach to bankruptcy. In the future, economic growth and regulation of the credit market are believed to make bankruptcy function more than just a method of removing uncompetitive business entities from the market. Economic awareness of the need of considering and providing other functions through bankruptcy procedure has developed in addition to those resulting in liquidation of business entities. The initiation of bankruptcy proceeding requires justified reasons from the market economy perspective that is, to protect and stimulate healthy business entities to survive and sustain their operations with no additional burden, with the ultimate goal of removing faulty and unproductive business entities that are inefficient and detrimental for the employees and the economy of the country in general, and even in a broader sense.

Achievement of the set goals that lead to an effective procedure, practical and operative implementation of the reorganization plan with all the participants in bankruptcy proceeding, requires minimum costs and time, and maximum satisfaction of the creditors. Incentive for development of this institution emerges from a focus on prevention of premature business closure because sustained business operations are of great importance for a country.

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