BiH BANKRUPTCY AND LIQUIDATION LAWS:

CHECKLIST FOR CREDITORS OF COMPANIES IN OR ABOUT TO ENTER BANKRUPTCY PROCEEDINGS

August 31, 2004

INTRODUCTION TO THE CHECKLIST

The attached *CHECKLIST FOR CREDITORS OF COMPANIES IN OR ABOUT TO ENTER BANKRUPTCY PROCEEDINGS* initially was prepared in outline form for USAID's Fostering an Investment and Lender-Friendly Environment project (FILE) **with the special assistance of Chief Judge Gregory F. Kishel of the United States Bankruptcy Court for the District of Minnesota.** After its delivery to USAID on May 31, 2004, this draft outline was circulated to a broad group of bankers, bankruptcy trustees, trade union leaders, tax administrators and general managers for their comments. During July and August, FILE staff followed up with telephone calls and letters to this group of locally-based professionals, seeking out their comments and suggestions for revisions to the Checklist.

Because this vetting process took place during the summer months, however, only a limited amount of feedback specific to the items contained in the Checklist was generated from the local partner vetting audience. Four bankers and eight trustees provided useful verbal and/or written comments, some of which were quite incisive and helpful to the process of analyzing and improving the Checklist's value to creditors finding themselves confronted by a debtor company's bankruptcy case.

FILE's professionals have revised the Checklist, accordingly, based on the thoughtful comments of these local professionals. After the attached *Checklist for Creditors of Companies in or About to Enter Bankruptcy Proceedings* receives broad circulation, FILE expects to receive additional comments and suggestions from a larger group of interested local stakeholders, notably from participants in FILE's training events and seminars scheduled to take place over the next several months. As these comments and suggestions come in, further thought will be given to the contents and structure of the Checklist and, if appropriate, revisions will be made and a "second edition" published.

CHECKLIST FOR CREDITORS OF COMPANIES IN OR ABOUT TO ENTER BANKRUPTCY PROCEEDINGS

Successful implementation of BiH's new bankruptcy laws requires the knowledgeable participation of the debtor company's creditors. The BiH entities recently enacted new bankruptcy laws, conforming to internationally recognized standards for bankruptcy reorganizations and liquidations; and FILE is launching educational and Pilot Case programs that will demonstrate the efficient handling of bankruptcy adjudications under the new laws from start to finish. Such efficient bankruptcy administration is a necessary factor in the effort to transform the BiH economy to a market economy, i.e., the process needed to restructure and/or liquidate inefficient businesses to free up capital for viable enterprises.

Under the BiH laws, a bankruptcy case is commenced by a voluntary or involuntary petition, and proceeds under administration by a trustee under a presumption of liquidation. A debtor may elect to propose a reorganization plan by filing it with its voluntary petition, or by filing it at any time before the final hearing in the case. With the approval of the Board of Creditors, the trustee also may file a reorganization plan.

As business enterprises begin to use reorganization procedures, more creditors will have to respond to bankruptcy case openings and participate in the cases in a knowledgeable fashion. Bankruptcy is a collective remedy, which involves the interests of all of a debtor's creditors and may affect them all in differing ways. The situation is further complicated by the addition of parties whose status is created by the bankruptcy filing itself, such as the trustee and the Creditors' Board. This means that a single creditor must deal with the assertion of competing rights by multiple parties, while protecting its rights to recover on its own claim.

The following are some of the factors and circumstances that a creditor should consider when its debtor is likely to be placed into bankruptcy, or has just been placed into bankruptcy.

☐ 1. Have Your Indebtedness and Security Documents in Order

Your rights as a creditor should be documented as thoroughly and clearly as possible.

☐ a. Assemble all documents related to the creation of the basic debt, stating the terms of payment and defining the creditor's rights, including any promissory note, written promise to pay, contract, invoice, or purchase order. In the absence of such documents which directly prove the debt, be prepared to present copies of letters, e-mails, other communications establishing terms of debt obligation.

☐ b. Assemble any documents which vary the terms of the debt from the original agreement, including anything that (arguably) creates a right of set-off or is probative about any issue relating to quality or quantity which may be disputed.

☐ c. Prepare a document which calculates the amounts due through a date certain.

☐ d. Organize documents to make them admissible into evidence at a court hearing.

☐ 2. Consider Whether Past-Actions/Payments Concerning Your Debt Will Have Any Special Effect *In the Context of a Bankruptcy Case.*

Creditors need to take account of various things they may have done before the bankruptcy was filed to protect themselves, or increase their chances of recovering from the insolvent debtor. Bear in mind that other creditors will receive less from the bankruptcy if more is paid on your claim (and *vice-versa* -- you will receive less if other creditors are paid more) and that all creditors' claims will be scrutinized by the bankruptcy trustee. Consider, accordingly, whether:

☐ a. You exercised any creditor "self-help remedies" before bankruptcy

☐ b. You received any payments greater than required under your contract

☐ c. You received any "in-kind" payments, or "payments" that are uncertain in amount

☐ d. You received payments routed through third parties or undisclosed payments

☐ e. Do you know of, or do you have any reasonably reliable information that, <u>any other creditor</u> unfairly benefited from "self-help," an excessive payment, an "in-kind" or uncertain payment, or an undisclosed payment

In bankruptcy, the trustee can bring "avoidance" proceedings against parties unfairly benefited by certain, past transactions. The trustee's special power to "avoid," or reverse, such transactions is unique to bankruptcy: The trustee has a duty to set aside past transactions that favor some creditors over others or which unfairly reduce the amount of property in the bankruptcy estate that can be shared among all of the company's creditors. These "avoidance" provisions can be found in Articles 80 through 86 of the Bankruptcy Law.

Bearing that in mind, consider the following

☐ f. Did you receive a "preferential" payment, i.e., one made within six months before the bankruptcy and when the debtor was insolvent, which enabled you to get paid more than you would have if you simply received the same bankruptcy distributions as other creditors

☐ g. Were you given a security interest, or lien on property of the debtor, to secure payment of your (previously- unsecured) debt, within six months before the bankruptcy and when the debtor was insolvent

☐ h. Did you benefit from a "fraudulent transfer," a transfer made within six months before the bankruptcy and when the debtor was insolvent, in which you received more in value than the debtor company

☐ i. Do you know of, or do you have any reasonably reliable information that, <u>any other creditor</u> of your debtor unfairly benefited from a "preferential" payment or grant of security or a "fraudulent transfer"

☐ 3. Consider Whether You Should, or Need to, Report any of the Above Questionable Matters (2. a. through i.) to the Bankruptcy Trustee, the Creditors Assembly, or the Debtor.

☐ 4. Consider the Main Options of the Debtor and the Trustee in a Bankruptcy Case: <u>Liquidation</u> versus <u>Reorganization</u>, and Weigh these Options in Terms of Your Own Best Interests (Long-Term as well as Short-Term).

Most bankruptcy cases are simply "liquidations," where the debtor company's business is closed (or some limited, on-going operations are transferred to other owners), the trustee does the best he can to sell off any assets of value, and he makes the appropriate "distributions" to creditors, according to their classification and priority and *pro rata* in accordance with the amount of their claims

Other cases, however, may be described as "reorganizations," where all or a substantial part of the debtor company's operations are continued and creditors receive payments, *pro rata* in accordance with the amount of their claims, in accordance with negotiated terms, which also are usually structured in accordance with the creditor's classifications and priorities. A bankruptcy that results in a successful reorganization may be advantageous to you, as a creditor, in that (i) you may receive a greater payout, or distribution, over time than you would in a liquidation and (ii) you may benefit from the continuation of the debtor company's business, by selling your products or services to or finding employment with the reorganized debtor company in the future.

Based on your own observations, ask whether the debtor company has the strength to continue some or all of its operations and generate enough revenues to pay its debts after reorganization and/or whether it can attract a new investor or purchaser to continue operations. Consider each of the following factors:

- ☐ a. Will the company have capable management
- ☐ b. Will the company have a strong or weak position in its market
- ☐ c. Will the company be able to attract enough capital to restart or maintain operations, address problems of deferred maintenance of plant and equipment, increase its level of operations to improve its market position, establish a "cushion" to meet any foreseeable downturn or emergency, etc.
- ☐ d Consider the potential value of the company in a hypothetical reorganization
- ☐ e Consider the potential value of the company in a standard bankruptcy liquidation

☐ 5. Consult with other Creditors.

☐ 6. Examine Public Records for Other Claims (Taxes, Liens, Judgments).

☐ 7. Contact the Trustee (question him about his evaluation of the company, his plans for interim operations, if any, and for the preservation and realization of its assets

☐ 8. Determine You Own, Creditor's, Bottom Line (i.e. minimum expectation):

- ☐ a) What can you expect from a liquidation conducted by the trustee (and not controlled by a secured creditor)
- ☐ b) What can you expect the result of a realistic, hypothetical reorganization to be
- ☐ c) What can you expect as a secured creditor, from exercising your right of separate settlement (with or without waiver of deficiency)

☐ 9. For secured creditors, are the documents creating debt and lien in order?

☐	10. Has this secured creditor taken any action to enforce its rights recently?
☐	11. Prepare ancillary claims if allowed under contract or statute.
☐	12. Visit locations of debtor's operations, and management headquarters.
☐	13. Check for each of the following, if practicable: condition and likely value of collateral, and proof that debtor is protecting value of secured creditor's interest (casualty insurance, repair and maintenance, physical security).
☐	14. Develop a worst-case/liquidation scenario with the help of a liquidator or professional salesperson in industry to serve as a baseline against which to measure all other options and risks
☐	15. Develop a going-concern ("best-case") scenario for creditor's position.
☐	16. If debtor or trustee will undertake attempt at reorganization: try to measure the potential cost of time spent in plan negotiations and delay
☐	17. Consider whether the debtor will be running at a deficit that will reduce value of unencumbered assets. Is collateral decreasing in value from market obsolescence or wear?
☐	18. Measure the value of collateral that is decreasing due to market obsolescence or wear against the potential return from leaving collateral with debtor, and receiving repayment with interest from a rehabilitated operation.
☐	19. If creditor is a major secured party, *contact debtor* and demand participation in the reorganization effort and assurances of accountability.
☐	20. Determine this creditor's strategy for the creditors' assembly meeting.
☐	21. Decide whether to seek membership on creditors' board.
☐	22. Bring evidence of wrongdoing, fraud, etc. by debtor's management to attention of trustee and court.