Bankruptcy Trustees' Manual

(second edition)

Guidance with appendices for administration
of
liquidation and restructuring cases

Manual for Bankruptcy Trustees in BiH

Introduction

New economic and political developments (*e.g.*, transformation of company ownership, opening markets, securing foreign investment, *etc.*) require that economic flows be legally regulated as a guarantee to protect creditors. Accordingly, there has been an ongoing initiative to pass new legislation in the economic arena, chiefly the Law on Bankruptcy.

Bankruptcy legislation falls under the authority of Bosnia and Herzegovina's entities, and nearly identical laws have been passed at the entity level to regulate the field of bankruptcy. The Law on Bankruptcy in Republika Srpska was passed in 2002 and published in the Republika Srpska Official Gazette, no. 67/02; the Law on Bankruptcy in the BiH Federation was passed in 2003 and published in the FBiH Official Gazette, no. 29/03.

The bankruptcy laws were based on the Law on Insolvency of the Federal Republic of Germany. The new laws have abandoned some of the provisions contained in the Law on Enforced Settlement, Bankruptcy, and Liquidation, which placed the bankruptcy debtor in a more favorable position in relation to creditors. In addition, the old law did not provide efficient implementation of bankruptcy procedure and did not contain provisions which would enable a successful reorganization of the bankruptcy debtor.

With the new laws on bankruptcy, the preconditions have changed for opening a bankruptcy proceeding, as have the legal consequences of opening the proceeding, such as the ability to avoid legally binding actions of the bankruptcy debtor, and the method of liquidating the bankruptcy estate and settling the claims of creditors. International bankruptcy and reorganization of the bankruptcy debtor are regulated in a new way.

The roles of the parties in bankruptcy have also been re-defined, especially the role of creditors and the trustee. This is because the trustee's role is the most complex and he is considered a central figure in the bankruptcy proceeding. The trustee, in cooperation with and under the supervision of a bankruptcy judge, operationally implements the bankruptcy procedure. Therefore, special conditions for appointment of this party have been prescribed.

Passing this new and modern law has legally regulated the field of bankruptcy in our country, and harmonization of this regulation with bankruptcy legislation of the Western European countries has created the legal conditions for implementing bankruptcy.

In order to apply the law, however, it is necessary to educate those involved, especially bankruptcy judges and trustees, which is being accomplished by USAID through the FILE Project. Experts from this Project have drafted this text, titled *Manual for Bankruptcy Trustees in BiH*. Using the text of the Law on Bankruptcy and other legal provisions regulating issues related to bankruptcy, and also the initial experience in applying this law and experience from other countries, the authors have explained bankruptcy proceedings from both the legal and economic standpoints.

This text is especially concerned with the role of an interim trustee during the preliminary bankruptcy proceeding, actions taken by the trustee during the opening of a bankruptcy proceeding, securing the bankruptcy debtor's property, and liquidating and distributing cashing the debtor's property. Attention is paid to legally binding actions taken by the trustee as the legal representative of the bankruptcy debtor. Special attention in this text has also been accorded to the activities of the trustee during a bankruptcy debtor's reorganization. Other procedures and actions undertaken by the trustee during the course of the entire proceeding have also been explained.

This *Manual for Bankruptcy Trustees in BiH* is the first publication of its kind in the states that have emerged on the territory of the former Yugoslavia, and it treats the bankruptcy proceeding and the role of the trustee during that proceeding in an accessible way. The need for a manual of this kind is significant because the issue of bankruptcy itself is complex, and new concepts introduced by this new Law are unfamiliar to local legal and economic experts. Because the text of this manual is of high quality and is thorough, it should be released as soon as possible, for it would be of great benefit to trustees, and also other legal and economic experts that deal with bankruptcy in their work. Therefore, I am very pleased to recommend this publication, as I am convinced of its ultimate usefulness.

Honorable Nedeljko Milijevic,
Bankruptcy Judge and President of Commercial Department
Banja Luka Basic Court

A Basic Glossary of Terms in Bankruptcy

Bankruptcy Estate. The bankruptcy estate is a new legal entity created the moment a bankruptcy case is opened that includes all the debtor's tangible and intangible property and claims to property, the corpus of assets and rights available to satisfy the claims of creditors. This estate, which also includes property that comes into the debtor during the proceeding, is used to satisfy the administrative costs of the proceeding and the prioritized claims of creditors that arose before and during the proceeding. See Article 30 (defining "bankruptcy estate").

Because the estate is a new entity created when the bankruptcy proceeding is opened, the bankruptcy debtor's old bank accounts must be closed and the funds deposited in new accounts on the day the bankruptcy is opened, Article 89.1, a new business year begins on the day of opening, Article 97.2, any powers of attorney granted by the debtor are revoked, Article 76, and the notation "in bankruptcy" must be added to the name of the firm or title of the debtor, Article 90. The bankruptcy estate as a distinct legal entity may sue and be sued, and may incur liabilities in its own right. Article 42. These expenses incurred by the bankruptcy estate (including its costs and liabilities) must be paid first from the estate before any other creditors. Articles 40-42.

The exclusive authority to manage and dispose of the assets of the bankruptcy estate is automatically transferred to the Trustee when the bankruptcy is opened. Articles 51 and 88.

Claims Investigation Hearing. One of the critical junctures in the bankruptcy proceeding (along with the *reporting hearing* and *confirmation hearing*). At this hearing, the Trustee either accepts or rejects the claims filed by the creditors. Article 114.1. This hearing is also the first assembly of the creditors.

As soon as the bankruptcy is opened, the Judge sets the date of both the claims examination hearing and the *reporting hearing*. Article 47.1. At this first hearing, the creditors' claims and their right to participate are established. The date of this hearing must be scheduled between eight and 30 days after the conclusion of the 30-day period for creditors to register their claims. Article 47.1.2. Between the claims registration deadline and the claims examination hearing, the Trustee reviews the claims that have been filed or that he discovers in the books and records, and prepares objections to those claims that do not establish a sufficient legal basis for allowance. Articles 114.1, 115, 25.2 and 95.1. This hearing may be held at the same time as the *reporting hearing* and the *confirmation hearing*. Articles 47.2 and 161.

Collateral. Any property, real or personal, tangible or intangible, or any right or claim voluntarily pledged to or legally obtained by a creditor to secure payment of a debt or other performance in the event of default in payment. The collateral securing a debt may belong to the debtor or to a third party, and may be in the possession of the debtor, a third party, or the creditor. A creditor with a debt for which there is collateral is a *secured creditor*.

Confirmation Hearing . An important juncture in the bankruptcy proceeding (along with the *claims investigation hearing* and *reporting hearing*), at which the creditors vote to accept or reject the proposed plan of reorganization for the debtor. Article 160.

Creditors may vote on the proposed plan of reorganization in accordance with the right to vote in the creditors' assembly as defined by Article 28, which essentially provides that the undisputed bankruptcy creditors may vote their approval by a majority in number and a majority in the amount of the claims. Article 162.1. After the deliberations at the hearing, the Judge will compile a list of all the creditors eligible to vote. Article 164. Each class of creditors identified in the plan of reorganization votes separately as a class on whether to confirm the plan. Article 168. The confirmation hearing may be held together with the *claims examination hearing*, and the *reporting hearing* on the same date. Articles 47.2 and 161.

Creditors. Legal entities or individuals to whom a debt is owed. In bankruptcy, the debts are generally divided into those incurred by the debtor before the filing of the bankruptcy (bankruptcy creditors), Articles 31 and 32, and those incurred by the *bankruptcy estate* (creditors of the estate), Articles 40-42. The creditors are paid in accordance with the priorities set out in a scheme of classification. Articles 31-34. Creditors may be *secured*, partly secured, or *unsecured*, depending on whether they have *collateral* and the value of this collateral in relation to the debt it secures.

Creditors' Assembly. A democratic institution including all the creditors in attendance with allowed claims. The assembly of creditors supervises the Trustee, to whom he or she reports, and authorizes the Trustee's significant legal actions in the absence of a *creditors' committee*. Articles 29.6 and 108. The assembly votes by **both** a majority of the creditors and a majority of the amount of the debt represented by the creditors present at the meeting. Article 28.4. When opening a bankruptcy, the Bankruptcy Judge sets the first two meetings of the creditors' assembly – the *claims examination hearing* and the *reporting hearing*. Article 47.1.

Creditors' Committee. The creditors' committee is elected by the creditors' assembly. It comprises three, five, or seven members, Article 29.4, and must include representatives of the creditors with the largest claims, creditors with the smallest claims, the debtor's employees, and the secured creditors, Article 29.3. The committee votes by a simple majority. Article 29.10. If one has been impaneled, the Trustee must obtain its authorization before undertaking significant legal actions. Articles 29.6 and 108.

Debtor. In bankruptcy, the legal entity or individual by or against whom a petition has been filed with the Bankruptcy Court. After the opening of the bankruptcy, the notation "in bankruptcy" must be added after the debtor's name. Article 90. Legal entities that pass through bankruptcy are removed from the commercial registry by order of the Court when the case is closed. Article 140.3.

Fiduciary Duty. Although this term does not occur in the bankruptcy law, it accurately characterizes the Bankruptcy Trustee's duty to the allowed creditors. A fiduciary duty is among the highest recognized in law, imposed on persons in whose trust another's property has been placed and for whose benefit the person is granted control over this property. It contemplates scrupulous honesty, integrity, good faith, diligence, and candor.

Insiders. The bankruptcy law clearly identifies legal and natural persons who are regarded as insiders of the debtor, *i.e.*, those with special knowledge that might compromise their objectivity. For an individual, these include spouses and former spouses; relatives of these persons and their spouses; and persons living or formerly living in the debtor's household. For a legal entity, members of management or supervisory bodies and personally liable members of the debtor, partners, and those holding more than ten percent of the debtor's capital; entities or companies that are associated with the debtor and could learn about the debtor's economic situation; an entity that has a personal connection with the foregoing and is obligated by law to maintain secrecy about the debtor's affairs; and third parties that are effectively in a position to exert influence on the debtor tantamount to that of a majority shareholder or representative body. Article 87. Of course, a person may not be appointed to serve as a Trustee for a debtor for whom he is an insider. In addition, persons who would need to be excluded as judges in the bankruptcy proceeding, close relatives of the Bankruptcy Judge, those responsible for liabilities in the bankruptcy or who are members of firms or institutions representing such debtors, creditors or competitors of the debtor, current or former employees of the debtor or members of its corporate bodies, and those who worked as advisors to the debtor or who participated in business activities connected with the property or the capital of the debtor may not serve as Trustees. Article 23.4.

For purposes of establishing a preferential transfer, creditors who are "insiders," as defined in Article 87, are conclusively presumed as a matter of law to know of the debtor's inability to pay or the filing of a bankruptcy petition. Article 81.4.

Liquidation. The sale of property of whatever kind, real or personal, tangible and intangible, and the reduction of this property to cash, which represents the "proceeds" of the sale of the property. Sometimes translated as "realization."

Liquidation of the property of the bankruptcy estate for the benefit of the creditors is one of two options that a Trustee will recommend to the creditors at the *reporting hearing*. The other option is continuing the business operation and preparing a plan of reorganization. Article 98.

Reorganization. The application of legal, financial, operational, and structural measures for restoring the debtor's solvency and repaying its creditors in time under a confirmed plan of reorganization.

At the *reporting hearing*, the Trustee is required to present a comprehensive report, which must "state whether there is any likelihood of saving, in whole or in part, the business of the bankruptcy debtor, what possibilities exist for a restructuring plan, and what the results would be for satisfying the creditors." Article 98.1. On the basis of this report, Article 47.1.1, the creditors will vote on whether provisionally to continue the debtor's business operation and, if so, may instruct the Trustee to prepare a plan of reorganization, specifying the purpose of this plan. Article 99.1. Reorganization is covered in Part V of the bankruptcy law, Articles 142-194.

Reporting Hearing. A decisive juncture in the bankruptcy proceeding (along with the *claims investigation hearing* and *confirmation hearing*) at which the debtor's ultimate fate is decided by the creditors. At this hearing, which also represents the second

assembly of creditors, the Trustee presents a comprehensive report to the creditors and recommends either liquidating or reorganizing the debtor. Article 98.1.

When a bankruptcy is opened, the Judge sets the date of the reporting hearing, Article 47.1, which must take place no more than 15 days after the *claims investigation hearing*, Article 47.1.1. At the reporting hearing, pursuant to Article 98.1, the Trustee must present a report on the debtor's financial position and its causes, explaining whether there is any likelihood of saving the debtor's business, what prospects there are for a restructuring plan, and what the expected results would be for satisfying the creditors.

The *creditors' assembly* at the hearing votes on whether to close the debtor's business or to continue the operation on a provisional basis. Articles 99.1. The creditors may also direct the Trustee to prepare a plan of reorganization and may specify the purpose of the plan, a decision the creditors are free later to rescind. If the creditors vote instead to *liquidate* the debtor, they may also decide how and on what terms to sell the property. Article 99.2. The reporting hearing, the second meeting of the creditors' assembly, must be held within 15 days of the *claims examination hearing*, Article 47.1.1, and may be held at the same time. Article 47.2.

Secured Creditor. A creditor who has obtained from a court or been granted by the debtor the right to satisfy its claim against the debtor from particular, specified assets, which serve as *collateral* for the debt. Examples of such rights include voluntary agreements by the debtor to grant a mortgage or security interest in the debtor's immovable (real) or movable (personal) property, liens arising as the result of a statute or legal action, or creditors with the right to retain the debtor's assets that are in their physical possession. Article 38. Depending on the value of the collateral in relation to the debt that it secures, secured creditors may be over- or under-secured.

Such creditors are entitled to receive either the property, or if the Trustee sells this property, the proceeds realized from the sale up to the amount of their claim *(over-secured creditors*). Such creditors may also become bankruptcy creditors if the debtor is personally liable to them and they either waive their secured claim or the value of the collateral is not sufficient to pay the claim in full (*under-secured creditors*). Article 39. In bankruptcy, an under-secured creditor actually has two claims – a secured claim up to the value of the collateral under Article 38 and an unsecured claim as a bankruptcy creditor of general priority under Articles 32 and 39. Such creditors do not have the right to vote at the *creditors' assembly* as secured creditors but only as unsecured creditors with a claim for a deficiency (the amount by which they are under-secured). Article 28.2.

Separate Recovery. Creditors with rights to separate recovery are persons or entities that have the right to take possession of property because this property is not owned by the debtor but belongs to this person or entity. Such creditors (sometimes known as "extraction creditors") may not exercise their right to recovery before the *reporting hearing*, but may assert a claim against the *bankruptcy estate* for any loss in value resulting from excessive wear of their property before this hearing. After the *reporting hearing*, they are entitled to receive their property back – subject to the Trustee's right to seek the Judge's permission to offer adequate protection payments

and continue to use the property in ongoing business activities – and may claim both lost value and compensation for the use of their property. Article 37.

Trustee. Although supervised by the creditors and answering to the Bankruptcy Judge, the Trustee is the single most important party in actually implementing the bankruptcy proceeding and fulfilling its purpose of satisfying the bankruptcy creditors collectively. Article 2. He works for the benefit of the entire pool of creditors with allowed claims, to whom he owes a *fiduciary duty*. The Bankruptcy Trustee is appointed by the Bankruptcy Judge, Article 22, and may be removed by the Judge for good cause, Article 27.

Among his or her duties is to take immediate possession of the property in the *bankruptcy estate* after the opening of bankruptcy; manage the debtor's operations until the *reporting hearing* unless continuing the business will impair the debtor's creditors; compile an inventory of the property of the estate, indicating the book and liquidation values of this property; compile a list of the debtor's creditors; examine the creditors' claims and object to questionable claims; make a cogent report to the creditors recommending either liquidation or reorganization of the debtor with the supporting data; and depending on how the creditors vote, either liquidate the property and distribute the proceeds to the creditors or prepare and file a plan of reorganization. Articles 25, 51, 88, 98-101, and 124.

Unsecured Creditor. A creditor with a claim against the debtor that arose before the bankruptcy petition was filed and that is not a *secured claim* . The unsecured creditors generally comprise the ordinary obligations of the debtor that are not included in either the higher (privileged) or lower priorities in the priority scheme of the law. Article 32. The bankruptcy creditors of lower priority consist largely of derivative (interest, costs), punitive, or gratuitous claims for which the debtor did not give value. Article 34. After the opening of the bankruptcy, all creditors must file their claims within 30 days in order to preserve their rights, Article 46.1, except creditors of the lower payment priority, who do not file claims unless instructed by the Judge, Article 110.7.

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1. Overview of the Trustee's Role in Bankruptcy Proceedings

A. Issues of Transition to the New Bankruptcy Laws

Two sets of bankruptcy laws – this new law and the old, superseded law – will operate in tandem until the inventory of cases filed under the old law is cleared. Chapter VIII, Transitional and Final Provisions, of the new law determines which law applies.

Article 233 requires all cases filed under the old law to be adjudicated under the new law unless both of the following conditions are met:

1. A bankruptcy proceedings has been opened; and
2. A Bankruptcy Trustee has assumed his duties under the old law.

Article 235 governs cases filed by the former State Payment Bureau BiH, now abolished, in which no bankruptcy proceeding was actually opened and none of the interested parties had performed any action to continue the proceeding in the three years before the new law took effect. In such cases, the Court is to publish a notice in the "Official Gazette" giving any interested party 30 days to take over prosecution of the case. The case will continue if an interested party responds in writing within the 30-day notice period, with such party being treated as the petitioner under Article 4 of the law. If there is no response in these 30 days, the case will be dismissed.

B. The Objectives and Institutions of the Bankruptcy Proceeding

The new bankruptcy law can be one of the most important tools available for accomplishing a successful transition to a market economy. The economic health of the State and all its citizens, including businesses and their owners and employees, depends in large part on:

- Each stakeholder having a clear understanding of the law's intended purpose; and
- Steadfast and consistent rulings by the Bankruptcy Court requiring that the parties adhere to the law's requirements despite alternative remedies available under other, older laws.

As we shall see, the Trustee is a central figure and focal point in the bankruptcy proceeding. Among his most important roles is one that is not written down. He is the leading advocate for the bankruptcy process. Especially in the early days of implementation, the Trustee will be required to argue, persuade, educate, and cajole all stakeholders to participate fully in the bankruptcy process. At the same time, he must advocate to the Court for the centrality and primacy of the bankruptcy proceeding over all other remedies that might be provided to individual creditors by other, older laws. Accordingly, it is essential that the Trustee have a clear understanding of and commitment to the objectives and institutions of the bankruptcy proceeding. Among the most important principles for the Trustee to understand, defend, and implement are:

1. **The bankruptcy law is *lex specialis***: In the event of a conflict or inconsistencies, the special procedures of this law override all earlier laws and

all laws of a more general character. That the more specific provisions of law take precedence over the more general and those enacted later over earlier laws are time-honored principles of statutory construction, reflecting necessary presumptions about legislative intent. This privileged status of the bankruptcy law is further reinforced by the explicitly "urgent" character of the proceeding. Article 9.1.

2. **The primary purpose of the bankruptcy proceeding is "collective satisfaction" of creditors' claims.** Article 2.1. Achieving this objective requires that *all* creditors participate in their assigned roles in the bankruptcy proceeding. Those who ignore or abstain from the proceedings will suffer the consequences provided by the bankruptcy law, including the loss of rights and remedies other laws might grant to them.

3. **For this purpose, a bankruptcy estate is created as soon as bankruptcy is opened.** Once the bankruptcy is opened, a new, separate entity – the bankruptcy estate – is created that includes all the debtor's property and claims to property. See Article 30 (defining "bankruptcy estate"). It is the Trustee's statutory obligation "forthwith" to take possession of all the property in the bankruptcy estate and, in the case of an operating entity, to continue the business of the debtor until the reporting hearing, Article 25.1. The bankruptcy estate as a distinct legal entity may incur liabilities in its own right, Article 42.

4. **Fulfilling this purpose requires determining the prospects for reorganizing rather than liquidating the debtor.** Under the new law, bankruptcy may result in either liquidation or reorganization of the debtor. It is critical, therefore, to determine whether the debtor may be restored to financial health through reorganization in bankruptcy, Article 2.2. The Trustee must analyze and report to the creditors on the debtor's economic circumstances and on the prospects for satisfying the creditors by restructuring the debtor. See Article 98.1.

5. **The rights and interests of the debtor and its owners are subordinated to the goal of paying creditors.** Although bankruptcy may result in either liquidation or reorganization of the debtor, it is the creditors who are entitled to choose which option they prefer as meeting their best interests. See Articles 99.1 and 143.2.

6. **Bankruptcy is an "urgent" proceeding.** Article 9.1. Bankruptcy is a special proceeding, *in extremis*, and time is necessarily of the essence. In developed countries, "time is money." Time undermines value, and the more time that elapses in the bankruptcy proceeding, the less money may finally be available for creditors. Accordingly, the law provides a number of tight time limits to keep the process moving briskly along. For example, appeal rights are limited. Parties may appeal only those court decisions that the law explicitly states are subject to appeal. See Table of Appealable Issues, Appendix 1C; and Article 11.1. Appeals must be filed within eight days, Article 11.2, and decided within 15 days after receipt by the appellate court, Article 11.4. See

the Table of Appealable Issues, Appendix 1C, for a summary of the rules governing appeals of specific issues.

C. The Centrality of the Trustee's Role

The Trustee is, in many respects, the central actor in the Bankruptcy Proceeding. His many functions facilitate and empower the other key actors and institutions to carry out their roles. This section provides a brief overview of the Trustee's different functions. The details of most of the Trustee's various functions are covered in the text of this manual. Coverage of two aspects of the Trustee's role that are not otherwise covered in depth – managing public relations and providing pre-bankruptcy advice – is more extended in this section.

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1. The Trustee as the Eyes and Ears of the Bankruptcy Judge

The Bankruptcy Judge is responsible for managing the Bankruptcy Proceeding "from the moment" the petition to initiate the proceeding is filed until the case is closed. Article 22.1. As we shall see, the Trustee plays a crucial, ongoing role in making certain that the Judge has accurate, timely, and objective information at every phase of the proceeding. The Interim Trustee is available to investigate to ensure that cause exists to open the bankruptcy proceeding, that sufficient assets are available to fund the proceeding, and to take measures on behalf of the Judge to preserve and protect the debtor's assets so they are available for the benefit of creditors if and when the Bankruptcy Proceeding is opened.

2. The Trustee as the Instrument of the Creditors' Collective Settlement

Bankruptcy exists to achieve the "collective satisfaction" of the creditors' claims against the debtor in accordance with an orderly process of adjustment and in compliance with a priority scheme established by the law, Article 31, *et seq.* The Trustee does *not* represent individual creditors or any groups of creditors, but rather the entire pool of creditors as a whole, in accordance with their statutory priority. He is the vital instrument of the process itself that makes collective satisfaction possible. His role in reviewing and ranking the claims of individual creditors is fundamental to the process of forming the democratic bodies of creditors that the law empowers to decide on the conditions for satisfying the pool of creditors and providing for all the claims against the debtor, whether by liquidating the debtor's assets or by reorganizing the debtor. After these bodies of creditors have been impaneled – the creditors' assembly and the creditors' committee – the Trustee investigates, analyzes, and advises on the most likely alternatives to achieve resolution, in the first instance, whether through liquidation or reorganization, and then is the instrument of these bodies in carrying out their decisions. Appendix 6C provides a summary of the Trustee's rights and responsibilities to the creditor bodies.

3. The Trustee as the Successor of the Debtor

When the Bankruptcy Court recognizes that the debtor has slid into a condition of insolvency – the inability of a debtor to pay its obligations as they become due – and opens a bankruptcy proceeding, the law works a transformation of rights. The debtor

loses the right to manage and dispose of its business and property. The debtor's assets and activities are transferred to the bankruptcy estate, the corpus of assets and rights available to satisfy the claims of creditors. Responsibility for preserving and protecting the bankruptcy estate and managing the debtor's business is transferred to the Trustee, whose actions and activities are subject to the decisions of the creditor bodies and the supervision and approval of the Bankruptcy Judge. See Articles 25, 51, and 88.

4. The Trustee as Spokesman -- the Media and Public Relations

Bankruptcy filings, particularly those that involve large companies with many workers, are likely to generate attention in the media. Unfortunately, most media, like the public at large, do not understand bankruptcy, consistently reversing cause and effect: Bankruptcy is not the problem; it is the solution.

The public is likely to focus on bankruptcy as the cause of factories closing, large-scale layoffs of employees, fraud investigations, *etc*., not understanding that the problem is insolvency, and that bankruptcy is the solution that lets creditors, including workers, collectively decide how best to emerge from insolvency and return the debtor's assets to productive use to generate jobs and economic growth.

Issues likely to attract the attention of media and provoke public controversy include:

- Discovery of fraud or corruption;
- Strikes or walk-outs by employees and disputes with unions;
- Terminations of employees during downsizing;
- Plant closures;
- Plans of reorganization; and,
- Emergence of potential investors or buyers.

Often, the Trustee will become the target of public criticism. Certain special interests may attack his impartiality or credibility. Debtors and creditors may complain that he is "squeezing too hard," is too heavy handed, is one-sided. Politicians too may join in this public criticism.

Most Trustees are not accustomed to dealing with the media. Media exposure presents many risks for the Trustee and few countervailing benefits or opportunities. The best policy may be to avoid media attention. There are times, however, when this is not possible. Accordingly, the Trustee should be prepared to deal with the media from the outset, and should institute a clear media policy and plan that is enforced on all experts and employees of the debtor who are subject to his control. Key elements of the plan should include the following:

- **The Trustee (or his designee) is the sole contact for the media.** At the time of assuming control or shortly thereafter the Trustee should prepare an internal media policy statement. It should, at the very minimum, state that the Trustee is the single source for media contact for all matters unless the Trustee gives specific permission to a designated spokesperson. This should be circulated to all employees at all levels.

- **Initial press release.** At the start of a high profile or politically sensitive case, the Trustee may wish to issue a press release. The release could contain a plain and factual statement of how and why the case was opened, a description of the Trustee's role going forward, what actions have been or will be taken, and measures that will be instituted.

- **Put Facts in Writing.** As a general rule, the Trustee should avoid press conferences, and should instead deal with the media through written press releases. He should not respond to the provocations that will occasionally appear in the press, and should try to minimize contact with the media, except to achieve some specific objective of his own. If a public statement is necessary, use written press releases containing direct, unambiguous statements. Only facts should be presented. The Trustee should avoid any speculation about the future.

- **If necessary, explain causes:** Downsizing in high-profile cases may generate controversy sufficient to threaten the Trustee's ability to carry out his role. When taking actions such as layoffs of employees or closure of a plant or division, explaining the reasons for the action may reduce controversy. In particular, the Trustee should identify the facts about the debtor's current condition and the factors that caused the debtor's financial distress, such as:

  - History of past poor financial performance, including concrete information about income and expenses, and whether or not the debtor is operating;
  - Poor products and services – lack of competitiveness;
  - Poor sales history – trends of decreasing sales;
  - Declining market share and weakness of the company's position in the industry;
  - Shrinking overall market demand;
  - Poor pricing compared to the competition;
  - High costs to produce products compared to the competition;
  - Difficulties with deliveries;
  - Lack or disorder in points of sale;
  - Fraud, waste, inefficiency;
  - Failure to attract capital; and
  - Other particular obstructions and deficiencies.

Key Components of the Trustee's Public Relations Policy

- Have a written media policy from the first day;
- Distribute and enforce it throughout the organization at all levels;
- Designate one spokesperson for all media relations;
- React quickly, but not hastily or rashly;
- Get the facts out quickly;
- Understand the principles of damage control;
- Avoid public appearances, rely on written press releases
- Avoid speculation, emphasize facts and causes
- **Stress that bankruptcy is not the cause -- it is the solution!**

Trustees are well advised to be aware of the Law on Free Access to Information and should not impose any obstacles to the media that may run afoul or appear to run afoul of this law. In addition, it may be useful to consult the Press Code of Conduct by which the press is governed.

5. The Trustee as Pre-Bankruptcy Advisor

At present, there is little, if any, practice of Trustees in BiH of providing pre-bankruptcy services. Experience in other jurisdictions, however, suggests that demand for pre-bankruptcy advice from individuals qualified to serve as Trustees is likely to become commonplace. Potential sources of such business include:

- Enterprise directors and individual businessmen who take their responsibilities seriously will need access to timely professional advice on the problems of their enterprises and guidance on how to comply with the law. An experienced Trustee can help them avoid personal liability under Article 4.2 for allowing the debtor's finances to deteriorate.
- Individual creditors or creditor groups, such as employees, may seek the advice of a Trustee in preparing a bankruptcy petition and developing a strategy for achieving the best results. Once the bankruptcy proceeding is opened, such creditors or creditor-groups may nominate the private Trustee to sit on the creditors' committee and represent their interests, for Article 29.3 specifically contemplates that "persons who are not creditors may also be appointed as members of the committee if they can contribute to the work of the committee through their professional knowledge."
- Potential investors who want to acquire the assets of a debtor without assuming its liabilities may ask the Trustee to assist them in negotiating a suitable bankruptcy outcome before the bankruptcy petition itself is actually filed.

The bankruptcy law itself specifically contemplates careful pre-bankruptcy planning, with a number of interacting provisions designed to accelerate the proceedings so that results negotiated in advance of the filing can be implemented with great speed. For example:

- The debtor is entitled to file a reorganization plan at the same time it files its petition to open a bankruptcy proceeding. Article 143.1.
- When the debtor itself or a creditor with a writ of execution not satisfied within 60 days files the petition, the Court may open a bankruptcy proceeding directly, with no preliminary proceeding. Article 44.
- The claims examination hearing, the reporting hearing, and the hearing on a reorganization plan may all be held together on the same date. Articles 47.2 and 161.

Thus, a "pre-packaged" bankruptcy – liquidation or reorganization – could proceed at great speed, closing from two to three months after initiation. See, for example, Items 29 and 37 of the Bankruptcy Timeline. To take advantage of these possibilities offered by the law, interested parties will need the pre-bankruptcy services of knowledgeable and experienced professionals, including Trustees.

A Trustee who provides pre-bankruptcy services must resolve several key issues at the outset:

- **He is acting in a private, advisory capacity:** Clients must understand that a person qualified as a Trustee under Article 23.2 who provides pre-bankruptcy services has *no* official position or legal standing in relation to the enterprise's affairs and is acting in a strictly private, advisory, consultative capacity. It is only his experience and knowledge, not his position as Trustee, that the client has retained him to provide. Pre-bankruptcy services may include advice on how to proceed and what to expect, but in no way relieve the directors or owners of their duties to manage the enterprise and file a petition to open a bankruptcy proceeding within 30 days of first becoming unable to make payments. Article 4.2.
- **Whom does he work for?** The person qualified as a Trustee and his pre-bankruptcy client must be absolutely clear about whether he is being retained to help one party (the debtor, a creditor, or a group of creditors) pursue its private interests, or is instead being asked to assume the same objective, collective, intermediary duty a Bankruptcy Trustee owes to all interested parties in preparing for the bankruptcy. This relationship with the client, the nature and scope of the pre-bankruptcy services to be performed, and the purpose of these services must be identified and delineated in a written agreement between the client and the Trustee. Either role for the Trustee is acceptable, but representing one party prior to the bankruptcy will create a conflict of interest that disqualifies the person otherwise qualified as a Trustee from acting as a Trustee during any ensuing bankruptcy proceeding. See Articles 23.4 (general prohibition) and 87.2.2 (treating those employed by the debtor as "insiders").
    - **How will he get paid?** Pre-bankruptcy services are not subject to the constraints on compensation for Trustees set forth in Article 237. If the debtor is paying for the Trustee's pre-bankruptcy services, however, the private Trustee should make certain he is paid before bankruptcy, or he will find himself a general bankruptcy creditor. See Article 32.

D. Obligations of the Debtor and Enforcement Mechanisms

Once appointed, the Trustee will be thrust into a situation of crisis about which he is often quite ignorant. The law provides numerous and stringent deadlines for the Trustee to perform various functions critical to the successful outcome of the Bankruptcy Proceeding. See Bankruptcy Timeline, Appendix 1.F.1. Accordingly, it is essential for the Trustee to obtain accurate and complete information as soon as possible.

The most direct source of information about the debtor's assets, liabilities, and business activities is the debtor. The bankruptcy law requires the debtor and third parties (witnesses) to provide full and correct information and ongoing cooperation to the Trustee. Articles 10.1, 14.2 and 62. Among the Trustee's first actions after appointment should be to serve on the debtor's legal representatives a detailed questionnaire about the debtor's tangible and intangible assets, secured and unsecured liabilities, lawsuits, employees, managers, owners, business operations, financial

affairs, and specific history and reasons for insolvency, including a demand to identify all the debtor's financial and other records and their location.

The Trustee should require that the debtor's legal representatives provide the completed questionnaire by a date certain, within a week or ten days after the receipt of the questionnaire, signed and certified by the debtor's legal representative. To underscore the urgency of timely submission of the questionnaire, the Trustee should consider asking the Court to schedule a hearing at which the debtor must appear to answer the questions of the Bankruptcy Judge and Trustee, and serving this hearing notice on the debtor with the questionnaire.

The law provides various enforcement mechanisms to coerce continuing cooperation by the debtor and its legal representatives, including mandatory court appearances and fines. Articles 10.2 and 10.3, and Article 230. Notice that these enforcement provisions can be applied against individual debtors, as well as the current and past legal representatives of debtors that are legal entities. Articles 63 and 230.2.

The continuing cooperation of the debtor and its legal representatives will be invaluable to the Trustee as he investigates the debtor's finances and prepares the list of creditors and inventory of assets. Once those tasks are complete, the Trustee may request that the Judge compel the debtor to certify the completeness and accuracy of the Trustee's summary of assets and liabilities. Article 95.2.

E. Overview of the Different Stages of the Bankruptcy Proceeding

The Bankruptcy Proceeding consists of three principal stages.

- The Bankruptcy Judge initiates the *Preliminary Proceeding* if he determines that a petition filed by a debtor or a creditor provides an adequate basis for investigating whether a full-fledged Bankruptcy Proceeding should be opened.
- If the investigation conducted in the Preliminary Proceeding establishes the necessary conditions, the Judge opens the main *Bankruptcy Proceeding*. During this phase, the Trustee:
  - Takes possession of the debtor's property;
  - Prepares inventories of the debtor's assets and liabilities;
  - Reviews creditors' claims and assists the Judge in impaneling the creditors' assembly, the decision-making body of the creditors; and
  - Reports to the creditors' assembly on the debtor's financial situation, including recommending whether to realize on the debtor's assets (liquidation) or reorganize the debtor's business.
- At the *Reporting Hearing*, the creditors' assembly decides whether and how to liquidate or reorganize the debtor. In the third and final stage of the bankruptcy process, the Trustee carries out this decision by the assembled creditors.

Several appendices are attached to assist the Trustee in understanding and monitoring the bankruptcy process:

- The Bankruptcy Time Line, Appendix 1.F.1, delineates the duties of the various participants in chronological order, specifying deadlines and providing references to the relevant statutory provisions. The electronic version of the Bankruptcy Timeline is interactive, with "hyperlinks" that permit the user to navigate directly to the relevant article of the law.
- Appendix 1.F.2 charts a General Overview of the entire Bankruptcy Process.
- Appendix 1.F.3 summarizes the criteria and procedure for the Bankruptcy Judge's initial review of a petition to open the Bankruptcy Proceeding.
- Appendix 1.F.4 provides an overview of the Preliminary Proceeding to investigate whether to open a full-fledged Bankruptcy Proceeding.
- Appendix 1.F.5 describes the main features of the Bankruptcy Proceeding.
- Appendix 1.F.6 outlines the main features of a reorganization of the debtor.

2. The Preliminary Proceeding

A. The Judge's Decision to Initiate the Preliminary Proceeding

A bankruptcy begins with the filing by the debtor or by a creditor of a written petition to open a Bankruptcy Proceeding. The petition must establish a probability that the debtor is insolvent on account of an inability to meet its obligations as they come due. In addition, a creditor must also establish that its claim against the debtor is probable. Article 4.1.

The debtor is obliged to file a petition within 30 days of first becoming unable to pay its debts, and the failure to do so may give rise to personal liability for subsequent losses to creditors. Article 4.2. The debtor may file before it actually becomes insolvent, when its projections first show that it is under threat of becoming insolvent in the future. Article 6.4.

The Bankruptcy Judge has 15 days to review the petition and to determine whether it provides an adequate basis to initiate a Preliminary Proceeding. If the Judge finds the documentation inadequate, he will order the petitioner to submit adequate documentation within an additional 15 days or the petition will be dismissed. Article 4.3.

Within 15 days of deciding that the documentation is adequate to establish the probability of the debtor's insolvency and the validity of the petitioning creditor's claim, the Judge estimates the sum required to fund the Preliminary Proceeding. Article 4.4. A petitioning creditor must deposit this sum with the Court within 15 days; otherwise the Judge is required to dismiss the petition. Article 13.2. When the debtor rather than a creditor is the petitioner, the Judge may exempt the petitioning debtor from paying the deposit if the debtor can show that it has assets sufficient to fund the Preliminary Proceeding. Article 13.4.

Once the Judge receives an acceptable petition, the Preliminary Proceeding begins and the Judge is obliged to determine, "forthwith," whether circumstances justify opening a full-fledged Bankruptcy Proceeding, and may appoint an Interim Trustee and experts to assist in this inquiry. Article 14.1. If the debtor's business is still operating, an Interim Trustee *must* be appointed. Article 15.2.

B. Measures to Preserve and Protect the Debtor's Property

A variety of measures go into effect on commencement of the Preliminary Proceeding, either automatically or by Order of the Bankruptcy Judge, to protect the debtor's property and ongoing business against continuing losses and the depredations of creditors and the debtor, and to preserve the assets for the benefit of creditors in the event a Bankruptcy Proceeding is opened. Article 15. These measures include:

- A temporary prohibition against all actions by secured creditors or those with rights of separate recovery (such as lessors) to enforce their rights enters into force immediately and automatically. Article 15.3.
- Parties who have contracts with the debtor are forbidden from terminating ongoing obligatory relations. Article 17.1. The fact that a bankruptcy has been filed or that the party contracting with the debtor feels insecure are not grounds for this party to declare a default and terminate the contract.
- An interim Trustee must be appointed if the debtor's business operations are continuing, Article 15.2, but may still be appointed even if business operations have ceased. Article 15.1.3.
- The court may impose specific security measures including:
  - Special protective measures for specific assets of value, deposit accounts, or claims of the debtor. Article 15.1.1.
  - Limit the debtor's right to manage the business and control assets, Article 15.1.2, or turn all or some part of the management rights over to the Interim Trustee, Articles 15.4 and 15.5. Any limitations on the debtor's management rights must be duly announced. Article 18.1.
  - Order the debtor's mail forwarded to the Interim Trustee. Articles 15.1.4 and 61.

C. The Interim Trustee's Role in the Preliminary Proceeding

Appointment as Interim Trustee opens a period of intense and decisive activity. The Trustee must ensure the security of the property and maintain this property. Within 30 days after his appointment, he must report to the Bankruptcy Judge on whether the debtor's assets are sufficient to fund a Bankruptcy Proceeding and whether cause – the debtor's insolvency – exists to open the proceeding. Article 16.2. If the business is still operating, the Trustee must also assess whether all or some parts of the business should be closed down. Article 16.3. If continuation will damage the debtor or diminish the potential of the bankruptcy estate, the Trustee must immediately recommend suspension of the debtor's business activities.

The Trustee should be aware of the extent to which continuing business activities affects his own potential liability:

- The Interim Trustee is responsible for paying the claims that arise from his actions and decisions, as well as those made by the debtor with his approval. He remains obligated to creditors whose claims arise during the Preliminary Proceeding even after the main Bankruptcy Proceeding is opened. Article 16.4. Indeed, if the Preliminary Proceeding is terminated without passing to the main Bankruptcy Proceeding, the Interim Trustee will not be relieved of this responsibility until after the claims that arose during his administration are satisfied. Article 21.3.

- The Interim Trustee is also obligated to pay the wages and contributions of workers during the Preliminary Proceeding. Although precisely what must be paid is far from clear in Article 17.3, it does limit his liability to those workers who are actually working. Claims of workers who cease to work are enforceable only in the main Bankruptcy Proceeding. See Articles 32 and 33.2.
- Claims from ongoing contractual relations that arose before bankruptcy are also enforceable only in the main Bankruptcy Proceeding, Article 32, unless the Interim Trustee has entered into a special agreement otherwise. Article 17.4.
- The Trustee is not obligated to pay tax, contributions, or other public duties arising during the Preliminary Proceeding. These are also enforceable only in the main Bankruptcy Proceeding. Articles 16.5 and 17.2.

The Trustee must assess whether the income received from continuing the debtor's business will produce more than enough to pay off the expenses generated thereby, including those for which he is himself liable. Unless he is confident of a surplus, he should recommend to the Court that the business be closed.

D. The Legal Basis to Open the Bankruptcy Proceeding

After receiving the Interim Trustee's report and the opinions of any experts appointed to assess whether the debtor is insolvent, the Bankruptcy Judge must convene a hearing on whether to open a Bankruptcy Proceeding. Summoned to participate are the debtor, the Interim Trustee, and the party who filed the petition to open the Bankruptcy Proceeding. Article 43.1.

The Judge must issue a decision on whether to open the Bankruptcy Proceeding within three days after the hearing, Article 43.2. In addition, Article 43.4 requires the Judge to make specific findings to justify opening the proceeding:

- Cause to open the proceeding exists, *i.e.*, the debtor is insolvent as defined by Article 6.
- The petition to open the proceeding was acceptable, *i.e.*, the claim of the petitioning creditor is probable. Article 4.1.
- Sufficient resources are available to pay for the costs of the proceeding. This requirement can be satisfied either by projections that show the debtor's assets will be sufficient or by a cash deposit in requisite amount from an interested party. Note that this deposit will become an administrative expense of the bankruptcy proceeding. Article 43.4.

3. Opening the Bankruptcy Proceeding

A. The Decision to Open a Bankruptcy Proceeding

The law requires that the Bankruptcy Judge's decision contain specific information that will define the course of the Bankruptcy Proceeding:

- Debtor's name and address, Article 45.2.1;

- Appointment of the Trustee, who must be identified by name and address, Article 45.1 and 45.2.2;
- The date and hour that the Bankruptcy Proceeding is commenced, which is presumed to be noon on the date the decision was issued if no time is specified, Articles 45.2.3 and 45.3.
- Notice to creditors to register their claims with the Bankruptcy Court within 30 days, Articles 46.1 and 110;
- Notice to creditors claiming security interests in the debtor's property to inform the Bankruptcy Trustee within 30 days of the nature and basis of the claim, identifying the property that secures it, Article 46.2;
- Notice to persons owing obligations to the debtor to assert these claims without delay, Article 46.3;
- The date set for the Claims Examination Hearing, the first meeting of the Creditors' Assembly, which must be held within 8-30 days after the end of the 30-day period for creditors to submit their claims, Articles 28.1 and 47.1.2;
- The date set for the Reporting Hearing, the second meeting of the Creditors Assembly, which must be held within 15 days of the Claims Examination Hearing, Article 47.1.1, and may be held at the same time. Article 47.2.
- Article 161 allows the hearing on the Reorganization Plan to be held at the same time as the Claims Examination Hearing. For this to happen, the Judge would also need to schedule the hearing on the Reorganization Plan in the decision announcing the opening of the Bankruptcy Proceeding. This option would be very attractive in cases involving pre-packaged bankruptcy plans. See Section 1.C.5 of this Manual.

The Bankruptcy Judge is also required to determine the level of insurance coverage the Trustee must obtain to protect interested parties from all risk of damages that he might cause while carrying out his duties. Article 26.2. Unfortunately, such insurance is not currently available in BiH, providing grounds for the Trustee to request a waiver of this requirement from the Judge, as authorized in special circumstances by Article 26.2.

Articles 48 and 49 set out the requirements for notice and publication of the decision announcing the opening of the Bankruptcy Proceeding. This decision must be published on the Court Bulletin Board, in the Official Gazette, and the Public Register. A copy should be sent to creditors, to the debtor's debtors, and if the proceeding is not opened, to the prosecutor. The debtor and the petitioner are entitled to have a copy delivered to them personally. The decision to open a bankruptcy must also be entered in any public registries for property of the estate.

Although the Trustee is not responsible for the Judge's decision or for ensuring adequate notice and publication, it is to his benefit to verify compliance with statutory requirements to avoid arguments by interested parties later on that they are not obliged to participate because of defective notice or other technical defects.

B. Legal Consequences of Opening the Proceeding

Opening the Bankruptcy Proceeding gives rise to a host of significant legal consequences that fundamentally alter rights and relationships. In various ways, these

changes try to ensure fairness, prevent creditors from dismantling the debtor, treat similarly situated creditors similarly, and maximize the recovery of assets for the benefit of the entire pool of creditors. Resourceful use of certain provisions may greatly enhance the bankruptcy estate and, in appropriate cases, promote the reorganization of the debtor. Important adjustments to rights and relationships include the following:

1. Bankruptcy Estate Created: A new and distinct entity, the bankruptcy estate, encompassing all property and rights belonging to the debtor, is created once the bankruptcy is opened. This estate, which also includes property that comes into the debtor during the proceeding, is used to satisfy the administrative costs of the proceeding and the prioritized claims of creditors that arose before and during the proceeding. Article 30.

2. Trustee Succeeds to the Debtor's Management Rights: All rights to administer the debtor and to manage and dispose of its property vest in the Trustee. Neither the debtor nor its governing bodies, clerks, legal representatives, or authorized attorneys have any remaining powers. Article 51. Any powers of attorney granted by the debtor are revoked. Article 76. Accordingly, transfers by the debtor of property or rights belonging to the bankruptcy estate are void, and the Trustee has the right to compel the return of the asset. Article 52. Similarly, all payments made on account of obligations owed to the bankruptcy debtor must be paid to the Trustee, who has the right to demand such payment until actually received by him, even from someone who has already paid the debtor directly if this person knew of the bankruptcy at the time. Article 53.

3. Unmatured, Conditional, and Non-Cash Claims Become Due: Opening the Bankruptcy Proceeding also changes the nature of a variety of claims. For example:

- Accelerating the due date of claims due in the future so that they are deemed due on the date of opening. Article 36.1. This is a legal fiction that operates to accelerate the maturity of term loans where payments are amortized over time into the future (*i.e.*, monthly, semi-annually, annually) so that the entire amount is deemed to be due even if the particular individual payments are not yet due. Without such a provision, it could be argued that the debtor has no legal obligation to pay amounts not yet due under an installment contract and therefore such a future obligation is not a debt.
- Non-monetary claims must be reduced to their cash value as of the date of the opening. Article 36.4.
- Claims that the debtor is required to pay in a foreign currency must be converted into their BiH currency equivalent on the date of opening. Article 36.4.

4. Creditors' Rights to Enforce Claims Limited: The bankruptcy law imposes a number of constraints on creditors' rights to enforce their claims against the debtor or property of the bankruptcy estate.

- Rights to separate recovery of assets belonging to a third party and used by the debtor can only be enforced, at the earliest, after the Reporting Hearing.

The Trustee may postpone enforcement for an additional 90 days if the asset is necessary to the debtor's business operations, and may also request that the Court authorize him an additional period of use. Use of such assets by the Trustee after the Reporting Hearing entitles the owner to payment for their use and to protection from deterioration in the asset's value. Article 37.

- Any liens or secured rights to property or other restrictions obtained within 60 days before opening the proceeding or thereafter through coercive enforcement proceedings are deemed ineffective as of the opening of the bankruptcy. Article 57. Unlike the provisions dealing with avoiding security interests in Articles 80-86, which require initiating litigation, Article 85, this provision seems to be automatic and self-executing.
- The Trustee may avoid any security interest against the debtor, even if voluntarily granted, obtained within six months of the petition and while the debtor was insolvent. Article 81.1.1. See also Section 4.E.2 of this Manual.
- No actions may be instituted to execute or obtain a lien against property of the bankruptcy estate after commencement of the proceeding, Article 58.1, and any such actions pending at this time are stayed. Article 58.2.
- Secured creditors may execute on their collateral after opening the Bankruptcy Proceeding. Articles 38 and 58.4. The Court may disallow or stay execution, however, if the Trustee provides the creditor with adequate protection against any loss that might result. Article 58.5. Notice also that the Trustee may liquidate movable (personal) property without the consent of the secured creditor, Article 103.1, although such consent is required in the case of a mortgage on immovable (real) property, Article 102.4. Compare Section 7B and Section 7C of this Manual.

5. Pending Legal Disputes Stayed: Pending legal disputes that affect the bankruptcy estate are stayed for the duration of the Bankruptcy Proceeding, Article 55, with the following exceptions:

- The Trustee may continue pending litigation involving assets of the bankruptcy estate in which the debtor was the plaintiff. Article 55.2.
- Litigation about excluding an asset from the estate, separate satisfaction of a secured claim, or debts of the bankruptcy estate (see Section 5.A.1.c of this manual), may be continued. Article 55.3.
- Litigation by a creditor concerning a bankruptcy claim may be continued only after the Trustee has had an opportunity to dispute the claim at the Claims Examination Hearing. Article 55.4.

6. Dissolution of Debtor's Legal Entities: The Trustee has the right to dissolve legal entities in which the debtor is a co-owner, joint owner, or partner outside the bankruptcy proceeding, and to demand preferential distribution to the bankruptcy estate of the debtor's ownership share. Article 54.

7. Limits Imposed on Bankruptcy Creditors: Bankruptcy creditors, see Section 5.A.2, may only enforce their claims within the Bankruptcy Proceeding. Article 56.

8. Limits Imposed on Other Parties to Debtor's Agreements: A key element of all modern bankruptcy laws is the right of the Trustee to choose whether or not to accept or reject the debtor's existing contracts that have not been fully

performed. Article 65.1. This right can be particularly useful in reorganizing the debtor because it allows the Trustee to reject unprofitable contracts. The Trustee must exercise the right immediately after a request by the other party to make a choice or the Trustee is deemed to have rejected the contract. Article 65.2. The other party, however, then has a claim as a bankruptcy creditor if the Trustee rejects the contract. Article 65.3.

If the debtor is a lessee or tenant under a lease of real property, this lease will continue to be binding on the bankruptcy estate, but the lessor or landlord may assert any pre-petition claim only as a creditor in the bankruptcy. Article 70. If the Trustee as lessee or tenant terminates the lease prematurely, the lessor or landlord may pursue a claim for compensatory damages as a creditor in the bankruptcy. Article 72.1. On the other hand, if the debtor was the lessee or tenant, the lessor or landlord may not terminate the lease because of a pre-petition default in payment or the deterioration of his financial condition. Article 73.

9. Termination of Labor Contracts: In the FBiH, the Trustee must terminate in writing the labor contracts of employees whose services will not be required during the Bankruptcy Proceeding; in the Republic of Srpska, such contracts are automatically terminated by operation of law on the day the bankruptcy is opened. Article 74.1. Claims for damages as a result of termination are treated as bankruptcy claims of the general payment priority. Article 74.2. By contrast, claims of employees for labor injuries and unpaid wages at the minimum wage for the past eight months (in FBiH) or six months (in RS) and contributions at the applicable minimum wage rate are entitled to priority at the higher payment priority. These claims are paid before all others except the unpaid claims incurred during the period of provisional administration. Article 33.2.

4. The Trustee's Role in Maximizing the Value of the Bankruptcy Estate

A. Taking Possession of the Debtor's Property

Commencement of the Bankruptcy Proceeding results in the automatic creation of the bankruptcy estate, which encompasses all property rights of the debtor, Article 30. The authority to manage and dispose of the assets of the bankruptcy estate are also automatically transferred to the Trustee when the bankruptcy is opened. Article 51. The Trustee's obligation to take possession of the Bankruptcy Estate "forthwith," Article 25.1, and to manage this property as an owner, 88.1, is among his most important duties, and lays the foundation for the entire course of the Bankruptcy Proceeding. Experienced Trustees will establish standard systems and procedures and develop relationships with businesses that can help them secure and rapidly take control of the debtor's physical assets, books and records, and bank accounts. Among the key considerations to keep in mind are:

- Gaining possession of the debtor's books and records as early as possible is crucial to identifying assets, especially accounts receivable; to discovering avoidable transfers of the debtor's property; and to preventing fraud. In addition, the books and records are essential for the Trustee to carry out his obligation to maintain the debtor's business ledgers. See Article 97.1.

- In some cases, books and records will be maintained in electronic form on desktop, laptop, or hand-held computers. The Trustee must obtain possession of all such records and assure their integrity, including changing passwords to prevent unauthorized access.
- The Trustee should consider hiring former employees of the debtor's to assist him in identifying all books and records, whether in hard copy or electronic form, and in understanding and maintaining them.
- The Trustee, on the first day, must close the debtor's bank accounts and transfer any funds to new accounts over which he has exclusive control. Article 89. (Notice that the new accounts should be in the name of the debtor with the words "in bankruptcy" added, Article 90.)
- The Trustee is required to obtain Court approval of the location for depositing or investing any cash, shares, or valuables that he takes into his possession. Once a creditors' committee is appointed, however, a member of the committee must countersign any receipts or directives for removal or transfer of such assets. Article 91.
- The Trustee must assure the physical safety of tangible assets to prevent theft, deterioration, or loss in value. Depending on the type of asset involved, this might require changing locks, hiring guards, feeding livestock, or maintaining utility services.
- In some cases, maintaining the value of the estate will require the Trustee to operate the debtor's business. For a discussion of the issues raised in this connection, see Section 4.C of this Manual.
- If necessary, the Trustee may obtain a Court order requiring turnover of assets of the bankruptcy estate and imposing penalties in the event of a failure to comply. Article 88.2.

B. Preparing the Inventory

Within 45 days after his appointment, the Trustee must submit to the Court a written report that includes:

- A list of all the debtor's creditors. This requirement is discussed in Chapter 5.
- A detailed inventory of the bankruptcy estate. Articles 25.2 and 93.1.
  - The inventory must state the book value for each item and also an estimate of its "expected" liquidation value. Articles 25.2.
  - If the liquidation value of an asset depends on whether the debtor's business continues to operate, then the Trustee's inventory must state both the liquidation and the going-concern values. Article 93.2.
- A "well-organized summary" of the debtor's assets and liabilities as of the commencement of the Bankruptcy Proceeding, which includes identifying the assets available for the benefit of creditors. Articles 25.3 and 95.1.

These elements are the basis for the Trustee's Report at the Reporting Hearing at which he will provide creditors with his analysis, projections, and recommendations on whether and how the debtor should be liquidated or restructured. Suggestions for the Trustee's Report are discussed in Section 6.D.1 of this Manual. Sample forms for

each of these elements of the Trustee's Report are contained in the Forms section of this Manual. Use of the electronic versions of these forms will save the Trustee much time in calculation. Perhaps most important, the Liquidation Balance Sheet component will enable the Trustee to provide creditors with a realistic estimate of what each payment priority and rank of creditors is likely to receive from liquidating the debtor's property. This amount of organized information will assist the creditors in making informed decisions and will facilitate the process of negotiation and compromise that will make the proceedings efficient and successful, especially in the event of reorganization.

1. Confirming the Sufficiency of Assets to Fund the Proceeding

The first step in preparing the inventory must be to confirm that the liquidated value of assets in the bankruptcy estate is sufficient to pay the costs of the Bankruptcy Proceeding. If the Bankruptcy Proceeding has been opened after a Preliminary Proceeding, the Trustee may have the benefit of the Interim Trustee's report to the Bankruptcy Judge. See Article 16.2. In some cases, however, the Bankruptcy Proceeding may be opened directly, without a Preliminary Proceeding. Article 44. Although Article 43.4 requires that the Judge find that projections show sufficient assets before the Bankruptcy Proceeding can be opened, projections are sometimes overly optimistic, and the Trustee may discover that he has worked for free unless he personally verifies the availability of sufficient unencumbered assets.

This determination will also help the Trustee scale his activities appropriately so he does not "spin his wheels" and put in great effort where little is warranted. The Trustee should also continually reconsider his initial determination. New information may require changes in his original estimate of the value of unencumbered assets, which must also be adjusted to take into account the costs the Trustee is incurring on behalf of the bankruptcy estate as he carries out his duties.

To make an initial determination about the sufficiency of assets the Trustee must compare the estimated costs of the Bankruptcy Proceeding with the estimated liquidation value of unencumbered assets. Form in Appendices provides a representative example of usual costs, and, in its electronic form, can be used by the Trustee to monitor and update costs on an ongoing basis.

Estimating the liquidation value of the bankruptcy estate involves making a quick, very rough assessment to determine whether there are unencumbered assets in the estate. To make this assessment, the Trustee must quickly:

- Identify the main assets;
- Determine the market for these assets;
- Estimate the likely liquidation value of each of the main assets;
- Separate the main assets into two categories:
  - **Unencumbered assets** that are available directly and immediately to fund the bankruptcy proceedings; and
  - **Encumbered assets** that are under the primary control of secured creditors. Unfortunately, the Bankruptcy Law does not require such creditors to participate in the liquidation process, even when the liquidation value of an encumbered asset exceeds the amount of the

secured creditor's debt. Accordingly, the Trustee will need to assess carefully the degree to which the creditor is likely to be cooperative in facilitating recovery of the excess value by the estate before including such value in his estimate of the sale proceeds available to fund the Bankruptcy Proceeding.

- Total the liquidation value of unencumbered assets and only the surplus liquidation value of encumbered assets in excess of the creditor's secured debt that the Trustee is confident he can recover.

If this total amount is not sufficient to cover estimated costs, the Trustee must advise the Bankruptcy Judge immediately so the Bankruptcy Proceeding can be terminated swiftly to avoid additional costs. Article 132. Once the Trustee satisfies himself that there are sufficient assets to fund the proceedings, and he has a basic idea of their value, the Trustee can conduct the inventory and valuation, as described below, adjusting his plan of action as appropriate to the amount of unencumbered assets in order to maximize returns to creditors and minimize costs.

2. Conducting the Inventory

a. General Considerations

The main purposes of the inventory of the bankruptcy estate are to:

- Alert the parties as early as possible if there are insufficient unencumbered assets available to fund the bankruptcy proceedings. Article 132.1;
- Discover any unauthorized removal or concealment of assets or any avoidable transfers or preferences that may be recovered for the benefit of the creditors (see Section 4.E); and,
- Identify what property is potentially available for liquidation to fund distributions to the creditors, or alternatively, whether a reorganization plan would produce greater payouts.

To meet the 45-day deadline and minimize costs, the Trustee will need to proceed expeditiously. The law requires an itemized, detailed inventory of assets. The methods used by the Trustee, especially in valuation (see Section 4.B.3), should focus first on the major tangible and liquid assets. The Trustee cannot waste time and money counting and pricing every bolt in a container when the principal value of the bankruptcy estate obviously consists of real property. The Trustee must use common sense methods of estimation that minimize costs while providing a reasonably reliable valuation so that creditors are able to make informed decisions. The Trustee's report should disclose to creditors the methods he used to develop his estimates of value so that the creditors can decide whether to spend the money necessary to obtain additional, more accurate estimates or appraisals.

Taking an inventory involves identifying the quantity, ownership, characteristics, and condition of the property over which the Trustee has taken control in order to obtain a sound basis for the valuation. In a bankruptcy situation, this inventory count should take place as soon as possible after the bankruptcy is opened, especially if the debtor is operating and the Bankruptcy Trustee is continuing to sell the products of the debtor.

Unfortunately, this is not always possible in a bankruptcy. In this event the Trustee might consider organizing the inventory count incrementally, in stages, taking into account the quantity and speed with which various categories of assets are sold. Perishable inventory should be counted first, and then sold at once. See Article 25.1. Next, the Trustee should count the finished products on hand as of the date of his appointment, followed by the inputs and raw material inventory that will be used or converted in the production process, where this is relevant. Despite the peculiarities of the particular case that might affect the timing of the inventory, the Trustee must prepare an initial accounting in the form of a "well-organized summary" that reflects the book and liquidation values of assets *as of the date the Bankruptcy Proceeding commences*. Article 95.1.

b. Means and Methods

Ordinarily, taking the actual inventory is scheduled to occur on a single day in order to avoid counting it twice (or not at all) as inventory moves in and out or between different locations of the debtor. Ideally, the inventory in all places should be counted on the same date, and there should be no transfers between different offices or divisions of the debtor during the count. All shipments in and out must cease, and all stores must stop doing business on the day inventory is taken.

The Trustee will count the less liquid (less saleable) assets after he has counted the volatile inventory like perishables, inputs, raw materials, work in progress, *etc.* In many cases, buildings, equipment, and vehicles are likely to constitute the majority in value of the debtor's assets; however, depending on the asset, they are also less likely to be stolen or to deteriorate quickly in value after opening the proceeding.

Another way of conducting the inventory count is to focus on the items of highest value first, then gradually move to the less valuable items. This approach is especially appropriate when there is no activity, that is, when the debtor's business is not operating and there are neither perishable goods nor work in process. Given the very strict time deadlines, and the time that is usually required to value the inventory once it has been physically counted and listed, it may sometimes make little sense to count high volume, low value items. The Trustee's practical goal is provisionally to provide creditors with an adequate basis for decision in a timely manner, which does not necessarily require absolute accuracy at this stage.

Whenever possible, the Trustee should use the debtor's records, especially those from previous inventory counts, as the initial point of reference for his own inventory count. It is unlikely that the type of assets used by the debtor will have changed significantly since its previous year's end. Thus, the most recent records of a physical inventory by the debtor will provide an invaluable resource for the Trustee. These records can supply the categories and identification of the assets for the Trustee's inventory. Equally important, a significant and conspicuous absence of inventory in certain categories will alert the Trustee to the possibility of recent theft or improper transfer.

Where possible, the Trustee should use the former employees of the debtor to assist in the inventory count, for they will be familiar with the detailed characteristics and

source of the inventory. The Trustee should also use the same methodology for counting inventory employed by the debtor in the past, unless it is obviously deficient, to prevent "mixing apples and oranges" and facilitate historical comparison.

c. Using Inventory Specialists

Certainly, the Trustee cannot be everywhere at once. If there are large or multiple locations, the Trustee may wish to hire an accounting firm, a firm of inventory takers, or other such experts to assist in the actual counting and tabulation. Even if such experts are hired, however, it is the Trustee who remains responsible for the integrity of the process and the reasonable accuracy of the result, so close supervision of these experts is important. The inventory process must be carefully planned, setting out who will count what areas and when. Persons other than the original counter should be designated to re-count items to verify the original count. A system of tags and labels should be used to keep track of what has been counted and what has been checked and verified, to avoid omitting items or double counting. The Trustee can test the result by counting certain items at random to see that his own count matches that of the designated counter. Of course, the premises must be secured during the inventorization so items of inventory cannot be added or removed during the process.

d. Accounts Receivable

In preparing his inventory, the Bankruptcy Trustee must include a list of the debtor's debtors. These amounts owed to the debtor by third-party trade creditors or customers are known as accounts receivable. A crucial measure to protect the value of the debtor's accounts receivable (or any other claims against third parties) is to protect the books and records that contain evidence of the amounts owed to the debtor. These documents include contracts, orders, invoices, shipping or delivery slips, receipts, and correspondence, as well as the payment records for the accounts receivable maintained by the debtor. Much of this information may be stored in electronic form on computer files that can be easily misplaced or deleted if the Trustee is not diligent in protecting them.

It is also important to note that the actions of the Trustee in taking possession will have a direct bearing on the liquidation value of intangible assets. An extreme example potentially amounting to misfeasance would be a case where the Trustee fails to secure the accounting records of the debtor. The amounts owed to the debtor by its customers may lose all value if there is no ability to identify and enforce the claim because the basic records needed to establish the amounts due are lost.

e. Identifying Inventory Shortages

The Trustee must carefully compare the book value of the physical inventory taken after his appointment with the books and records of the debtor. Depending on the circumstances, this may involve a comparison with the updated books of the debtor, or more likely, with the detailed entries in the latest physical inventory taken by the debtor. In addition to fixing a current, synchronic picture of the debtor's tangible and intangible assets, the Trustee will thus construct a historical, diachronic picture of the fate of these assets, a prerequisite not only to reporting on the debtor's prospects, but also to exercising the Trustee's avoiding powers. See Section 4.E of this Manual.

It is not unusual for business inventories to change -- the Trustee might expect these inventories to shrink as the debtor attempts to generate cash to keep the operations going. The Trustee should compare the actual change in inventory, however, with the cost of goods sold reported in the income statement or other records. A major discrepancy may indicate that some of the inventory has been improperly removed or deliberately sold at a loss. Where there are unexplained changes in the inventory of equipment and vehicles (and occasionally buildings), this is a red flag and the Trustee must investigate further. Among other issues, such an investigation should identify whom the inventory has been sold to and their relationship to the debtor.

The Trustee should report any shortages, whether or not he considers that they have been adequately explained, to the creditors, who may be aware of the debtor's history in their own right. This is necessary in order to allow creditors to express their opinion about the shortages identified, as well as to obtain the creditors' views on the appropriate course of action in light of these shortages.

f. Contingent Assets

Unfortunately, it is not unusual for a debtor to make significant transfers of assets out from the debtor immediately before the proceedings are opened. Such transfers may include physical transfers of property or funds to a third party, or the grant of a questionable mortgage against the assets. The Trustee must investigate the timing of such transfers and whether fair consideration was paid to the debtor. This will establish whether there are grounds for an action to recover the assets back into the bankrupt estate for the benefit of the creditors, through the avoidance provisions of Articles 80 through 87. (See Section 4.E of this Manual for a discussion of Avoidance Actions). In addition, any liens or secured rights to property obtained within 60 days before opening may be void as a matter of law. Article 57. Such questionable transactions should be clearly listed in the inventory as "contingent assets."

A contingent asset is one that is not finally determined at the time of the inventory and depends on some future event the result of which is uncertain, but is nevertheless reported to creditors so they can decide whether to invest estate resources in further investigation, and if necessary, litigation. By definition they are "contingent" on another event occurring, such as prevailing in an avoidance action to set aside a mortgage or recover a preference or improper transfer. Of course, contingent assets should not be included in any estimate of whether there are adequate resources to fund the proceeding.

3. Valuing the Assets

In order to fulfill his obligations, the Trustee is required to value the assets identified by the inventory on at least two bases, book value and liquidation value. Article 25.2. If the liquidation value is likely to be different because the debtor is continuing to operate ("going concern value") as compared to if the business activities were to stop, the Trustee's inventory must state an estimate of the liquidation value for both scenarios. Article 93.2.

a. "Book" Value

The term "book value" is somewhat of a misnomer because it is not really a standard of value, but an accounting term. The book value of fixed assets like land, buildings, or machinery and equipment represents its historical cost less periodic deductions for depreciation at rates set by applicable tax and accounting principles. The book value of fixed assets often has very little relation to its real worth. For example, a fully depreciated asset might have a book value of 0 KM, yet still have considerable value in a sale. Typically, though, the book value of an asset will be far in excess of what a buyer will pay to acquire it.

Book value has very little meaning with reference to the more liquid assets such as inventory, accounts receivable, cash, and marketable securities. For these types of assets, the Trustee should assume no more than that the "book value" means the value as reflected in the debtor's books, since the Trustee will copy the book value of the assets from the debtor's books and records.

If the debtor's records are not up to date, the Trustee may have to apply appropriate accounting rules to bring them current, at least with respect to fixed assets, machinery, and equipment. In general, however, the Trustee should avoid large expenses for revising the debtor's books and records, and simply do the best he can with what he has to work with, making sure to disclose to creditors the deficiencies that he discovers in his Report and at the Reporting Hearing.

b. Liquidation Value

The Trustee is required to state, for each item in the inventory, "the amount which is expected to be collected from its liquidation." Article 25.2. The amount realized will, of course, depend to a large extent on the manner and method of sale. Article 101.1 directs that the Trustee "must immediately liquidate the assets" after the Reporting Hearing unless the creditors instruct him otherwise.

Immediate liquidation of the assets through a distressed sale, often through public auction, will produce lower sales prices than a more orderly process of piecemeal sale over a longer period of time to a targeted market. The benefits of immediate liquidation, however, are that it both minimizes costs and gets money into the hands of creditors faster. Experience shows that the benefits of immediate liquidation generally outweigh the disadvantages, except with respect to specific high-value items that require separate, targeted marketing to ensure the best price. Accordingly, the Trustee's estimates of liquidation value in the inventory should be based on the assumption that assets will be realized immediately after the Reporting Hearing. If the Trustee identifies specific assets that are likely to produce considerably greater recovery if sold in a different way, he should note this in his Report and at the Reporting Hearing.

Exact values are not required. By definition, the values are estimates, a prediction of what the assets will sell for; there is no such thing as an exact "expected" value. The time and cost involved in attempting to obtain a precise value for each asset is unlikely to justify such an effort. The obligation of the Trustee is to take control of the assets, value the bankruptcy estate, and then formulate a proposed strategy, either

liquidation or reorganization, for consideration and approval by the bankruptcy creditors. Owing to the time pressures for the preparation of the inventory and the initial summary, the Trustee should initially focus on the main assets.

In order to allow the appraiser or other valuator to determine the "expected" liquidation value of the assets, it is important that the physical inventory contain clear references to physical characteristics such as age, composition, and condition, especially of the main assets. The debtor's employees are often a prime resource in this respect. For example, they can describe in detail when a machine was last ran, whether it works well, whether it has had parts removed to repair other machines, or other irregularities affecting value.

The track record to date suggests that appraisers in BiH tend to make unrealistically high valuations of the bankruptcy estate. Such exaggerated appraisals create unreasonable expectations and make it difficult for a Trustee to convince creditors that they would receive more through reorganization than in liquidation, although experience has shown (and many Trustees and Judges now simply assume) that in a forced (fire) sale of the bankruptcy estate it is not realistic to expect to receive more than 30% of the appraised value or 50% if the liquidation is pre-planned and concerns such fixed assets as land and buildings.

In arriving at the liquidation value, the appraiser should distinguish *orderly liquidation,* the sale of assets over a reasonable period of time in an attempt to expose them to the market and obtain the best available price for each asset, on the one hand, and *forced liquidation,* the sale of assets as quickly as possible, typically all at once at an auction sale, on the other. Both these liquidation values should be included in the Trustee's report to the creditors.

Some other considerations to keep in mind with respect to the valuation process in general and valuation of specific types of assets include the following:

Value as you go: Because different categories of property may be counted at different stages in the process of taking inventory, the task of valuing these different types of property can also proceed independently. It is not necessary to wait until the entire inventory is finished before the task of valuing the various assets and identifying any related liens can begin. To increase the efficiency of a Trustee and his team in preparing inventory lists and providing the necessary information the appraisers in time, it would be well for the Trustee to furnish this information successively on an ongoing basis, phase by phase, during the course of inventorization, allowing the appraisers to participate in the dynamic of the team that compiles the inventory lists.

Using experts: Occasionally, a Trustee will encounter significant assets of a specialized nature that are hard to quantify or value. Examples include assets like iron ore or mineral deposits in a mine or underground oil or natural gas reserves; unusual or specialized items such as diamonds, gems, or rare artwork; intellectual property such as patents or copyrights; or other items of value such as special licenses, permits, or concession agreements. In such cases, the Trustee will need to determine whether to hire specialized experts to value such assets. The Court must approve retention of such experts in advance, pursuant to the procedure set out in the

bankruptcy law in Articles 22.3 and 93.2. In many cases, however, the Trustee's own experience with liquidating assets is likely to be as reliable – and less costly – than an appraisal by an expert. If the Trustee expects to liquidate immovable property (real estate) under the law on coercive execution, Article 102.1, he may want to obtain an appraisal of the liquidation value during the inventory process in order to speed the process. See Section 7B.

Estimating quantities and values: The Trustee must be on the alert for efficient ways to conduct inventories so that costs are minimized and returns to creditors maximized. For example, when measuring high-volume, low-value items of a homogenous nature, the Trustee can weigh 100 units, establish the value for these units, and then weigh the entire inventory of that item. The total weight would then be multiplied by the value to obtain a reliable estimated valuation.

Similarly, surveying the volume of items that are stacked in piles is another method. If, for example, the Trustee encounters a pile of coal or grain occupying a certain area, he can establish an estimated value of a cubic meter of the item. The Trustee can then multiply this value by the estimated volume of the item in cubic meters to obtain the total value. Of course, the Trustee must be certain to verify that the volume is indeed occupied by the item, and that it is not merely resting on top of another type of item of differing value.

Inventory: Generally, a debtor's inventory is not worth very much because:

- Even high-value inventory of a bankruptcy debtor will probably not sell at the "normal selling price," that is, at fair market value. The fact that the debtor may cease to exist means that customers cannot return their purchases, expect any guarantees to be honored, obtain service or spare parts, or have their purchase repaired by the debtor, which will force the price down.
- The Trustee will usually be required to discount the price to convert the inventory to cash quickly if he is to minimize the costs of the administration and maximize the net return to the creditors.
- The remaining inventory the Trustee has to sell is likely to be of negligible value. Most debtors sell everything that can be easily sold in a desperate attempt to generate cash during the long, slow slide into bankruptcy. This means that there may be very little value in the current inventory.
- The debtor's financial records may show inventory with high book value. In many cases, however, most of this inventory consists of old or obsolete items that the debtor itself has been unable to sell. The Trustee is not likely to be more successful.

Machinery and equipment: Frequently, the debtor's machinery and equipment is old or obsolete because it has not been able to keep current with changes in technology. Stocks of spare parts and supplies will have been exhausted, and may be difficult or impossible to replace; maintenance will have been deferred. In many cases, some of the machinery itself will have been cannibalized in order to keep at least a few of the remaining machines running. This serious impairment

of the capacity of these machines is seldom reflected in the books of the debtor, but must be taken into account in the Trustee's estimation of liquidation value.

Accounts receivable: The Trustee must also value claims that are due to the debtor. This is a two-step process:

1. The Trustee first determines the face amount of the claim by the bankruptcy estate. This involves identifying the amount on the last invoice from the debtor, and adding statutory interest. A convenient tool for automating this process is found in the attached worksheet.
2. The Trustee next assigns a liquidation value to the debtor's claim, which will be affected by a number of factors, including:
    - Age of the claim;
    - Whether it is secured or guaranteed;
    - Whether it has been confirmed by an execution order;
    - Quality of the documentation supporting the claim, including invoices, receipts, and accounting;
    - Existence of any disputes regarding deliveries, quantities, quality, or suitability for its intended purpose;
    - Existence of offsets or counterclaims;
    - Estimated expenses in enforcing the debtor's claim; and
    - Accuracy and integrity of the debtor's accounting system.

In general, bankruptcy debtors are less likely to be paid than regular businesses; older accounts are less likely to be collected than more recent ones; and installment accounts that have not received regular payments recently are less likely to be collectible than those that have received recent payments.

The Trustee should consider selling the accounts receivable in bulk, in a single package, at a discount to a factor or other third party who would shoulder the burden of collecting these accounts. This approach would eliminate the costs of collection, eliminate the element of risk, and realize immediate and ascertainable value for the estate. (Although, like a secondary market in commercial paper, such factors or third-party purchasers of accounts receivable are not now active in BiH, once the bankruptcy law takes root, becomes established, and develops in practice, such peripheral commercial services will undoubtedly appear, at first informally, sporadically, but eventually as a well-established component of the secondary market.)

c. Going-Concern Value

The value of a business enterprise will vary depending on whether it is currently operating and is sold as a single, fully functioning whole, or whether it is out of business and is sold piece-by-piece, as illustrated by the simple example of an automobile. A used automobile that runs properly may be valued for resale at 5,000 KM when compared to others of a similar make, model, mileage, and condition. If it were sold piece-by-piece, for the value of its parts, it might be worth more or less, depending on availability of parts for that type of car. On the other hand, it will almost always cost more to sell each piece separately than to sell the car as a single

working unit. Therefore, the Trustee must always consider not only the price to be realized, but also the costs required to realize that price.

The same considerations apply to businesses and business units. The Trustee must be alert for opportunities to realize more for creditors by selling the entire bankruptcy estate, or a discrete operating portion thereof, as a "going concern" to a single purchaser, rather than selling the assets piecemeal to various buyers. Article 93.2 requires the Trustee to identify such opportunities and include them in his inventory. Conceptually, the going-concern value of an asset is based on the present value of the discounted future cash flow it can be expected to generate on the assumption it will be used in the ongoing business operations. As a practical matter, "going-concern" value usually applies to a category of assets (*e.g.*, all the equipment) where operations are continuing or it is possible to re-start operations easily. In short, it is the value of these assets in place in the business determined by their contribution to the income produced by the operation rather than their sale value. Note, also, that the business name of an operating or recently closed business, the list of customers, and assignable contracts may be assets in their own right that could have significant value to a competitor or supplier if the business is to be liquidated.

To professional appraisers, *Going-Concern Value* is the value of a business as a whole. The concept involves valuation of a continuing enterprise from which allocations or apportionments of overall *going-concern value* may be made to constituent parts as they contribute to the whole, but none of the components in itself constitutes a basis for *market value*. Therefore, the concept of *Going-Concern Value* can apply only to a property that is an integral business or entity, *i.e., Going Concern Value* expresses the value ascribed to an established business, not to any of its constituent parts. The value allocated or apportioned to individual assets making up a part of the going concern is based on their contribution to the whole, commonly referred to as their *value in use* when related to a specific business and its owner. It is not market related.

Going concern has several meanings in accounting and appraisal. In some contexts, going concern serves as a premise under which appraisers and accountants consider a business as an established enterprise that will continue in operation indefinitely. The premise of a going concern serves as an alternative to the premise of liquidation. Adoption of a going-concern premise allows the business to be valued above liquidation value and is essential to the development of the *market value* of the business.

In liquidations, the value of most intangible assets (*e.g.*, good will) tends toward zero, and the value of all tangible assets reflects the circumstances of liquidation. Expenses associated with liquidation (sales fee, commissions, taxes, other closing costs, administrative costs during close-out, and loss of value in inventory) are also calculated and deducted from the estimate of the value in liquidation.

The going-concern value requires the application of the income and sales comparison approach. The most applicable method for appraising a company as a going concern, however, is the depreciated cash flow method. Alternatively, with careful consideration and the development of an appropriate set of comparable parameters, the sales comparison method could also be applied.

The following guidelines are used by appraisers for final adjustments to going-concern value:

- The estimated cash flow is based on market value.
- Deductible entries for owners' expenses that are in conformity with the market.
- Appraisal, via realization of the net returns, of comparable transactions.
- Potential correction entries for, among others, initial vacancy and for the present value of the difference between actual rent and market rent, overdue maintenance, possible future renovations, *etc.*

If a business enterprise is fully operational, productive, and generating income, it should be valued using this business valuation model valuing the business as an income-producing asset. This is a complicated process best undertaken by an accountant or appraiser. Most important, the Trustee must make sure that the going-concern valuation reflects the changed environment that bankruptcy itself produces. Basing the valuation of a business on its pre-bankruptcy performance will result in a going-concern value below its real potential. The valuation must take into account the changes in the debtor's operations that the Trustee can make using his powers to maximize the value of the business, as discussed in the next sections of this manual.

For example, the Trustee can reject contracts that contributed to the debtor's descent into bankruptcy. These might include expensive lease agreements or long-term contracts to buy raw materials at prices that are now above market or to sell finished products at prices that are now below cost or market. Similarly, bankruptcy will reduce or eliminate requirements to service debt, freeing up operating capital. Accordingly, the post-bankruptcy earning potential of the debtor as a going concern will in some cases be more attractive, especially in the current environment in BiH where there is limited demand for assets sold on a piecemeal basis.

C. Managing the Debtor's Business Activities

If the debtor is an operating business, special care must be taken to preserve the business and protect the operation for the benefit of the creditors. Before the opening of the bankruptcy proceeding, the Court can order that the Interim Trustee continue legal activities that bind the debtor, in which case the debtor is removed from management, Article 15.4, or in special circumstances, that management of the debtor be transferred entirely to the Interim Trustee, Article 15.5. Dishonesty, incompetence, self-dealing, or the failure of management to cooperate would certainly constitute such special circumstances, requiring the Interim Trustee to move the Court as quickly as possible for an Order restricting or removing the present management.

Once a bankruptcy proceeding is opened and before any decision by the creditors on reorganizing rather than liquidating the debtor, the Trustee may decide to manage its ongoing business affairs. As soon as the bankruptcy proceeding has been opened, all rights to administer and dispose of the debtor's property are immediately transferred to the Trustee, Article 51, who is required to manage this property, Article 88.1. What is more, the Bankruptcy Trustee is specifically authorized to continue operating the business of the debtor until the Reporting Hearing, when the creditors will decide

its ultimate fate. Article 25.1. The creditors' committee supervises the Trustee in his management of the debtor's business operation, Article 29.5, and must approve all significant legal actions, including terminating the business of the debtor, Article 29.6. In the absence of a creditors' committee, the creditors' assembly must approve such actions or, if no decision is made at two consecutive sessions, the Bankruptcy Judge. Article 29.6. If it is in the ordinary course of the debtor's business, however, the Trustee may continue to sell goods or other assets of the estate, even before this decision is made. Article 25.1. The debtor may recover the right to manage the bankruptcy estate only after the conclusion of the bankruptcy proceeding. Article 184.1.

The Trustee should consider taking over management and operating the business of the debtor if:

- the debtor is an operating entity continuing to do business, producing goods or providing services, and generating income,
- the debtor's going-concern value as a whole exceeds the liquidation value of its assets,
- there is work-in-progress, unfinished goods and customers, that require the debtor to be gradually wound down, or
- there seems to be some prospect of restructuring and reorganizing the debtor.

How and to what extent to continue the debtor's business operations until the Reporting Hearing will raise numerous questions the answers to which will depend on the specific circumstances of the debtor's business affairs. First and foremost, the Trustee must be confident, at the risk of personal liability, that continuing to operate this business will not further deplete assets, generating additional losses for the creditors. See Article 25.1. In addition, the Trustee should consider whether to make changes in the structure or operation of the business, such as downsizing the debtor by closing unprofitable segments of the enterprise, eliminating waste, reducing the work force, cutting costs, rejecting unprofitable contracts, changing suppliers, adjusting expenditures such as advertising, restructuring points of sale, targeting additional or different markets, reviewing the pricing and credit policies, *etc.* Before seeking the creditors' approval for such decisions, as required by Article 29.6, the Trustee will need to consult the more experienced and competent representatives of the existing management, the supervisors and employees, creditors (such as suppliers) familiar with the operation, and in those cases where the cost is justified, hired experts.

In any event, the Trustee must act gingerly, erring on the side of caution, for his principal task is to maintain the business until the Reporting Hearing without additional losses to the creditors. Indeed, he is prohibited by law from closing down the debtor's ongoing business operations without the consent and approval of the creditors' committee, creditors' assembly, or Bankruptcy Judge. Articles 100.1 and 29.6. In the meantime, he should introduce changes only to correct obvious misjudgments, remove patent obstacles to profitability, or cut away indisputably deleterious aspects of the operation, and should be especially careful when proposing any irreversible changes. In the course of learning and maintaining the business operations, the Trustee will increasingly come to know the advantages and disadvantages of this debtor, gathering the information and making the analysis he

will need to present a cogent and credible recommendation to the creditors at the Reporting Hearing about whether and how to restructure or liquidate this debtor.

D. Minimizing the Debtor's Contractual Liabilities

One of the more powerful and useful options furnished by the Bankruptcy Law is the ability for the Trustee to elect whether to reject or to continue to honor contracts entered into by the debtor. This means that a Trustee may retain only those contracts that are advantageous to the debtor's business and reject those contracts that, for whatever reason, are or have become unprofitable or burdensome.

The Trustee may compel the other party to a contract to continue to perform under its contract with the debtor, Article 65.1, though this other party may require the Trustee to elect whether he will keep the contract or not, Article 65.2. Even if the debtor has failed to pay under a continuing contract for goods or services that have been supplied, building up a considerable arrearage in payment, the Trustee may compel the supplier to continue to honor the contract, treating the unpaid arrearage as a bankruptcy claim. Article 67. Likewise, if the Trustee rejects a contract, the other party may only assert a claim for non-performance as a creditor in the bankruptcy, Article 65.3, including leases when the debtor was the lessee or tenant and the Trustee rejected the lease, Article 72.1.

In light of these statutory vehicles for compelling performance or rejecting unprofitable contracts, it is incumbent on a Trustee to review each of the debtor's contractual agreements and determine whether to retain and honor a contract or to reject it and create a bankruptcy claim for non-performance, finding a different, less expensive or more advantageous alternative. In fact, the very threat of rejecting a contract may allow the Trustee to re-negotiate more favorable terms with the contracting party. It is a decision, however, that the Trustee should try to make as soon as possible in order to prevent contracting parties who are continuing to provide goods or services from asserting a claim against the bankruptcy estate for their post-petition performance. Article 42.2. In FBiH, labor contracts with employees whose services are no longer required must be terminated in writing within 60 days of the opening of the bankruptcy proceeding. In the RS, these labor contracts are terminated by operation of law once the bankruptcy is opened. Article 74.1.

E. Avoidable Transactions

1. General Considerations

As its financial position sinks in the last months and weeks before bankruptcy, a debtor and its managers often engage in increasingly desperate efforts to stay afloat. They may pay off arrearages to one creditor in order to keep much needed supplies flowing or to avoid enforcement actions, while allowing arrearages to other creditors to mount up. They may grant a security interest pledging assets as collateral for an otherwise unsecured creditor to induce the creditor to continue doing business with the debtor. Sometimes insiders attempt to gain control of valuable assets without paying fair compensation or to transfer such assets beyond the reach of the creditors. To assure that similarly situated creditors are treated equally and that the estate is not

depleted on the eve of a bankruptcy, most bankruptcy laws allow such transactions that occur in the period before the bankruptcy to be reversed or "avoided."

Without such avoidance power, a bankruptcy law would not be able to fulfill its intended purpose of achieving "collective settlement" of all creditors' claims against the debtor. Article 2. A debtor could use all its assets to pay only one creditor in full, leaving other equally situated creditors unpaid. Or worse, a debtor could transfer its assets to a third-party for little or no compensation, leaving nothing for creditors. What is more, the avoidance power prevents creditors from jockeying for advantage and benefiting from a rush to dismember the debtor as he slides into bankruptcy. To prevent these and other inequitable situations, Articles 80 to 86 of the bankruptcy law contain various powerful provisions to avoid or undo such transactions so that assets transferred prior to bankruptcy may be re-claimed, drawn back into the bankruptcy estate, and re-distributed to all the creditors in accordance with the priorities established by the law.

As with most modern bankruptcy laws, the BiH law distinguishes two general categories of debtor's transactions that may be the subject of avoidance within the bankruptcy proceedings: *preferences* and *fraudulent transactions*, which are discussed below. The Trustee must remember that any claim, lawsuit, or potential lawsuit of the debtor, including an avoidance action, is a contingent asset of the bankruptcy estate that must be included in the inventory of the estate's assets and reported to the creditors. Because of the expense associated with initiating a separate lawsuit to pursue an avoidance action, the Trustee should seek the creditors' consent to pursue it, Article 29.6. Failure to identify and report the existence of potential avoidance actions to creditors in time for these actions to be pursued is likely to be regarded as a breach of the Trustee's duties and may subject him to direct personal liability.

In valuing the avoidance action, the Trustee will have to balance the legal cost to pursue it and the likelihood of success against the net amount at stake and the likelihood of recovering the amount even if he wins. In making this assessment, the Trustee must keep in mind the legal requirements to establish an action. In a preference action, for example, it is not enough to prove that the creditor received a payment when other creditors did not. The creditor will win if it proves that although it received a payment, there was no unfair advantage gained over other creditors because its pre-bankruptcy payment was equal to the distribution it would have received in the bankruptcy. See Article 80.1.

2. Preferences

A *preference* is a transfer -- including payment or providing security for payment -- to an existing creditor made before the commencement of the Bankruptcy Proceeding that has the *effect* of treating that creditor more favorably than other creditors in a similar situation. Articles 57 and 81. Notice that there is no requirement that either the creditor or the debtor have acted in bad faith; neither the creditor's nor the debtor's intention is relevant. The preferred creditor may simply have pursued its legal remedies more aggressively than other creditors. And since equality of distribution is the principal concern, it makes no difference whether the debtor voluntarily granted the security interest or made the payment, or whether the creditor obtained a judgment lien or compelled the payment. The avoidable preference may

well be the result of a valid court judgment or execution order. The purpose of allowing a Trustee to recover a preferential transfer is not punitive but corrective, restoring the *status quo ante* so that no creditor is rewarded for elbowing its way to the front of the line during the period before the bankruptcy.

Even transactions undertaken in good faith and supported by a valid court judgment or execution order, Article 80.3, may be avoided if:

- The *result* of the transaction is to benefit this preferred creditor at the expense of the other creditors. Article 80.1.
- At the time the legal effect of the transaction first became evident, the debtor was unable to pay its obligations or a petition for bankruptcy had been filed. Articles 80.2 and 81.
- The preferred creditor either knew or was grossly negligent in not knowing of the debtor's insolvency.
  - Creditors are presumed to know of the debtor's inability to pay or the filing of a petition to open bankruptcy proceedings if they knew of circumstances making this conclusion unavoidable. Article 81.3. Therefore, the Trustee is not required to prove that the preferred creditor had actual knowledge of the debtor's financial statements. The fact that the creditor had to institute enforcement proceedings or knew of enforcement proceedings instituted by other creditors, for example, may well be enough to trigger this presumption and establish that the creditor knew of the debtor's inability to pay its obligations.
  - Creditors who are "insiders," as defined in Article 87, are conclusively presumed as a matter of law to know of the debtor's inability to pay or the filing of a bankruptcy petition. Article 81.4.
- The legal effect of the transaction first became evident during the six-month preference period defined by Article 81.1.

Any lien, security interest, or other security obtained by a creditor within sixty days before the filing of the bankruptcy petition is ineffective as a matter of law, without regard to the creditor's knowledge. Article 57. Knowledge by the creditor is also not required if it obtained security or a payment that was unusual, such as a payment that the creditor did not have the right to demand at the time, in the month before the filing of the bankruptcy petition, or if the debtor was insolvent, in the three months before the filing. Article 81.2.

3. Fraudulent Conveyances

A *fraudulent transfer* is a transfer of an interest in the debtor's property to a third party either for less than full value, regardless of intent, *or* with the intent to harm creditors. The purpose is to prevent what would otherwise become property of the estate after the filing of a bankruptcy from no longer being available to pay the creditors as a whole and to prevent the debtor from placing property beyond the reach of these creditors. The bankruptcy law defines several different types of fraudulent transfers:

- A transaction in which the debtor transfers property for less than equivalent compensation may be avoided if it took place within five years before the filing of a bankruptcy petition. Article 82.
- A transaction undertaken by the debtor with the intent of harming a creditor may be avoided if it took place within five years before the bankruptcy petition was filed and if the other party to the transaction knew of the debtor's intent. The other party's knowledge is presumed if it knew the debtor was threatened with an inability to pay its obligations and the transaction would have the effect of harming creditors. Article 83.
- In many cases, the debtor's owners will advance funds to the debtor as it begins its descent into insolvency, characterizing this transaction as a loan and, often, taking security in the debtor's assets. Article 84 allows such transactions to be avoided if they should have been treated as capital infusions:

    - Interests in the debtor's property to secure repayment of such capital-replacing loans may be avoided if the transaction took place within five years before the bankruptcy petition was filed. Article 84.2.
    - The Trustee may recoup actual repayments of such capital-reducing loans if made within one year before the bankruptcy petition was filed. Article 84.3.

4. Procedural Issues

The Trustee may bring an avoidance action against the party receiving the benefit of the transaction. Article 85.4 and 85.6. A creditor may also bring an avoidance action if the Trustee does not bring the action within 30 days after the creditor's request. Article 85.2. Since the purpose of recovering the avoided transfer is to replenish the bankruptcy estate for fair and equal distribution under the bankruptcy law, avoidance actions are brought on behalf of the bankruptcy estate regardless of who brings the action. Article 85.1 and 85.5. This lawsuit may continue even after the conclusion of the bankruptcy proceeding when a plan of reorganization so provides. Article 184.3.

Avoidance actions, which are decided by the Bankruptcy Judge, Article 7.4.2, are initiated by filing a lawsuit within two years from the date the bankruptcy proceedings were opened. The avoidable transaction may also be submitted as a counter-claim or defense to a lawsuit, in which event this two-year time limit to initiate a lawsuit does not apply. Article 85.3.

Whenever possible, the Trustee should raise the avoidable transfer as a defense to the creditor's claim. For instance, the Trustee should object to a secured creditor's claim if this claim is based on an avoidable transfer of the lien or security interest. Although Article 115 places the burden of initiating litigation to resolve a contested claim on the Trustee when the creditor has "an enforceable title," title based on an avoidable transfer is arguably not enforceable, thereby shifting the burden of filing the lawsuit on to the creditor.

5. Identifying Avoidable Transactions

Because of the potential to recover funds or property for the bankruptcy estate, the Trustee must, in each case, scrupulously review all the debtor's transactions -- all transfers and payments to creditors and insiders – that occurred in the applicable period (generally six months for preferences; five years for fraudulent transfers; Articles 81.1 and 82-83). Of course, the older the transaction, the more difficult it will be to establish the nature of the transaction, the values of property and consideration exchanged, and (when required) the parties' intention.

Such recovered transactions represent a significant potential but hidden source of property with which to enhance the bankruptcy estate. How can the Trustee discover such transactions? In the first instance, he would be well advised to comb all the debtor's books and records, including accounting records, bank account statements, invoices, receipts, and correspondence, whether in tangible or electronic form, to reconstruct all payments made by the debtor and its affiliates to creditors or insiders and all transfers outside the ordinary course of business during the pertinent period of time. For a large and active business debtor, this may be a daunting task, requiring the Trustee to hire an accountant or other financial expert. In a sizable case, such expenditure may be warranted because of the likelihood of significant funds coming into the bankruptcy estate.

Fraudulent transfers and preferences may be uncovered not only through a careful study of the debtor's books and records, but also through interviews with the debtor's managers, employees, bookkeepers, and insiders. Other creditors, especially regular suppliers, who may be intimately familiar with the debtor's business affairs and history, are also an excellent source for such information. Indeed, it is not unusual, in other developed bankruptcy systems, for creditors who are aware of a substantial preferential payment or fraudulent transfer by a debtor to open a timely bankruptcy proceeding against this debtor primarily in order to recover the payment or transfer for the benefit of all the creditors *pro rata*.

F. Set-Off

Occasionally, a creditor in the bankruptcy proceeding will also be indebted to the debtor by virtue of some unsatisfied obligation. Reducing the creditor's bankruptcy claim to account for this creditor's own indebtedness to the debtor (when the debtor owes more to the creditor than the creditor to the debtor) is a typical kind of "set-off," for the one debt is set off against the other. A bankruptcy proceeding does not affect a creditor's lawful right to a set-off. Article 78.1. In calculating the claims of creditors, the Trustee is required to take rights of set-off into account, which he must estimate in calculating the liabilities of the bankruptcy estate. Article 94.3. See also, generally, Section 5 of this Manual.

If there is a condition subsequent that must first occur, however, then the creditor may not set off before the condition is satisfied. In the meantime, if the creditor furnishes adequate protection to the bankruptcy estate, any counter-claim by the Trustee will be stayed. Article 78.2. Moreover, under Article 79, certain creditors may not set off, including:

- Creditors whose debt to the estate arises after initiation of the bankruptcy;
- Creditors who acquired their claim after initiation of the bankruptcy;
- Creditors who obtained the set-off through a transaction that may be contested;
- Creditors who have claims also against property of the debtor not included in the bankruptcy estate; and
- Creditors who are insiders against whom the estate prevails on a claim to recover an avoidable transaction under Article 81.2.

5. Preparing the List of Creditors

The goal of bankruptcy proceedings is to maximize the payments to creditors with legally enforceable claims against the debtor and its assets. The Bankruptcy Law obligates the Trustee to compile a list of all the debtors' creditors he has been informed of or has discovered in the debtor's books and records and to file this list with the Court within 45 days of his appointment. Article 25.2. The Trustee's role in preparing this list of creditors requires him to:

- Provide an opportunity for all persons or entities with claims against the debtor or assets owned or used by the debtor to file and establish their claims with the Court;
- Review each claim to confirm independently that it is legally valid; and
- Categorize each claim correctly, so that the creditor is able to exercise its rights to participate in the bankruptcy proceeding along with other creditors of the same status and to receive the payments or property to which this status entitles the creditor.

A. Priority of Payment of Creditors' Claims

1. Four Categories of Creditors

In order to ensure that similarly situated creditors are treated the same, the BiH Bankruptcy Law categorizes claims based on the type of interest in the debtor's property and the timing of the claim. The law identifies creditors who have an ownership or secured interest in the debtor's property, and distinguishes between creditors of the bankruptcy estate (with post-bankruptcy claims) and bankruptcy creditors (with pre-bankruptcy claims).

The Bankruptcy Law recognizes four categories of creditors, each of which has different rights against the debtor and its assets. These four categories, in order of priority, are: Creditors with rights of separate recovery, secured creditors, expenses of the bankruptcy estate, and bankruptcy creditors. Only the fourth category – bankruptcy creditors – participates in the Creditors' Assembly and shares in the proceeds from the liquidation of the debtor's property.

a. *Creditors with rights of separate recovery* are persons or entities that have the right to take possession of property because this property is not owned by the debtor but belongs to this person or entity. Such creditors (extraction creditors) may not exercise their right to recovery before the Reporting Hearing, but may assert a claim against the bankruptcy estate for any loss in

value resulting from excessive wear of their property before the Reporting Hearing. After the Reporting Hearing, they are entitled to receive their property back – subject to the Trustee's right to seek the Judge's permission to offer adequate protection payments and continue to use the property in ongoing business activities – and may claim both lost value and compensation for the use of their property. Article 37.

b. *Secured creditors* are creditors who have obtained or been granted the right to satisfy their claims against the debtor from particular, specified assets, which serve as collateral for their claims. Examples of such rights include voluntary agreements by the debtor to grant a mortgage or security interest in the debtor's immovable (real) or movable (personal) property, liens arising as the result of a law or legal action, or creditors with the right to retain the debtor's assets that are in their physical possession. Article 38. Such creditors are entitled to receive either the property, or if the Trustee sells this property, the proceeds realized from the sale up to the amount of their claim (over-secured creditors). Such creditors may also become bankruptcy creditors if the debtor is personally liable to them and they either waive their secured claim or the value of the collateral is not sufficient to pay the claim in full (under-secured creditors). Article 39. In reality, an under-secured creditor actually has two claims – a secured claim up to the value of the collateral under Article 38 and an unsecured claim as a bankruptcy creditor of general priority under Article 32. Such under-secured creditors do not have the right to vote at the creditors' assembly as secured creditors but only as unsecured creditors with a claim for a deficiency. Article 28.2.

c. *Expenses of the bankruptcy estate* are claims that arise during and as a result of the bankruptcy proceeding. These claims must be paid in full before any payments are made to the bankruptcy creditors. Article 40. The BiH bankruptcy law divides this group of claims into two sub-categories, which have the same priority for payment:

   i. *Costs of the bankruptcy estate* include court costs of the bankruptcy proceeding, the fees and costs of the Interim Trustee and Bankruptcy Trustee, their experts, and members of the interim and the final Creditors' Committee. Article 41.

   ii. *Debts of the bankruptcy estate* include liabilities incurred by the Bankruptcy Trustee in the course of the management, liquidation, and distribution of the bankruptcy estate. Typically, these arise from contracts of the debtor that are not terminated by the Trustee, such as utility services, employee contracts that are not terminated, or new contracts entered into by the Trustee during the bankruptcy proceeding. Article 42.

d. *Bankruptcy creditors* are, with the sole exception of costs of the preliminary proceeding, creditors whose claims against the bankruptcy debtor arose before the filing of the bankruptcy case. Their claims are not linked to rights in a specific asset, but rather are ordinary obligations of the debtor. This category is divided into three priorities for payment, discussed in the next section. Higher priorities must be paid in full before *any* amounts may be paid to creditors of a lower priority. Creditors of equal priority and rank

share proportionally (*pro rata*) if there are insufficient funds to satisfy all the claims in this particular rank. Article 31.

2. Three Priorities of Bankruptcy Creditors

The three priorities of bankruptcy creditors, in order of priority, are:

a. *Bankruptcy creditors of higher payment priority* are further sub-divided into two heirarchical ranks:

   i. *Expenses of the preliminary proceeding* are expenses generated by the Interim Trustee during the preliminary proceeding that were not paid during that phase. These expenses must be paid in full before all other categories. Article 33.1.

   ii. Certain *labor expenses* are paid before all other expenses except the expenses of the preliminary proceeding. The debtor's employees are entitled to priority payment of unpaid wages accrued during the last eight months (in FBiH) or last six months (in the RS) preceding the opening of the bankruptcy proceeding. The maximum amount for each month is limited to the minimum wage provided by the General Collective Agreement for BiH. The same priority applies to social contributions required by law and compensation for damages for labor injuries. Article 33.2.

b. *Bankruptcy creditors of general priority* include the ordinary obligations of the debtor that are not included in either the higher or lower priorities. Article 32. Employees' claims for severance pay and damages as a result of premature termination of their contracts are also included in this priority. Article 74.2.

c. *Bankruptcy creditors of lower priority* consist largely of derivative, punitive, or gratuitous claims for which the debtor did not give value. This class has two ranks.

   i. The first, which has the higher rank, Article 34.1, includes:

      - Interest on the claims of the bankruptcy creditors arising after the start of the bankruptcy proceeding;
      - Costs of certain bankruptcy creditors incurred during their participation in the proceeding;
      - Fines, penalties, fees, and the consequences of certain criminal acts or misdemeanors that require cash payments;
      - Claims arising from acts the debtor performed gratuitously; and
      - Claims by the debtor's owners for repayment of a loan to replace capital or equivalent claims.

   ii. The second rank, which is paid after all claims of the preceding rank have been paid in full, consists of claims that have been assigned to this lowest priority and rank by agreement of the creditor and the debtor. Article 34.2.

Notice that bankruptcy creditors of lower priority do not have the right to vote at the creditors' assembly. Article 28.2.

B. Appointing and Working with an Interim Creditors' Committee

Before the initial creditors' assembly and the claims investigation hearing announced in the decision to open a bankruptcy proceeding, Articles 28.1 and 47.1.2, the Bankruptcy Judge may appoint an interim creditors' committee to serve until the assembly itself elects a creditors' committee, if the Judge believes such a committee is required to protect the interests of the creditors. Articles 22.3 and 29.2. The interim committee consists of an odd number of no more than seven creditors who make decisions by a simple majority of the members present. Article 29.4 and 29.5. The interim creditors' committee is a party in the bankruptcy proceeding, Article 3, and the fees and costs of the members of the interim committee are costs of the bankruptcy proceeding and must be paid first, Article 41.2.

Particularly at this initial stage, the Trustee must work very closely with the interim creditors' committee, if one has been impaneled, for this is the representative organ of the creditors, whose interests as a whole the Trustee has been appointed to protect and for whose benefit he serves. The Trustee may not undertake any significant legally binding actions without the approval of this impaneled committee, either at this stage or later. Examples set out in the law of significant legal actions requiring the committee's approval are:

- Assuming liabilities or obtaining a loan that significantly burdens the bankruptcy estate,
- Disposing of an entire enterprise, plant, or commodity warehouse,
- Disposing of the debtor's share of some other enterprise or the right to regular income,
- Disposing of or acquiring real estate, in whole or in part,
- Initiating, assuming, or defending litigation; declining to initiate litigation of significant value; or settling or resolving such litigation,
- Drafting a reorganization plan, and
- Moving to terminate the debtor's business.

Articles 29.6 and 108.2. In any event, at the outset, as the Trustee becomes familiar with the debtor's records, business affairs, operations, personnel, structure, and potential, he or she should proceed with extreme caution, considering such significant changes in the *status quo* only if they are absolutely necessary and only after the creditors have been fully informed and have freely consented. See the discussion of managing the debtor's business at Section 4.C of this Manual.

C. Establishing the List of Creditors

1. Requirements for Creditors to File Claims

In its decision announcing the opening of the Bankruptcy Proceeding, the Bankruptcy Court notifies all creditors to register their claims within 30 days. Article 46.1. All creditors, whether secured or unsecured, must file their claims in the bankruptcy proceeding in order to preserve their legal rights. Articles 46 and 110. The only

exception to this rule concerns creditors of the lower payment priority, who do not file claims unless and until the Bankruptcy Judge issues a specific summons for them to do so. Article 110.7.

A common misconception suggests that secured creditors or creditors with a right to separate recovery are free to pursue the remedies provided to them by other laws outside bankruptcy without regard to the requirements of the bankruptcy law. The Trustee must disabuse them of this erroneous notion. The bankruptcy law is clear that the Bankruptcy Estate is comprised of *all* property in which the debtor had rights, Article 30, and that only the Trustee can manage and dispose of assets of the Bankruptcy Estate. Article 51. The bankruptcy law is comprehensive and, by its nature, takes precedence over all other earlier or more general commercial laws that provide remedies for individual creditors outside bankruptcy. Otherwise, the purpose of the bankruptcy law – collective settlement of the creditors' claims – cannot be completely and fairly achieved.

Creditors must identify and document the legal basis for their claims. Articles 110.1 and 110.8. Secured creditors are required to indicate the amount and legal basis of their claims, to identify the property that secures the claim, and to state the amount of their claim that they expect will not be covered by the collateral (the unsecured part), as well as the amount covered (the secured part). Articles 46.2, 110.1, 110.5, and 110.6. Creditors with rights of separate recovery must likewise identify the legal basis for their rights and, presumably, the specific property they claim to own. Articles 37.3 and 110.1.

Creditors should comply with the Court-ordered statutory deadline requiring them to file their claims within 30 days of the announcement of the decision to open the Bankruptcy Proceeding in order for the Trustee to be able to review the claims, assess what assets are available to satisfy them, and make his report to the creditors' assembly. If creditors, including secured creditors and those with rights of separate recovery, are allowed to forego filing their claims or to file whenever they wish, then the process of delimiting the claimants against the property in the bankruptcy estate becomes impossible. Accordingly, the Trustee and the Bankruptcy Judge must insist unequivocally that creditors either file their claims in a timely manner or accept the consequences.

2. Investigation and Examination of the Creditors' Claims

The hearing at which the filed claims will be examined (Claims Examination Hearing) must be held before or at the same time as the Reporting Hearing at which the creditors will decide on the subsequent development of the bankruptcy case. The Examination Hearing, in turn, may be held no sooner than eight (or later than 30) days after the 30-day deadline for filing claims announced by the Bankruptcy Judge in the Order opening the bankruptcy case. 46.1 and Articles 47.

The Court will prepare a Table of Claims, which will be deposited at the registry of the Bankruptcy Court no later than eight days before the Examination Hearing to allow concerned parties an opportunity to inspect this Table. Article 111. The Table will contain the information that Article 110 requires the creditors to provide in the claims they file in duplicate with the Bankruptcy Court:

- The name and registered offices or residence of the creditor,
- The legal basis and amount of the claim in the national currency,
- The number of the creditor's account,
- If the claim is subject to a pending lawsuit, the Court where the proceeding will be conducted and the file reference number, and
- If the claim is secured, which of the bankruptcy debtor's assets secure the claim and the expected amount of the claim that is secured and that is not secured.

Significantly, besides this information, the creditors must submit "proofs justifying the claims." Article 110.8. A claim filed without disclosing the legal basis of the claim or without documentary proof of its validity is defective and should not participate in the distribution.

In addition, the Trustee is required to compile a register of all the claims of the debtor's current and previous employees incurred before the opening of the bankruptcy proceeding for them to sign in two copies, though these employees may increase the claimed amount if the Trustee has not included their claims in full. Article 110.3. These employees' claims, of course, will also be included in the Table of Claims.

Since the Trustee himself has the duty to prepare a well-organized summary including a list not only of all the assets but also of all the liabilities of the debtor, Articles 25.2 and 95.1, which he must file with the Court within 45 days of his appointment, Article 25.2, and no later than eight days before the Reporting Hearing, Article 96, which may be held simultaneously with the Claims Examination Hearing, Article 47.2, the Trustee will be pressed for time to become thoroughly familiar with the liabilities of the debtor by the time of the scheduled Examination Hearing.

One of the principal functions of the Trustee is to review and investigate all the claims filed in the case. Since the Trustee owes a fiduciary obligation to the entire pool of creditors, whose collective settlement he is charged with realizing, he is obligated to object to any defective claims, thereby enhancing the *pro rata* share of the remaining creditors. Articles 114.1, 115, and 28.2. In investigating and contesting claims, the Trustee should be familiar with the substantive, procedural, and formal requisites for a valid, enforceable claim of the given type and priority and should appear at the Examination Hearing prepared to challenge any deficient or inadequately supported claim included in the Court's Table of Claims, asking the Bankruptcy Judge to note the objection in the entry for such claims in the Table and confirming that it has been entered.

Among the grounds for objecting to claims, the Trustee should consider at least the following:

Form

- The proof of claim does not include the information required by Articles 110.1, 110.2, and 110.4-6.

- The proof of claim lacks "proofs establishing the claim" as required by Article 110.8.

Parties

- The debtor is not the contracting party (*e.g.*, the creditor filed the claim against the debtor who used the money but was a stranger to the contract).

- The creditor making the claim is not the contracting party, typically because:
  - The claim was assigned to a third party by the initial creditor (Article 436 of the Law on Obligations), or
  - The claim has been assumed by a third party (Article 446 of the Law on Obligations).

Accord and Satisfaction

- The debt has been paid, in whole or in part (by the debtor or by a third party).

Amount

- The claim has not been calculated correctly (duplication, errors in arithmetic, failure to credit payments, *etc.*).

Interest

- The method used to calculate default interest (contractual or legal) is erroneous, violating Article 400 of the Law on Obligations.

Setoffs & Counterclaims

- The Trustee can establish a setoff against this claim under Article 94.3.

- The Trustee can establish a preferential or fraudulent transfer to the creditor as a counterclaim. See Article 85.3.

Contract

- The contract is not legally binding. Articles 26 and 31 of the Law on Obligations.

Performance

- The obligation of one contracting party has not been performed (*e.g.*, the Fund for Health Insurance) and therefore there is no obligation of the other party to perform. Article 122 of the Law on Obligations.

- The creditor's obligations under the contract have not been properly performed. Articles 122, 148, and 124 of the Law on Obligations.

Claim Unenforceable

- The claim is considered satisfied. Articles 336-347 of the Law on Obligations.

- The claim has been remised. Article 348 of the Law on Obligations.

Statute of Limitations

- The claim is beyond the statute of limitations, which applies to all claims, including wage, contractual, and tort claims. Articles 360-393 of the Law on Obligations.

3. The First Assembly of Creditors (Claims Examination Hearing)

The claims examination hearing constitutes the first assembly of the creditors in the bankruptcy proceeding, since it is at this hearing that the Bankruptcy Judge, after examining the claims filed, will define the initial pool of creditors participating in the bankruptcy. The Trustee, creditors who have filed claims, and others involved with the debtor who have information to submit about the claims attend the hearing. So long as all the creditors who filed claims were notified of the date of this hearing, the hearing to examine the claims will take place even though some of these creditors are absent. Article 112. The Bankruptcy Judge chairs this creditors' assembly, Article 28.4, and examines the claims filed by the creditors, Article 112.1.

The Trustee must declare at the hearing which specific claims he officially recognizes and which are contested, including for secured claims his determination of the extent, if any, that the claim is actually unsecured. Article 114.1. The law does not require the Trustee to state the basis of his or her objection to a claim, but it may be prudent to indicate concisely the basis of the objection to prevent misunderstandings (and due process arguments) when the claim is subsequently litigated. Needless to add, the Examination Hearing is not a forum to debate the merits of the claim with the creditor.

If a claim is entered in the Table of Claims as officially recognized, *i.e.*, without objection, this entry has the effect of a final judgment fixing both the priority and amount of the claim. Article 114.3. If the Trustee (or another party) contests a claim at the examination hearing, the burden shifts to the creditor to commence a lawsuit within 30 days, unless the creditor has enforceable title, in which event the Trustee must file the lawsuit. Article 115. The decision after the litigation on the validity of a contested claim is binding on the Trustee and all the creditors; if the creditor with the contested claim prevails, he may require the Trustee to correct the Table of Claims. Article 116.

If proposed by the Trustee, claims filed after the deadline to file may be examined at this hearing. Article 113.1. Claims filed within three months after the examination hearing but before the notice of the final hearing will, on motion of the creditors involved, be examined at one or more separate examination hearings if the late-filing creditors jointly deposit the costs of these subsequent hearings within 15 days. Article 113.2. Claims filed after the notice of the final hearing will be disregarded. Article 113.4.

With the consent of the creditors' committee, if one has been impaneled, or of the creditors' assembly, the Trustee may begin making interim distributions after the examination hearing. Article 117.

6. The Trustee's Role in Working with Creditors

A. The Creditors' Assembly; Creditors' Voting Rights and Procedures

The purpose of bankruptcy is to provide for the claims of the creditors as a whole in accordance with the priority scheme established by the law. Articles 2.1 and 31. The principal innovation that enables this objective to be achieved is the creation of a creditors' assembly, a democratic institution that enables a majority of the participating creditors (in both number and amount of debt) to decide on the approach that the Trustee should use to achieve collective settlement of their claims, and to bind minority creditors to the settlement approved by the majority.

In order to be legally valid, a decision of the creditors' assembly requires approval by *both* a majority of the creditors present *and* a majority of the amount of the debt represented by the creditors present at the meeting. Article 28.4. The right to participate in the creditors' assembly depends on the nature and validity of the creditor's claim and compliance with the procedures of the Bankruptcy Law. Only creditors who have filed claims that were not contested by the Trustee or another creditor are entitled to vote in the creditors' assembly. Article 28.2. Nevertheless, the Bankruptcy Judge may decide to grant a creditor with a claim that is contested but seems probable the right to vote. Article 28.3. In any event, only bankruptcy creditors of the higher and general payment priorities may vote in the creditors' assembly; creditors of the lower payment priority do not have the right to vote. Articles 28.2 and 34. See also Section 5.A.2 of this Manual.

Be aware that at the first assembly of creditors, pursuant to Article 28.5, five or more creditors who represent at least one-fifth of the amount of the reported claims may propose to replace the Trustee. Fortunately, though, it is the Bankruptcy Judge who decides whether to appoint the creditors' newly elected candidate and who may refuse this appointment if the creditors' candidate is, in his judgment, biased or inappropriate or unqualified under Article 23. Although the Judge's ruling is subject to appeal, the appeal does not stay the ruling.

The Bankruptcy Judge in his decision announcing the opening of the bankruptcy proceeding sets the first two meetings of the creditors' assembly -- the Claims Examination Hearing and the Reporting Hearing. Article 47.1. The first creditors' assembly necessarily serves also as the claims examination hearing at which the creditors' claims and right to participate are established. The date of this hearing must be scheduled between eight and 30 days after the conclusion of the 30-day period for creditors to register their claims. Article 47.1.2.

During the interval between the claims registration deadline and the Claims Examination Hearing two events take place. First, the Court must prepare and deposit in its registry a Table of all claims filed within eight days after close of the 30-day period for creditors to file their claims. Article 111. Secondly, this interval allows the

Trustee to review the claims that have been filed or that he learns of from the books and records, and to prepare objections to those claims that do not establish a sufficient legal basis for allowance. Articles 114.1, 115, 25.2 and 95.1. See Section 2.C.2 of this Manual.

The second mandatory meeting of the creditors' assembly is the Reporting Hearing. The date of this meeting is also set in the Bankruptcy Judge's decision announcing the opening of the Bankruptcy Proceeding. This hearing must be held not later than 15 days after the Claims Examination Hearing, Article 47.1.1, but both hearings may be scheduled at the same time, Article 47.2. The purpose of this hearing is for creditors to hear the Trustee's report about the value of the bankruptcy estate and his recommendations about whether creditors will be better served by liquidating the assets in the estate or by reorganizing the debtor. Articles 47.1.1 and 98.1. At this hearing, the creditors' assembly will decide whether the debtor's business activities should continue, whether and how the Trustee should liquidate the debtor's assets, or whether to instruct the Trustee to prepare a reorganization plan. Article 99.

Other meetings of the creditors' assembly may be convened by the Trustee, by the creditors' committee, or by at least five creditors who jointly represent at least one fifth of the reported amount of claims. Article 28.1. The Bankruptcy Judge presides over the meetings of the creditors' assembly. Article 28.4.

B. Formation, Rights, and Responsibilities of the Creditors' Committee

In theory, establishing a creditors' committee will empower the creditors' assembly to pursue their objectives more efficiently. It may be prohibitively expensive for each creditor to represent itself in all aspects of the bankruptcy proceeding. Although each creditor is certainly entitled to hire its own attorney, attend meetings, raise objections, and vote, the cost may soon significantly offset the amount the creditor is likely to recover on its claim. When the rights of creditors are essentially identical, it makes sense for them to organize themselves by forming a committee of a few selected representatives that will act in their behalf for the benefit of the whole body of creditors.

Creation of an effective institution to represent creditors' interests is especially important under the BiH bankruptcy law because so many of the actions that the Trustee must take require explicit prior consent of the creditors. Articles 29.5, 29.6, and 108. See Table of Trustee's Responsibilities to Creditors, Appendix 6C, and also Section 5.B of this Manual. Most bankruptcy laws in other countries allow more latitude for the Trustee to act, usually requiring only that he give prior notice to creditors so that they can object if they disagree, rather than requiring approval in advance.

Arguably, the bankruptcy law restricts the creditors' assembly by dictating the composition of the creditors' committee that represents the assembly. Article 29.3 specifically requires that the Committee include representatives of each of the following four groups:

- Bankruptcy creditors with the largest claims;
- Bankruptcy creditors with the smallest claims;

- The debtor's employees; and
- Secured creditors.

In contrast to the creditors' assembly, the committee makes its decisions on the basis of a simple majority of the members present, without regard to the amount of debt they represent. This voting procedure relies on the assumption that the members of the committee represent the entire body of bankruptcy creditors, and not individual factions, special interests, or only their own claims. Though evidently intended to create a cross-section of the creditors on the committee, the statutory requirement that the committee include representatives of distinct factions undermines the goal of having the members represent the interests of the entire creditor body.

Requiring that specific categories of creditor be represented on the committee can produce deadlock and confusion. It may well result in a committee that does not actually represent the interests of the majority of creditors and makes different decisions than the creditors' assembly would have made. The committee must include representatives of the four creditor groups, which have very different interests, regardless of the amount of debt they represent. Decisions by the committee require that a majority of the members attend and the decision be adopted by a majority of those present. Article 29.10. Therefore, it is entirely possible that a majority of the committee's members, representing a minority of debt, can take decisions that are adverse to the interests of the majority of creditors and of the debt. Decisions by the creditors' assembly require a majority of creditors present and of the debt represented by the creditors present, Article 28.4, ensuring that in the creditors' assembly, at least, the majority controls.

One peculiarity in the composition of the committee is that a representative of the secured creditors must be included, even though fully secured creditors are not entitled to vote in the creditors' assembly except and only to the extent that they are also under-secured bankruptcy creditors. Article 28.2. What purpose is there in including such creditors on the committee that represents the assembly of creditors?

The Trustee can help the creditors' assembly avoid the dangers of electing an unrepresentative committee in several ways:

- The Trustee might explain the problems created by the law to the creditors at the first creditors' assembly, which takes place with the claims examination hearing.
- The Bankruptcy Law requires that the Committee consist of an odd number of members not to exceed seven. Article 29.4. Only four of the seven possible slots are allocated to specific creditor interests. Article 29.3. The Trustee could suggest that the assembly consider electing additional representatives to the Committee that would represent the interests of creditors holding a majority of the debt.
- The creditors' assembly may but is not required to elect a creditors' committee, and may instead carry out the committee's functions directly. Articles 29.1, 29.6, and 108. Regular attendance and active involvement at meetings to advance the interests of the majority of the creditors may be able to turn the creditors' assembly into an efficient, *de facto* representative committee.

Professionals who are not creditors themselves but who have special knowledge or expertise useful to the committee in carrying out its role may also be appointed as members of the Committee. Article 29.3.

The Bankruptcy Judge may dismiss a member of the committee, either on his own or at the request of another member or of the creditors' assembly. Article 29.7. The Bankruptcy Judge must be invited to all Committee meetings; the Trustee may also attend, though the Committee may decide to exclude him. Article 29.9. Article 237 governs the compensation for members of the committee.

C. The Trustee's Relationship with the Assembly and with the Creditors' Committee

Individual creditors may well regard the Trustee as their employee. This view is fundamentally wrong: The Trustee is an independent institution within the bankruptcy process and a separate party, Article 3; he is appointed by the Bankruptcy Judge, Article 22.3, and answers to the Bankruptcy Judge, Article 27. While the creditors' assembly is entitled to propose a new Trustee, it is the Bankruptcy Judge who decides whether to replace the original Trustee with the creditors' candidate. Article 28.5.

Although the Trustee is not the creditors' employee, he does represent their interests, not individually, but as participants in the bankruptcy process of collective settlement that provides specific legally defined and prescribed rights. The Trustee has a fiduciary duty to the entire body of creditors, a statutory obligation to preserve and protect the property of the estate, and a quasi-judicial role as the eyes and ears of the Bankruptcy Judge. Accordingly, it would be more accurate to say that the Trustee represents the process itself, which he is directed to implement and consummate. The Bankruptcy Law reserves to the creditors collectively, acting through either their assembly or the committee, the authority to make many of the major decisions affecting the bankruptcy proceeding. See, Table of Trustee's Responsibilities to Creditors, Appendix 6C. The guidance and practical advice of a seasoned Trustee will be indispensable to creditors in deciding wisely and effectively based on the likely outcome of their proposed course of action. Once their decision is made in accordance with the law, of course, the Trustee is responsible for carrying it out conscientiously and to the best of her ability.

Creditors may also be of great benefit to the Trustee in actually administering the bankruptcy estate. They are likely to know the debtor's business affairs and history far better than the Trustee does when appointed. Although the Trustee plays no formal role in the selection of the members of the creditors' committee, the Trustee should consider the possibility of encouraging certain creditors to serve on the committee if the Trustee believes that their participation would be beneficial to efficient administration of the case.

D. The Second Assembly of Creditors (Reporting Hearing):

1. Trustee Reports on the Debtor's Economic Situation, Prospects for Restructuring, and Possibilities for Liquidation of Creditors' Claims.

The first assembly of creditors, when the claims examination hearing must take place and the creditors may elect a creditors' committee, may be scheduled for the same time as the second assembly of creditors, the reporting hearing, Article 47.2, which in any event must occur no more than 15 days later, Article 47.1.1. Pursuant to Article 96, at least eight days before this reporting hearing, the Trustee is required to deposit with the Court registry, for inspection by interested parties, the following:

- An inventory of the assets in the bankruptcy estate, stating the value of each asset, including both the liquidation and going-concern value for the assets of a debtor who is still in business, Article 93,
- A list of all the bankruptcy debtor's creditors, including secured creditors, classified by payment priority, stating the address, basis and amount of each creditor's claim and any set-off, and for secured creditors, identifying the collateral and probable indebtedness, Article 94,
- A well-organized summary of the assets of the bankruptcy estate and the liabilities of the debtor at the time the bankruptcy proceedings were opened with an estimate of how much of the bankruptcy estate will be available to satisfy the bankruptcy debtor's creditors, Article 95.

The Trustee is required to prepare this material within 45 days of his appointment. Article 95.1. Notice that, since the reporting hearing may occur as soon as 38 days after the opening of the bankruptcy, along with the claims examination hearing, and the Trustee is required to deposit this material at least eight days prior to the hearing, in reality the Trustee may have only 30 days to pull all this information together and prepare his report.

Of course, this inventory of assets, list of creditors, and organized summary with the Trustee's estimate of what will be available for creditors, along with any adjustments required once the Court establishes the Table of Claims, Articles 111 and 114.3, will form the background for the Trustee's analysis of the debtor's financial circumstances and prospects and for his recommendations to the creditors at the reporting hearing on how to go forward.

2. Creditors Decide Whether and How the Debtor Will Be Liquidated or Restructured

At the reporting hearing, pursuant to Article 98.1, the Trustee must present a report on the debtor's financial position and its causes, explaining:

- whether there is any likelihood of saving part or all of the debtor's business,
- what prospects there are for a restructuring plan, and
- what the expected results would be for satisfying the creditors.

The debtor and the creditors at the hearing may comment on the Trustee's report. Article 98.2. After this opportunity to comment and, presumably, question the Trustee, the assembled creditors must vote to decide whether to shut the business down or to continue the operation on a provisional basis. Articles 99.1. The creditors may also direct the Trustee to prepare a plan of reorganization and may specify the purpose of the plan. At later hearings, however, the creditors are free to rescind this decision. If the creditors vote instead to liquidate the debtor, they may also decide how and on what terms to sell the property. Article 99.2.

Needless to say, the Trustee's report and recommendation to the creditors at this hearing are critically important, for the creditors' assembly "will, on the basis of the report of the Bankruptcy Trustee, decide on the subsequent development of the bankruptcy proceeding." Article 47.1.1. In addition, this reporting hearing will provide the first opportunity for the Trustee to share with the creditors the results of all his hard work in assembling the necessary information, analyzing the debtor's history and present circumstances, and making a coherent and persuasive recommendation about whether and how to liquidate or reorganize the debtor. Indeed, if the first (claims examination hearing) and second (reporting hearing) assemblies of creditors are held together, this may be the first time that the Trustee addresses the creditors as a body. It is in the Trustee's interests, as a matter of duty, professional pride, and reputation, to take the time and trouble to present the most comprehensive, well-supported, and articulate report to the creditors of which he is capable. It is at such a combined assembly, after all, that the creditors are entitled to elect a new Trustee. Article 28.5.

E. Dealing with Employees: A Digression

The debtor's employees represent a distinct and important group in the bankruptcy proceeding that deserves particular understanding and consideration from the Bankruptcy Trustee. If the employees are not satisfied that their interests are being taken into account and that they are being treated fairly, they may refuse to cooperate with the Trustee, act to oppose or undermine the proceeding, or even collectively go out on strike. What is more, in many cases the former and current employees may represent the numerical majority in number of claims (if not the majority in amount of the claims) for unpaid wages and benefits, Article 28, thereby effectively blocking any favorable vote. On the other hand, cooperative employees may be very helpful to the Trustee in identifying, locating, and valuing the property of the estate; in determining what property (real estate, machinery, and equipment) may be indispensable to the debtor's continued operation; and in uncovering fraudulent transfers and preferences. Articles 80-87.

It is important to appreciate that employees participate in the bankruptcy in two quite different capacities – as "insiders," in their capacity as the debtor's present or former work force, Article 23.4.6, and as creditors, in their capacity as claimants for unpaid wages and benefits. In addition, they may be members of unions (syndicates) that will advocate on their behalf. Many workers (and unions) naturally identify bankruptcy with failure, associate bankruptcy with the loss of jobs, and think only of liquidation rather than reorganization. They are therefore sometimes inclined to attribute the debtor's difficulties to the bankruptcy itself, confusing the cure with the

disease. In any event, ignorance or fear of the consequences of the bankruptcy proceeding will make the workers hostile to the bankruptcy and therefore to the Trustee.

Accordingly, it is most important that a Trustee take the time and trouble, at the very first opportunity, to meet with the workers and their representatives to explain how bankruptcy works and to answer their questions. The employees, some of whom may have worked with the debtor for many years, are understandably uncertain and concerned and will want to know what they can expect, the benefits of participating in the proceeding and cooperating with the Trustee, and what the prospects for reorganizing the company in bankruptcy are. This may apply to the union and its representatives as well, who, though they may not be parties or have any independent status in the bankruptcy proceeding, may nevertheless help to educate the workers and gather information useful to the Trustee and of value to all the debtor's creditors. (Parenthetically, a Trustee who develops good relations with the union or workers' representatives and is familiar with their problems may find work as a private trustee, retained by these groups in other cases and, perhaps, representing their interests on the creditors' committee as a person who can contribute professional knowledge under Article 29.3.) The bankruptcy law recognizes the special position of workers in various provisions and the Trustee should be thoroughly familiar with these provisions.

In FBiH, within 60 days of the opening of the bankruptcy proceeding, the Trustee must terminate in writing the labor contracts with employees whose services are no longer required; in the RS, these labor contracts are terminated by operation of law once the bankruptcy is opened. Article 74.1.

The debtor's employees are entitled to priority payment of unpaid wages accrued during the eight months (in FBiH) or six months (in the RS) immediately preceding the opening of the bankruptcy proceeding. The maximum amount for each month is limited to the minimum wage provided by the General Collective Agreement for BiH. This same priority applies to social contributions required by law and compensation for damages for labor injuries. Article 33.2. These claims are paid before all other creditors except unpaid claims incurred during the prelimary proceeding. In the preliminary proceeding, the Interim Trustee is obligated to pay the wages and contributions of workers actually employed during the preliminary proceeding, although precisely what must be paid is far from clear in Article 17.3.

All other claims for unpaid wages or benefits are classified in the general payment priority, however, and are paid with the debtor's other general unsecured creditors. Article 32. The employees' claims for severance pay and damages as a result of premature termination of their contracts are also included in this general payment priority. Article 74.2.

The claims of employees are also specially treated because the Trustee has an affirmative duty to find and compile a register of all the claims of the debtor's current and previous employees incurred before the opening of the bankruptcy proceeding for them to sign in two copies, though these employees may increase the claimed amount if the Trustee has not included their claims in full. Article 110.3. These employees' claims, of course, will also be included in the Table of Claims.

Special treatment is also accorded employees in that the creditors' committee must include a representative of the debtor's employees. Article 29.3. What is more, employees who are bankruptcy creditors, Articles 147.3 and 33.2, must be separately classified in a plan of reorganization. Employees should also be aware that such a plan of reorganization may provide for satisfying the claims of this class with shares of stock in the reorganized debtor. Article 142.2.

7. Liquidating (Realizing on) the Bankruptcy Estate

A. General Considerations:

The Trustee's sale of the assets of the debtor is among the most obvious and potentially controversial events in a Bankruptcy Proceeding. For this reason, it is essential that the Trustee conduct the process with the greatest transparency possible to avoid objections and criticism. Throughout the process of selling the assets, the Trustee must demonstrate scrupulous honesty, both in fact and in appearance. At the heart of the Trustee's fiduciary role is avoiding even the appearance of impropriety. The Trustee must be able to demonstrate that he acted with the highest level of competence and care. At a minimum, all sales of assets must be performed done in strict compliance with the law, applicable regulations, and best custom.

It is likely that the new rules on compensation of Trustees that will be issued by the Ministry of Justice, Article 237.1, will link the Trustee's remuneration directly to the amount of assets sold and the distribution to creditors. Whatever compensation system is eventually adopted, Bankruptcy Judges and creditors will learn to identify which Trustees are best able to realize on assets and it is such individuals who will consistently be appointed or elected as Trustees. Articles 22.3 and 28.5. A Trustee who cannot find and sell assets will not make money himself. So it is important for a Trustee to become proficient in the skills of grouping, marketing, and advertising assets in a manner most likely to attract the highest number of qualified bidders. And it is critical to develop a reputation in the community among creditors and buyers that the Trustee is professional, trustworthy, and transparent.

The Trustee does not have free reign to carry out the liquidation of the assets in the bankruptcy estate. Ordinarily, he may not begin to liquidate assets until the Reporting Hearing, after which he "must immediately liquidate" the assets, Article 101.1, unless the creditors' assembly or creditors' committee decides otherwise, Article 101.2. In any event, the Trustee is required to obtain the prior consent of the creditors for any important legal action that will affect the value of the estate, including the sale or transfer of assets. Article 108. What is more, if the creditors at the Reporting Hearing decide to liquidate rather than reorganize the debtor, they may also decide how and on what terms to sell the property. Articles 99.2 and 101.2. Of course, the creditors' instructions must comply with the specific legal requirements for liquidation of real and personal property set out in Articles 102 through 107.

It is in the interplay between the creditors' directives, the requirements of the law, and the Trustee's judgment on the most effective way to sell the assets that potential problems may arise. Suppose, for example, that the creditors' assembly decides that

the entire bankruptcy estate should be sold to a foreign investor as a "going concern," and that a creditor secured by the debtor's real (immovable) property consents. Should the Trustee comply with this instruction or, if it would be more advantageous, insist on selling the property using the coercive execution proceedings referred to in Article 102.1? What if a creditor secured by personal property does not consent but it is clear that the direct sale as a going concern will pay him as much or more than he would have received using the execution procedures? See Article 104.2. When such a situation arises, the Trustee should seek the Court's explicit approval to carry out the creditors' instruction. For the Court is specifically authorized to deny the secured creditor's enforcement rights if the Trustee provides adequate protection of the creditor's rights. Article 58.5.

Generally, in cases of such conflicting approaches to the liquidation of the property of the estate, it would be prudent for the Trustee to bring the matter to the attention of the Bankruptcy Judge, under whose supervision he performs his duties, and to obtain an official ruling. Articles 22.1 and 27. Keep in mind, also, that "an ounce of prevention is worth a pound of cure." A cogent, thorough, and well-documented report presented to the creditors at the reporting hearing should eliminate or reduce to a minimum the chances of such irreconcilable conflicts arising.

B. Liquidating Immovable (Real) Property:

For *immovable (real) property***,** the Trustee should first attempt to liquidate the property by following the procedures of the law on coercive executions. Article 102.1. These procedures require obtaining an appraisal and offering the property for sale at up to three advertised public auctions. The minimum price at the first auction is 50% of the appraised price, dropping to one-third at the second, and with no minimum at the third. Each of these auctions must be held at least 30 days apart.

If the auction process fails, then the Trustee may try to negotiate a direct sale to an individual buyer. Article 102.1. If the property is collateral for a secured debt, the Trustee must obtain the consent of the creditor, Article 102.4, who has the right to inspect the property before sale, Article 102.5. The Trustee is entitled to receive at least 5% of the proceeds from the sale of the collateral for the benefit of the estate, regardless of the amount of the secured creditor's claim. Article 102.4. This represents the cost to the estate of verifying the creditor's claim and liquidating the asset for the creditor's benefit. These costs may be described generally as those specific expenditures so directly and inextricably related to the sale of a specific asset that they are more appropriately categorized as a component of its sale rather than as a part of the general overhead of administering the bankruptcy estate. Such costs vary from case to case and depend on the circumstances. For example, the fee paid to a professional auctioneer or the cost of advertising the asset would be considered a direct cost of its sale. If the auction or advertising covered more than one asset, however, then the cost would either need to be apportioned or considered general expenses of administering the bankruptcy estate. Expenditures of a general nature not closely connected to an asset are not direct costs of sale. Apportioned storage costs or warehouse security, for example, would not be a direct cost of sale, but general expenses of administering the bankruptcy estate.

Immovable property (real estate) that can not be sold using the procedures of the law on coercive execution or by direct sale must either be distributed to the creditors in proportion to their claims, Article 102.2, or if the creditors are unwilling to accept the property, then turned over to the debtor's owners, Article 102.3. The Trustee's failure to dispose of *all* property may result in creating an anomalous situation where the legal owner of the property does not exist. See Article 140.3.

C. Liquidating Movable (Personal) Property and the Debtor's Claims Against Third Parties (Rights)

The Trustee may liquidate personal (movable) property in his possession either by public auction or direct sale, even if it is subject to a creditor's security interest. Article 103.1. The Trustee may also realize on secured personal property in his possession by turning the asset over to the secured creditor to sell. Articles 104.3. On request of the secured creditor, the Trustee must either provide the creditor with information about the property or permit an inspection. Article 103.3. At least eight days prior to sale, the Trustee must notify the secured creditor of the conditions of the sale and give the creditor an opportunity to produce a better offer and proof of the proposed buyer's solvency. Article 104.1. If the secured creditor produces a better offer within the time allowed, the Trustee must either sell to the new buyer or put the creditor in the same position as if the property had been sold on the terms of the offer produced by the creditor. Article 104.2.

The Trustee may deal with a claim of the debtor's against a third party by accepting payment, transferring the claim for liquidation by a creditor who has a security interest in the claim, or other means, even if the debtor has assigned the claim as collateral to a creditor. Articles 103.2 and 107.1. As with personal property, the creditor secured by the property has the right to receive information about the claim, Article 103.4, and prior notice of the conditions of any sale and an opportunity to produce a better offer. Article 104.

Secured creditors may liquidate personal property in their possession. Article 107.1. At the request of the Trustee, the Bankruptcy Judge may set a deadline by which the creditor must complete liquidation or the Trustee will be allowed to liquidate the asset. Article 107.2.

Pursuant to Article 105.1, the proceeds from the Trustee's liquidation of personal property and rights are distributed in the following order:

- Costs of the bankruptcy estate related to the identification of the property and the rights of secured creditors in the property and to its liquidation;
- Satisfaction of the secured portion of the claims of secured creditors; and
- As provided by law.

A creditor who liquidates property or rights transferred to him by the Trustee must pay to the Trustee the Trustee's costs in determining the creditor's rights in the property and the amount of any taxes due on the transaction. Article 105.2. The bankruptcy costs of identifying the property and secured rights are presumed to be 5%. The Trustee is entitled to retain or receive either 5% of the realized sales price or the actual costs, whichever is greater. Articles 105.3 and 105.4.

D. Strategies for Maximizing Liquidation Value

The types of assets a Trustee may encounter are diverse. Beyond the general requirements stated in the law, there are no specific rules on how best to market assets. Methods will vary depending on the type of asset. It is difficult, therefore, to discuss the best practices for selling assets with broad generalities. Maximizing value for creditors requires that the Trustee bring a variety of important skills to bear on the goal of getting the best price in the least amount of time.

1. Time Is Money

The bankruptcy law rightly emphasizes the importance of quick action. Bankruptcy is defined as an "urgent" proceeding, Article 9.1, and the Trustee must "immediately liquidate" the assets after the Reporting Hearing, Article 101.1. Assets should be disposed of as quickly as legal procedures and an effective marketing and sale process permit. Holding assets imposes two kinds of costs: first, the longer they are held, the higher the cumulative carrying costs. These carrying costs are considered costs of administering the bankruptcy estate, ranking at the first priority, Article 40, thereby reducing the amount the other creditors will recover from the estate. The second cost relates to the time-value of money — a Euro today is necessarily worth more than a Euro next week, which is worth more than a Euro next year.

Unless these costs are more than offset by an increase in value from delaying the sale, the sum available to distribute to the bankruptcy creditors will necessarily be smaller both in amount and in value as more time passes. For most assets, the value will depreciate. The Trustee must therefore act quickly to gain an understanding of the nature and extent of the assets in order to market them properly and sell them to advantage. Failure to sell the assets expeditiously may expose the Trustee to accusations that he has passively allowed the net value of the estate potentially available for distribution to the bankruptcy creditors to decline while allowing the level of senior claims to continue to accumulate. The law specifically provides that the Trustee will be liable for losses to secured creditors caused by delay in liquidating property subject to the rights of secured creditors. Article 106.

2. Obtaining Accurate Appraisals

Liquidation of real estate through under the law on coercive execution should rarely, if ever, require more than one auction. When this occurs, it is often because the Trustee has failed either to obtain an accurate valuation to set the minimum bid price at the first auction, or to identify and notify buyers appropriate for this property. The Trustee should cultivate ongoing relationships with appraisers who provide realistic estimates of value that are confirmed by the results of subsequent sales. Creditors should not be asked to pay for appraisers who consistently produce unrealistically high assessments that complicate and delay the liquidation process because they result in artificially high minimum prices at auctions under the law on coercive executions.

3. Choosing the Best Method of Sale

The Trustee must exercise his considered commercial judgment in proposing a particular method of sale. In all cases, the Trustee must act in a commercially reasonable manner. This may be generally described as marketing or selling the particular asset in a manner commercially appropriate for that type of asset under the circumstances. What is commercially reasonable for one asset may not be commercially reasonable for another. Some assets, such as tools and dies, equipment, and machinery, may have limited appeal because they are specialized. Other types of property, such as automobiles, trucks, and other vehicles, have a broad range of possible uses and will appeal to a much wider circle of potential buyers. Intellectual property may not have an easily discernible value or a ready buyer. A patent or trademark cannot be marketed or sold in the same way as real estate, machines, or shares of stock. The time, method, and location of the sale of each type of property should be advertised, timed, and organized to attract those buyers who are likely to be interested in such property. Sometimes, the most prudent course may be to acknowledge at the outset that the property is simply not worth selling because the costs of liquidation will exceed the proceeds. At the least, a successful sale requires:

- the ability to divide or group assets in a way that is likely to attract the largest number of qualified bidders and the highest net recovery;
- the ability to select the best method of sale when the Trustee has a choice among different methods like auction or direct negotiation;
- the ability to identify which markets to access for advertising the asset;
- the ability to determine the timing of the sale to take advantage of demand.

4. Attracting Buyers

To conduct a sale that protects the integrity of the bankruptcy proceeding, as well as being transparent to all participants, the Trustee should consider advertising more widely, and by different media, than the minimum requirements set out in the law on coercive executions. When the assets to be liquidated are potentially of interest to international bidders, or are highly technical and therefore of interest only to a limited number of potential bidders, additional approaches must be considered. The Trustee should be prepared to conduct a direct mail solicitation, and to contact the original manufacturer, if in existence, and any former competitors or equipment brokers specializing in similar assets. In addition, there are more and more Internet sites available for the sale of assets in bankruptcy, including on-line auctions such as eBay. A successful Trustee will become familiar with all these methods, for they expand the universe of potential buyers. If the assets have been properly marketed to attract as many qualified bidders as possible, creditors cannot allege that the price obtained at the auction or sale is “too low.”

It is important to make clear, however, that the Trustee cannot guarantee that the assets being sold have any particular characteristic regarding quantity, quality, or suitability for any use that the buyer may have for the assets. The Trustee should describe the assets in general terms and instruct the potential bidders that they must determine the characteristics of the assets themselves. The Trustee must clearly state that these assets are offered “as is” without any warranties or assurances, and that the bankruptcy sale is final without any recourse at a later date.

5. Direct sales

Some or all of the assets may be sold by direct agreement, if authorized by the creditors, Article 101.2, or in compliance with Articles 102.1 and 103.1. Two considerations should govern the manner in which the Trustee conducts sales by direct agreement. The Trustee must adopt mechanisms that both maximize value for creditors and protect him from claims that he has failed to do so. At a minimum, the Trustee should publish an announcement soliciting offers in at least three daily newspapers of general circulation at least 30 days before making the decision to select the proposed buyer. This will provide a degree of legal protection, but may well be insufficient to produce maximum value. In addition to providing legal notice, the Trustee should actively solicit offers directly and through brokers before presenting a particular offer to the creditors for acceptance.

The Trustee may want to structure the terms of the sale to require interested parties to produce satisfactory evidence of their financial ability to conclude the sale. Such evidence may take the form of financial disclosures, letters of credit, or a deposit. In requiring a deposit, the Trustee must make it clear whether and how much of the deposit is non-refundable and under what conditions.

It will sometimes be the case, as in a pre-packaged bankruptcy, that a single buyer emerges with an offer that is acceptable to creditors even before the assets have been advertised for sale or the market properly tested. Nonetheless, the Trustee should advertise the sale – and disclose the current offer – to provide an opportunity for other, higher offers to be made. It is often very useful to identify a potential bidder early in the process and invite its assistance in valuing and packaging the assets. Such initial bidders may not be willing to contribute their resources to helping the Trustee prepare solicitations to attract other bidders, unless the Trustee, with the consent of creditors, agrees to pay a fixed sum to the initial bidder if another bidder offers more for the assets. Such an initial bidder is colorfully known as a "stalking-horse."

On occasion, the Trustee may wish to dispense entirely with the procedure of soliciting offers, but only after obtaining affirmative approval of the creditors' committee. This exception may be necessary in special circumstances to permit the Trustee to move quickly, eliminating the time-consuming effort of advertising and collecting offers, where there is an attractive and eager buyer on the horizon. Similarly, there is no need to solicit offers to sell precious metals, minerals, securities, or other such assets usually bought and sold on regulated exchanges with disclosed market prices. Nor does it make sense to require a Trustee to solicit offers for shares of stock that are actively traded on a market with publicly disclosed prices. The Trustee may simply contact a broker and issue instructions to sell at the prevailing market price. Transparency is preserved because the market is public and the prices are accessible to all. The market price can be easily verified by anyone wishing to confirm the proceeds that should have been received on the date that the sale was executed.

Once the Trustee has found and reached agreement on the terms of sale with a proposed buyer, either through prior solicitation or otherwise, the Trustee must obtain the consent of the creditors' assembly or creditors' committee. Article 108. Notice of the proposed sale and the terms should also be provided to the Bankruptcy Court and

to all parties as a measure of protection. Creditors secured by real property must give their consent to the sale. Article 102.4. Creditors secured by movable assets that will be included in the sale must be provided with notice of the terms and conditions of sale at least eight days in advance. Article 104.1. The notice of sale should include, at a minimum, the following information:

- place and address where the property is located;
- detailed description of the property, including its condition and function;
- the procedure for soliciting offers;
- a summary of any offers received;
- relevant data on the proposed purchaser;
- all the terms of the proposed sale, including the price and the procedure for making payment.

The Trustee should be prepared to deal with the objections of the secured creditors. The direct sale must result in secured creditors receiving at least as much as from a sale using the procedure of coercive execution. The Trustee should be wary because secured creditors will sometimes conclude that such coercive execution will be unlikely to produce very much to satisfy their claims, so they will attempt to disrupt the direct sale to negotiate higher payments.

Secured creditors have different rights depending on whether their collateral is real (immovable) or personal (movable) property. Article 102.4 requires that creditors secured by real property consent to a direct sale. Creditors secured by personal property must be allowed at least eight days to identify and present higher offers for their property. Article 104.1. The Trustee must either sell the asset to the higher offeror identified by the creditor, or put the creditor in the same position as if the higher offer had been accepted. Article 104.2. The Trustee might choose not to sell to the higher offeror produced by the creditor in the case when one buyer is willing to pay more for a particular asset, but including that asset in a group of assets will produce a total sales price that is greater than selling it separately.

The Bankruptcy Court may stay the rights of secured creditors, including the right of creditors secured by real estate to consent to direct sales, if the Trustee provides adequate protection to compensate the creditors for any diminution in the value of their collateral as a result of the stay. This will require the Trustee to prove, by expert appraisal or otherwise, the value of the secured portion of the creditors' claim, *i.e.*, the amount they would have received from a sale at this time using the procedures of coercive execution, and to guarantee the creditors' recovery of this amount. Article 58.5.

6. Sale of an Entire Business as a Whole

In considering whether the business or a discrete unit or division of the business should be sold as a whole, the Trustee must establish whether the unit has more value as a going concern --- an operating entity --- rather than as the sum of its constituent parts, in short, whether the whole or the parts are worth more. This analysis is similar to that conducted to determine whether a company is a viable candidate for reorganization. It requires the Trustee to determine the present value of the debtor's future income from its business operations, taking into account the positive changes in

its operation and "bottom line" that result from the bankruptcy proceeding. Such positive changes include rejection of burdensome contracts, recovery of avoidable transactions, and reduced debt. Determining the going-concern value of a business or unit is complex, and is best established by an experienced accountant, financial expert, appraiser, or investment banker. Please consult the more extended discussion in Section 3.c of this Manual.

Such a bulk sale must be structured as a sale of all the debtor's assets. The debtor as a legal entity will not survive the liquidation procedure. Article 140.3. If the buyer desires to continue the debtor's legal existence, then the sale must take placing using the reorganization procedures of the bankruptcy law. See Article 142 and also Section 10 of this Manual.

The Trustee, with the consent of the creditors, Article 108.2.1, determines the terms of the sale. As with auctions and directly negotiated sales, the Trustee may structure the terms of the sale to require an interested party to produce satisfactory evidence of its financial ability to conclude the sale, requiring financial disclosures, guarantees, or a deposit to qualify for bidding.

Ordinarily, sale of the debtor's assets as a whole is best conducted by public sale, after extensive exposure to the market, including efforts by the Trustee to contact people directly who might be interested in the assets, such as major customers, suppliers, or competitors. The Trustee should encourage the widest possible competition by advertising extensively. In appropriate cases, he might prepare a marketing brochure to be sent to all interested parties and potential buyers. Retaining the services of a marketing professional, broker, or other agent may be worthwhile. When such agents are used, they will usually prepare the appropriate brochures and handle much of the marketing efforts.

In cases involving smaller businesses where such professionals are not engaged, the Trustee may decide to prepare such a marketing brochure himself. The actual contents of the sales brochure will depend on the nature of the business and the assets being offered. A concise summary description may be required for advertisement, followed by a more comprehensive brochure with photographs to supply on request of interested persons. Some of the items that should be considered for inclusion are:

- Summary of the business
- Brief history
- Disclaimer (see suggested format below)
- Financial results and projections
- Products and services
- Production volume and capacity
- Major Competitors
- Key customers and market
- Distributors
- Suppliers
- Premises (location, owned or leased)
- Plant & machinery
- Fixtures and other hard assets

- Major leases
- Inventory
- Major contracts
- Other assets: patents, trademarks, licenses, *etc.*
- Organizational chart
- Management
- Directors
- Employees (number, location, duties)
- Qualification requirements and selection process
- Information on the bankruptcy sale procedure
- The sale is "as is" without any warranty or recourse
- Contact information

Deciding which and to what extent the foregoing items should be disclosed will depend on what is being sold. Caution should be exercised in preparing disclosures because potential buyers will be relying on this information in making their decisions on whether and how much to offer. Most of the same concerns about this disclosure are present in ordinary non-bankruptcy sales of businesses or all their assets in bulk. The Trustee should carefully review the proposed brochure with an attorney to be certain that there are no misrepresentations and that confidential information is not inadvertently disclosed.

The Trustee must be careful to ensure that only the items that are actually offered for sale are included. The Trustee should not imply that leases, exclusive rights to sell, third-party warranties, trademarks, trade names, patents, or licenses are being included in the sale of the business or the unit if these are not in fact part of the sale, either because they are not assignable or have expired. Although it is expected that a potential buyer will perform due diligence before making an offer, the Trustee should ascertain if any of the enterprise's plant and equipment were manufactured under license or are likely to infringe patents or other rights of third parties.

The Trustee should describe the assets in general terms, and should make it clear that the potential bidders must establish the characteristics and condition of the assets for themselves. The Trustee must disclose his knowledge of any material obligations that the purchaser may be assuming in acquiring the assets, as well as any obvious limitations or defects. This should be done in light of the requirements of applicable other laws. The Trustee should make explicitly clear, however, that he has no further obligations after the sale is concluded and does *not* guarantee or warrant in any way that the assets have any particular characteristic, quality, or suitability for any use the potential bidder may have in mind for the assets. There should be an explicit statement, **in bold type**, that the items are being sold "as is" without any warranties, and that the bankruptcy sale is final, without any recourse at a later date. The Trustee must be very careful that none of his employees, and none of the former employees of the debtor whom he employs, makes any representations about what is, or is not, being sold. See the section on disclaimers below.

Beware of undisclosed or improper interests. Requests for brochures are often received from parties with interests other than the purchase of assets. Such apparently interested parties may be competitors seeking information to gain a competitive

advantage or others who do not have any serious intention of purchasing the assets. The Trustee should consider who the applicant is before providing requested information. Information on the enterprise's customers should not be released until the Trustee is certain the prospective buyer's interest is definite, and even then, should be redacted to prevent misuse or theft. It is important to avoid providing competitors with information that would enable them to divert customers at the enterprise's expense, diminishing the value of the business. Where the information accompanying the brochure is confidential, the Trustee should consider requiring interested parties to sign a confidentiality or non-disclosure agreement. Again, the Trustee should seek the advice of competent legal counsel in these matters to avoid problems later.

Disclaimer for marketing brochure: It is advisable for the Trustee to include a legally valid disclaimer in any brochure he proposes to release to third parties and in other materials furnished in connection with a proposed sale. The disclaimer must comport with applicable law and should operate to protect the Trustee and the bankruptcy estate from liability. A Trustee should retain legal counsel in formulating a disclaimer.

The brochure should contain detailed information so that interested parties may easily contact the Trustee. In addition, the Trustee should maintain information on all prospective purchasers or serious inquirers so that appropriate follow-up may be performed. This information should generally include:

- Name of interested party;
- Contact details (address, telephone, fax, e-mail);
- Names, addresses, and titles of principal decision-makers;
- Date of inquiry and how interested party learned of sale;
- Copies of information provided and notes on information withheld;
- List of any additional information requested;
- Whether a confidentiality or non-disclosure agreement has been signed;
- Running chronological notes on the progress of negotiations.

When the business is continuing to operate, it is important that the employees, customers, and suppliers are informed of any proposed advertising of the business unit for sale to avoid any misunderstanding about continuing operations. The Trustee should communicate the intent to sell the unit to these parties to avoid inaccuracies, speculation, and the potential disruption that often follows when such parties learn from others of the possible sale of the business unit.

Equally important for protecting the Trustee and the integrity of the bankruptcy process itself, which he represents, is ensuring the transparency and unimpeachable honesty of any sale. The Trustee's fiduciary duty to the bankruptcy estate categorically precludes any insiders or persons associated with the Trustee from bidding on or acquiring, directly or indirectly, any of the debtor's assets. The effectiveness and credibility of the Trustee depend on strict adherence to this prohibition.

E. Ownership and Transfer of the Assets

Once the bankruptcy is opened, the debtor's right to dispose of property belongs exclusively to the Trustee, who becomes the sole owner. Articles 51 and 88.1. Any transfers by the debtor after this time have no legal effect and may be recovered by the Trustee. Article 52. Once property enters the bankruptcy estate, it may not be legally acquired by or from any other entity, neither the debtor nor any creditor, except the Trustee. Article 60.

To accomplish this transfer to the Trustee and ensure that he has good title to convey the property in a sale to the buyer, the Trustee should move the Bankruptcy Court at the outset to issue an Order compelling the debtor to execute all the necessary documents transferring title to the Trustee, and requiring that the Trustee's ownership be recorded in the appropriate public registries. Article 88.2. Of course, the Trustee may hold title to property of the bankruptcy estate only in his representative capacity as Trustee, *e.g.*, "[Trustee's Name], as Trustee for the Bankruptcy Estate of [Debtor's Name]." And it is in this capacity that, in accordance with applicable law, the Trustee sells property and transfers the legal title to the buyer.

Because of political events, the breakup of large holdings into constituent entities, the absence of proper recording in the cadastre and other public registers, and the absence of documentation or surveys, complex issues of title to property may plague Trustees in BiH. Such title issues may prevent the Trustee from administering or disposing of property of the bankruptcy estate, paralyzing the proceedings. Until there is new legislation to resolve these problems, the Trustee should consider, whenever possible, gathering representatives of all interested parties (*e.g.*, adjoining landowners), hammering out an agreement, executing a legally binding document reflecting this agreement, and asking the Bankruptcy Judge to endorse this agreement, after notice to all affected parties, in the form of an order of the Court authorizing any subsequent sale of the disputed property. However inadequate, this may provide enough comfort to buyers to allow a sale to proceed after all.

8. Distributions to Creditors

A bankruptcy proceeding is opened for the purpose of paying the debtor's creditors through the liquidation of the debtor's property and the distribution of the proceeds to the creditors. Article 2.1. The creditors for whose benefit the Trustee is liquidating the bankruptcy estate will therefore have a keen and immediate interest in this phase of the proceedings.

The Trustee will need to review very carefully all the claims that have been filed and entered into the table of claims without objection, checking and re-checking the amounts involved, the priority classification of each claim, and the other information about the creditors before preparing the schedule of allowed claims for review by interested parties and issuing the public notice of the total claims and the amount available for distribution to satisfy these claims. Article 118. Basically, fulfilling this task will require providing for the total claims in each discrete class, class by class, in order of priority, until a lower class is reached that cannot be wholly satisfied. The members of this last class will then be paid *pro rata* from the remaining proceeds, according to the allowed amount of their claims. Distribution to creditors will be further complicated, however, by special considerations affecting secured creditors,

by late-filed claims, by contested claims and later court decisions, and by the possibility of interim distributions before the main distribution.

A. Rules for Distributions to Creditors

The Trustee may only begin paying the creditors after the first assembly of creditors and claims examination hearing. Article 117.1. It is at this hearing that the Bankruptcy Court will prepare a Table of Claims. Article 111. The entry of an officially recognized claim into this Table of Claims has the effect of a final judgment and fixes both the priority and the amount of the claim. Article 114.3. Nevertheless, before making any distribution, the Trustee must obtain the consent of the creditors. Article 117.3. See, generally, Section 5.C of this Manual.

Before he can distribute anything to the creditors, however, the Trustee will need to prepare a proposed distribution schedule. Article 118. Depending on the timing and whether the claims examination hearing and reporting hearing are held together, Article 47.2, this proposed distribution schedule may be incorporated into the Trustee's Report to the creditors that is due 45 days after the opening of the bankruptcy, which in any event must include all the debtor's known creditors, an inventory and valuation of the property of the estate, and a well-organized summary of the debtor's assets and liabilities. Articles 25.2, 93, and 94. This proposed distribution schedule should:

- identify all the creditors entitled to distribution at this time, either because there were no objections to their claims or because the creditor whose claim was contested prevailed in a lawsuit filed pursuant to Article 115,
- indicate the precise amount each allowed creditor is owed,
- allocate these creditors among the various classes of priority, Article 31, arranged from highest (first) to lowest (last) priority,
- disclose the total amount available to satisfy these creditors,
- reflect the declining balance remaining as this total amount is paid down class by class in order of priority until a class is reached for which there is not enough remaining to pay 100% to the claims in this class,
- show the calculation of the amount that can be paid to each claim in this last class by dividing the remaining balance by the total claims in this class to arrive at a percentage, then applying this percentage to the amount of each individual allowed claim to determine how much this claim will be paid, and
- disclose the inferior classes, if any, which will receive no distribution because the assets of the estate have been exhausted.

The calculations for a proposed distribution schedule are especially amenable to formalization and there are software programs available that will perform this function, reducing the chances that arithmetic errors might creep in.

Once the Trustee has established a schedule of the claims entitled to distribution, he must deposit this schedule with the Bankruptcy Court for inspection by interested parties and give public notice of the total claims and the amount available for distribution. This, as well as the creditors' approval, is a prerequisite for making a distribution. Article 118.

What about claims that are contested but still unresolved or claims that are secured? A creditor with a claim that was not officially allowed and for which there is no enforceable title or a final decision after a lawsuit, Article 115, must provide documents to the Trustee establishing that a lawsuit is pending and the amount in question. The creditor must provide this documentation within 15 days after the public notice of the total claims and the amount available for distribution. Article 119.1. If the creditor with a disallowed claim provides such documentation within 15 days, the Trustee is required to withhold the disputed amount of this claim from any distribution while the litigation is pending, reducing the total amount available to the creditors by the disputed amount of this particular claim. Article 119.2.

A creditor with a claim secured by property of the bankruptcy estate must provide evidence to the Trustee, pursuant to Article 120, that either:

- the creditor has waived its secured claim and agreed to have the claim treated as unsecured, as well as the amount of this unsecured claim, *or*
- the sale of the collateral has not satisfied the claim, leaving an unsecured claim for the outstanding deficiency.

Compare Article 39. If the creditor does not produce this evidence within 15 days of the Trustee's public notice, the claim will be disregarded in the next distribution. Article 120.1. Of course, if the Trustee is entitled to liquidate the creditor's collateral, Article 58.5, then the foregoing provisions do not apply, Article 120.2, and the secured creditor must be paid the proceeds (minus the costs of sale) up to the amount of its claim, Article 105.1.

B. Interim Distributions

Naturally, satisfaction of the bankruptcy creditors may begin only after the claims examination hearing (the first assembly of creditors). Article 117.1. Before the main distribution, the Trustee may make interim distributions. Article 117.2. In order to make any distribution, however, the Trustee must first obtain the consent of the creditors' committee, if one has been impaneled, or otherwise of the creditors' assembly. Article 117.3. See, generally, Section 6 of this Manual. Besides obtaining the approval of the creditors before any proposed distribution, the Trustee must prepare a schedule of the claims or remaining claims entitled to distribution, file it with the Bankruptcy Court, and give public notice of the total claims and the amount available for distribution. Article 118.

Creditors whose claims were disregarded in an interim distribution but who had a pending lawsuit or filed such a suit within 15 days after this public notice of the claims and amount available for the distribution, Article 119, or secured creditors whose collateral the Trustee has liquidated and who have either waived their secured claim or been left with an unsecured deficiency after the sale, Article 120, must receive an amount in advance from the remaining bankruptcy estate in any subsequent distribution to equalize their share with the other creditors of general payment priority. Article 121. These changes must be reflected in the Trustee's proposed distribution schedule within 18 days of the public notice of the total claims and the amount available for distribution, *i.e.*, within three days of the expiration of the 15-

day deadline set out in Articles 119 and 120 for disregarded and secured creditors. Article 122. Needless to add, the Trustee must be as meticulous in revising the distribution schedule as he was in preparing it in the first instance. See Section 8A of this Manual.

After the Trustee has prepared the distribution schedule or subsequently revised distribution schedules and notified the public, creditors may raise objections to this proposed distribution in the Bankruptcy Court. Such objections must be filed within 23 days of the public notice, *i.e.*, within eight days of the expiration of the 15-day deadline for disallowed and secured creditors to act provided by Articles 119 and 120. Article 123.1. If the Bankruptcy Court overrules a creditor's objection to being excluded from the distribution, the creditor may appeal directly to the Appellate Court within eight days. Article 123.2. Should the creditor prevail in its objection before the Bankruptcy Court, which ordered a modification of the claims register, the Trustee and the other bankruptcy creditors may appeal. Article 123.3.

C. Main Distribution

There must be a hearing on the main distribution so that creditors may object, the Trustee is able to provide a final accounting, and after the distribution has been completed, the Bankruptcy Court can order the termination of the bankruptcy proceeding. The time between the announcement of this hearing and the hearing itself must be at least 15 days and no more than 30 days. Article 124.7.

At this hearing, the creditors and the Trustee will examine the proposed main distribution, which may be revised or supplemented. Once a proposed main distribution is adopted, with or without changes or additions, the Bankruptcy Judge must certify the proposed distribution. Article 124.1. After the Bankruptcy Judge certifies the proposed distribution, the Trustee is required to pay the creditors strictly in accordance with this certified distribution. Article 124.2.

The Bankruptcy Court must personally serve notice on the creditors whose claims have not been paid or been paid only in part, returning their documentation, issuing judgments from the certified register of claims, and notifying them that the unpaid claims against the bankruptcy debtor may be prosecuted in an execution proceeding. Articles 124.2, 124.3, and 127.

It is at this hearing on the main distribution that the Trustee is obligated to render his final accounting. Article 124.4. After the distribution, the Bankruptcy Court will require the Trustee to provide evidence that he has paid the credtors pursuant to the certified main distribution. Article 124.6. If there is any amount left after the distribution, the Trustee must deposit this amount with the Bankruptcy Court. Article 125. Once the Trustee has completed the main distribution, the Bankruptcy Judge must issue an order closing the bankruptcy proceeding and setting forth the reasons, publishing this order in the *Official Gazette of the BiH*. Article 126.

D. Distributions after Conclusion of the Bankruptcy Proceeding

The Bankruptcy Judge's order closing the bankruptcy proceeding does not, however, prevent the Judge from ordering a subsequent distribution. Article 128.2. On his

own initiative or after a motion by the former Trustee or a creditor, the Judge may order another distribution after the final hearing if:

- the amount left in the bankruptcy estate is enough to make it worth distributing to the creditors;
- amounts paid out from the bankruptcy estate have flowed back into the estate;
- new assets are subsequently discovered in the bankruptcy estate.

Article 128.1. The Bankruptcy Judge may still refuse to order another distribution, turning the amount left in the bankruptcy estate or the newly discovered asset back to the debtor, if the amount left or the value of the asset is negligible considering the costs of this distribution. The Judge may also require that enough money be deposited to cover the costs of the distribution as a condition of granting the order. Article 128.3. If the Bankruptcy Judge orders a distribution after closing the bankruptcy proceeding, the debtor may appeal this order; if the Judge denies the order, the party who requested it may appeal. Article 129.

After the order providing for another distribution has been issued, the former Trustee must distribute the amount left in the bankruptcy estate or the proceeds of the sale of the newly discovered asset based on the final register of claims and must render an accounting to the Bankruptcy Court. Article 130. Only those creditors may demand payment whose claims were first brought to the former Trustee's attention in:

- an interim distribution after filing the proposed distribution,
- the main distribution after the hearing on this distribution, or
- a later distribution after notice to the public.

Article 131. All other creditors are excluded from participating in a distribution after the bankruptcy proceeding has been closed.

9. Conclusion of the Bankruptcy Proceeding

A. After Completion of the Main Distribution

After the hearing on the main distribution has been completed and the Trustee has rendered his final accounting, provided evidence that he has paid the creditors according to the approved main distribution, and deposited any funds remaining with the Bankruptcy Court, Articles 124.4, 124.6, and 125, the Bankruptcy Judge will issue a published order closing the bankruptcy proceeding and explaining the reasons for doing so. Article 126. Besides satisfaction of the creditors to the extent of the assets of the bankruptcy estate, there are other possible reasons for closing a bankruptcy proceeding, including insufficient funds in the estate, the absence of grounds for opening the bankruptcy, and the consent of the creditors, which are discussed in more detail below.

B. Termination Due to Insufficient Estate

If the Trustee determines and reports that there are insufficient assets or funds in the bankruptcy estate to pay for the costs of the bankruptcy proceeding, the Bankruptcy Judge will schedule a hearing -- which at the Trustee's request may take place at the

same time as the reporting hearing (see Articles 47.1.1 and 98) -- to determine whether to terminate the bankruptcy proceeding. Article 132.1 and 132.2. The Trustee, the creditors of the bankruptcy estate, and the bankruptcy creditors attend and deliberate at this hearing, Article 132.2, though the Bankruptcy Judge is obligated to terminate the proceeding if there is not enough in the estate to pay the costs of the proceeding, unless the creditors deposit a sum sufficient to cover these costs. Article 132.1. Compare Article 43.4 and the discussion at Section 2D of this Manual.

If the costs of the proceedings themselves (Article 41) are covered but there is not enough value in the bankruptcy estate to pay the debts of the bankruptcy estate that have accrued or will come due (Article 42), then the Bankruptcy Court will give public notice and serve notice on the creditors of the bankruptcy estate of this insufficiency. Article 133. After such notice, the Trustee must provide a separate accounting of his services. Article 136.2. The Bankruptcy Law strictly regulates how the property of the estate is to be distributed if there is not enough property to pay the creditors of the bankruptcy estate in full. In this event, pursuant to Article 134, the Trustee must distribute what assets there are in the estate in the following order of priority:

- Costs of the bankruptcy proceeding, Article 41,
- Debts of the bankruptcy estate, other than costs, incurred *after* the notice of the insufficiency of the assets of the estate pursuant to Article 133, including debts arising under:
    - A bilateral contract that the Trustee elected to perform after notice of insufficient assets,
    - A continuing obligation since the first hearing that the Trustee could have rescinded after notice of insufficient assets, and
    - A continuing obligation that the Trustee claimed the benefit of for the bankruptcy estate after notice of insufficient assets.
- Remaining debts of the bankruptcy estate, Article 42.

After the Bankruptcy Trustee has distributed the assets of the bankruptcy estate in accordance with this scheme, Article 134, the Bankruptcy Judge must terminate the bankruptcy proceeding. Article 136.1.

If assets of the bankruptcy estate turn up after the Bankruptcy Judge has terminated the bankruptcy proceeding, the Judge may order a subsequent distribution on the motion of the Trustee or a creditor of the estate or on his own initiative, so long as the amount involved is worth distributing taking into account the additional costs of the distribution. Article 136.3. The rules governing a subsequent distribution in this event are the same as for a subsequent distribution after the main distribution and closing of a case. See Articles 128-130.

C. Discontinuation Because No Grounds for Bankruptcy Exist

The principal justification for opening a bankruptcy proceeding against a debtor is the debtor's inability to pay its debts as these debts come due. Article 6. It is this inability that justifies depriving the debtor of control over its own affairs and invoking the complex and costly legal mechanism that is bankruptcy. It is not intended to give competitors, investors, or potential purchasers who are or become creditors an unfair

advantage. Accordingly, a debtor against whom a bankruptcy proceeding has been opened may ask the Bankruptcy Court to discontinue the proceeding if the debtor can clearly establish the ability to pay its debts currently and as they come due. Such a motion must be accompanied by *prima facie* evidence of the debtor's ability to pay and to continue paying its debts. Article 137.

Such a motion by the debtor must be publicly announced and deposited for inspection by all parties at the Court's registry. Within eight days of the public announcement of the motion, creditors may file written objections or record their objections in the registry. Article 139.1. Before issuing a decision on the motion, the Bankruptcy Judge must hear from the debtor, the Trustee, the creditors' committee, if there is one, and any objecting creditors. Article 139.2. In any event, the Judge may not terminate the bankruptcy proceeding until the Trustee has first paid all the undisputed debts and provided security for the disputed claims. Article 139.3.

Although it is primarily the debtor who will carry the burden of proving its solvency and, when applicable, the creditor's improper motive for initiating the bankruptcy, the Trustee should be vigilant not to be drawn into a proceeding intended to take illegitimate advantage of the bankruptcy law. The Trustee is the representative of the bankruptcy estate and an advocate for the integrity of the bankruptcy system itself. Moreover, in his fiduciary capacity, the Trustee owes a duty to *all* the creditors as a whole. These loyalties require the Trustee to prevent the abuse of the bankruptcy law not only by debtors, but also by particular creditors.

D. Discontinuation by Consent of the Creditors

Since the satisfaction of the creditors is at the heart of a bankruptcy proceeding, the law naturally provides that the proceeding may be terminated with the consent of the creditors. A debtor may therefore move the Bankruptcy Court to terminate the bankruptcy proceeding if it can obtain the consent of all the bankruptcy creditors that filed claims after the latest deadline to file expired. For creditors with contested claims and for secured creditors, the Bankruptcy Court may in its discretion decide the extent to which their consent or the payment of security might be required. Article 138.1. If the debtor obtains the consent of all known creditors, however, the debtor need not wait for the latest deadline to file claims to expire. Article 138.2.

As with a debtor's motion to discontinue the bankruptcy proceeding because the debtor can pay its debts, a motion to discontinue by consent of the creditors must be publicly announced and made available *with the creditors' declarations of consent* for inspection at the Court's registry. Creditors may file written objections or record their objections in the registry within eight days of this announcement. Article 139.1. The Bankruptcy Judge must hear from the debtor, the Trustee, the creditors' committee, if there is one, and any objecting creditors before deciding on the motion, Article 139.2, and may not actually terminate the proceeding until the Trustee has first paid all the undisputed debts and provided security for the disputed claims, Article 139.3.

E. Legal Rights and Remedies Following Conclusion of Proceedings

Unfortunately, the BiH Bankruptcy Law does not provide for the discharge of an *individual* debtor's liability for his debts after the conclusion of the bankruptcy

proceeding, denying the individual debtor who has fallen on hard times and turned over all his property to the Trustee the blank slate, fresh start, and possibility of renewal that most bankruptcy laws in developed economies provide. Even after passing through bankruptcy, an individual debtor's creditors may still pursue their claims against the debtor, in accordance with the applicable provisions of the Civil Code, for the amount of the judgment in the claims register issued by the Bankruptcy Court that remains unpaid after the conclusion of the bankruptcy proceeding. Articles 127 and 140.2. See also Article 124.2 and 124.3.

By definition, however, the provisions allowing creditors to assert their unpaid claims after the conclusion of a bankruptcy apply only to individual debtors, for legal entities who pass through bankruptcy are removed from the commercial registry by order of the Court, Article 140.3, and there is therefore no longer any such entity for the creditors who have not been fully paid to pursue.

If the Bankruptcy Judge decides to discontinue a bankruptcy proceeding because there are insufficient assets in the bankruptcy estate or because the statutory grounds for a bankruptcy are lacking or because the creditors have consented to dismissal, the debtor, the Trustee, and the members of the creditors' committee must be notified of the effective date of the termination in advance. Article 140.1. Any creditor and, if appropriate, the debtor have the right to appeal the Bankruptcy Judge's decision on whether or not to discontinue the proceeding. Article 141.

10. Trustee's Role in Reorganization Cases

The *raison d'être* and goal of bankruptcy proceedings are to distribute as much as possible to an insolvent debtor's creditors. Article 2.1. The critical question in the circumstances of each case, then, is what the best way to pay these creditors will be: immediately, through the orderly liquidation of the debtor's assets and distribution of the proceeds, or instead over time, through reorganization and the restoration of the debtor's solvency? This question goes to the heart of a bankruptcy system -- how its principal purpose is to be accomplished. Euthanasia is not necessarily the best prescription at the first signs of a debtor's illness.

A developed bankruptcy system necessarily acknowledges that, in the appropriate case, the debtor's creditors will receive more for their claims through payments over time under a confirmed plan of reorganization than they could hope to receive if the debtor were shut down, liquidated, and removed from the commercial registry. In the right set of circumstances, a rehabilitated debtor will not only make payments to its creditors as it continues to operate, but will also purchase raw materials, supplies, and equipment from some of these creditors as suppliers with an ongoing business relationship with the debtor. What is more, affording an enterprise in financial distress an opportunity to reorganize and to continue producing goods or providing services, retaining and perhaps adding employees, maintaining existing contractual relations with suppliers and lessors, servicing existing and assuming new debt, and participating actively in its particular market are likely to benefit the economy as a whole more than the demise of the enterprise. Accordingly, the BiH Bankruptcy Law recognizes reorganization as a desirable alternative to liquidation. Article 2.2.

As an aside, the very existence of this option, experience suggests, will encourage informal, pre-bankruptcy, extra-judicial "work-outs" in appropriate cases, which are more likely to take place in the shadow of a bankruptcy reorganization law that provides an incentive for the parties to negotiate in good faith. In any event, a significant additional advantage of reorganization in bankruptcy is that, unlike liquidation, it does not pit the creditors against the debtor, but allows them to work together towards the common goal of reviving the debtor's business to enable it to satisfy these creditors.

The reorganization of the debtor is accomplished through the confirmation of a proposed plan of reorganization. Once such a plan is confirmed, it will re-define the debtor's relations with the universe of its creditors in accordance with the provisions of this plan, essentially working a novation, a new obligation, with each of the debtor's creditors thereafter. Article 2.2.

The Trustee plays a central role in the creditors' determination about whether to support a reorganization of the debtor and, potentially, in the preparation, filing, and supervision of the plan of reorganization. It is the Trustee who is duty-bound to gather all the necessary information about the debtor and its operations; to sift through, organize, and analyze this data; to inform the creditors about the debtor's present financial condition and future prospects; to recommend the best course of action in the bankruptcy; and to assist the creditors in implementing the crucial decision about whether to liquidate or reorganize this particular debtor. At the Reporting Hearing, the Trustee is required to present a comprehensive report, which must "state whether there is any likelihood of saving, in whole or in part, the business of the bankruptcy debtor, what possibilities exist for a restructuring plan, and what the results would be for satisfying the creditors." Article 98.1. On the basis of this Report, Article 47.1.1, the creditors will vote on whether provisionally to continue the debtor's business operation and, if so, may instruct the Trustee to prepare a plan of reorganization, specifying the purpose of this plan. Article 99.1. See also Section 6D2 of this Manual. By law, the right to file a plan is limited to the debtor and, at the direction of the creditors, to the Trustee, Article 143.1, who may also be charged with supervising the consummation of the confirmed plan, Article 185.

A. Mechanisms for Implementing a Plan

The plan of reorganization is the road map to the rehabilitation of the debtor. Along with its financial and other supporting data, the plan of reorganization represents a comprehensive, tailor-made document, carefully adjusted to the particulars of the specific debtor in bankruptcy and the exigencies of its circumstances, setting out all the operational, structural, and legal measures to be undertaken. It is a flexible instrument through which the debtor is renewed by re-defining itself and its relationship with all its creditors. Articles 146.1 and 2.2. And it need not comply with the provisions of the law concerning liquidation and distribution. Article 142.1. Indeed, the bankruptcy law imposes few limitations on the contents of a plan of reorganization and instead encourages the drafter and proponent of the plan to be creative in approaching the task of rehabilitating the debtor, tailoring the solutions to the problems.

The law specifically contemplates such measures as the creation of new, independent legal entities for discrete components of the business or for the business in its entirety; downsizing the debtor by liquidating or closing unprofitable parts of the business; paying debt with shares of stock in the restructured entity; issuing new stock to raise capital; recovering avoidable transfers (Articles 80 to 86); collecting or assigning accounts receivable; incurring additional secured or unsecured debt; pledging unencumbered property as collateral, including accounts receivable; modifying the rights of secured creditors; substituting equivalent security; satisfying creditors through the surrender or sale of property; paying creditors' claims over time, including balloon payments; deferring payment; providing for debt forgiveness; assuming, modifying, or rejecting contracts and leases; and any other structural or financial measures not prohibited by the law. But see, *e.g.*, Article 150.3 (prohibiting the elimination of fines or equivalent obligations).

In Article 142.2, the law sets out a non-exhaustive list of options that may be included in a plan of reorganization, significantly ending with the term "*etc.*", allowing the debtor to:

- continue operating with all or part of its property,
- transfer all or part of its property to one or more existing or new legal entities,
- merge with one or more legal entities,
- sell all or part of its property, subject to or free of liens,
- distribute all or part of its property to the creditors,
- convert creditors' claims into shares of stock,
- determine how to satisfy the bankruptcy creditors,
- pay or modify the rights of secured creditors,
- reduce or cease payments to creditors,
- transform liabilities into credits,
- issue guarantees or other security for the satisfaction of debt,
- determine its surviving liabilities after the conclusion of the bankruptcy proceeding,
- issue new shares,
- *et cetera.*

In addition to these structural and legal measures incorporated into a plan of reorganization, the Trustee should consider whether to recommend changes in the day-to-day operation of the business, such as altering, reducing, or discontinuing less profitable product lines, streamlining production, eliminating duplication and waste, reducing or reassigning the work force, adjusting salaries or commissions, cutting overhead costs, renegotiating or replacing unprofitable contracts, changing suppliers, finding optimal levels for such expenditures as advertising, restructuring, reducing, or expanding points of sale, targeting additional or different markets, reviewing the pricing and credit policies, *etc.* In making such recommendations, certainly, the Trustee will want to consult the more experienced and competent representatives of the existing management, the supervisors, employees, and sales staff, and ongoing creditors (such as suppliers) and major customers familiar with the operation, as well as hired financial and industry experts.

Because of the short amount of time available to the Trustee after the filing of the bankruptcy, see Appendix 1.F.1, whenever possible the underlying analysis of the debtor's prospects for reorganization and an adumbration of the plan should be undertaken in advance, at the earliest opportunity.

B. Contents of the Plan

1. Format of the Plan

The format of a plan of reorganization is prescribed by the law, which requires that a proposed plan contain an introductory, declarative section and a main, substantive section, accompanied by certain prescribed financial information and legal statements. Article 144.

The declarative section of a plan should introduce the debtor to the reader, set the enterprise into its historical and present context, and provide enough reliable underlying information to allow the creditors to make an informed and intelligent decision about whether to approve the specific treatment of the classified creditors proposed in the substantive section of the plan.

2. Declarative (Introductory) Section

The initial, declarative section of a plan of reorganization is essentially a prospectus, not unlike a stock offering or business plan. It must provide reliable, objective, verifiable factual information about the debtor's history, its current circumstances, and the operational changes that have been and will be introduced in the operation of the debtor's business. Article 145.1. In reliance on this information, the Court, each of the participating creditors, and any other concerned parties (*e.g.*, potential investors) will make their decisions on whether to support the substantive section of the plan, which sets out in detail the treatment of the various classes of creditors. Article 145.2. This declarative section, therefore, should be sufficiently comprehensive and detailed to acquaint the reader with the debtor, objectively identify its financial difficulties and the proposed solutions, and disclose all other factual information that might have a bearing on its prospects of recovery.

Accordingly, the declarative section of a proposed plan of reorganization should, when applicable, include at least the following:

- definitions of important legal and technical terms used in the plan;
- identification of the founders, owners, and directors of the company and their respective ownership interests, now and since its founding, including major capital contributions;
- identification of the management, supervisors, employees, and outside contractors of the business, listing their respective duties and, for larger enterprises, including a chart;
- a narrative history of the debtor since its initial founding, describing its purpose, scope of operations, and direction;
- a concise account of its particular lines of production, its targeted market, and its methods of distribution, delivery, and sale;

- a brief statement of the supplies, raw materials, and equipment and machinery required to maintain production;
- an explanation of how, when, and why it found itself in financial trouble, unable to pay its debts;
- a disclosure of all litigation the debtor has been involved in and the results;
- a list of all the debtor's leases and other contractual obligations and how it intends to handle them;
- a précis of the debtor's current financial position with specific reference to its cash flow, balance sheet, and statement of assets and liabilities attached to the substantive section of the plan;
- a listing of the specific operational measures it has undertaken to remedy the problems, which measures it has retained or discarded, and what additional measures it intends to introduce;
- the actual and projected effect of these measures on the debtor's financial position;
- a summary of the debtor's debt structure and proposed treatment of the creditors in the substantive section of the plan;
- an account of the history of the case and its procedural posture since the filing of the bankruptcy; and
- a disclaimer.

When the plan of reorganization provides that the creditors will be paid from future income, the law requires that additional and detailed financial information be attached to the substantive section of the proposed plan. Article 154.

In any event, it is customary in such declarative sections of a proposed plan to include a conspicuous disclaimer. Such a disclaimer might state: "Each recipient of this proposed plan of reorganization is urged to read the declarative section, the substantive section, and the attached documentation together and to review all this material carefully. The financial information underlying this plan has not been subject to a certified audit or any other accounting review. Because of the accounting complexities inherent in any bankruptcy reorganization, the complexity of the debtor's financial affairs, and the state of the debtor's financial, accounting, and legal records, it is impossible to warrant or represent that this information is free of any inaccuracy. Every effort has been made, however, to be accurate. Projections have been made based on the best available information, disclosing the assumptions that these projections rely on. Creditors are urged to study all of this material and to consult their professional advisers before making their decisions about this plan of reorganization. The proponent of this plan of reorganization believes that confirmation of this plan is in the best interests of each and every class of creditors and recommends that you vote to accept the plan."

Regardless of any such disclaimer, however, it is most important that these disclosures be objectively factual, well supported, and verifiable, since the Court, the creditors, and other parties will be relying on this information in making their decisions. If the declarative section includes information that is not accurate, an affected party may argue that it was misled, withdrawing its support or worse. For this reason, also, the presentation of the material in the declarative section of the plan should be strictly factual, honest, and complete, whether positive or negative, and should avoid any tendentious, propagandistic, or partisan slant or tone. Only such a

declarative section will be credible and will inspire confidence in the stated predictions and conclusions, increasing the likelihood that the creditors and the Court will approve the substantive section of the plan of reorganization.

3. Substantive (Instrumental) Section

The substantive (instrumental) section of a proposed plan of reorganization must describe how the proposed reorganization is to be accomplished, Article 146.2, and how it will affect the creditors, the debtor, and the other parties, Article 146.1.

The law prescribes that this section of the plan must describe:

- how, when, and how much the secured and other creditors will be compensated,
- any conversion of creditors' claims into capital in the debtor,
- any assumption of new debt and the guarantees offered to each class of creditors and new investors,
- how the creditors or investors will be paid in full or protected from impairment in implementing the plan,
- the extent to which debt will be forgiven (discharged),
- how the different classes will be compensated under the plan and what they would receive in a liquidation,
- the financial projections of the debtor,
- the measures to be undertaken to restore the debtor's profitability,
- how the reorganization is to be carried out, especially with reference to the following measures:
    - organizational
    - management
    - legal,
    - financial,
    - technical, and
    - reduction of employees,
- sources of funds and financing to implement the plan of reorganization, including increasing the capital base and the debt,
- any other measures to be undertaken, and
- how the legal status of the debtor and the other parties will be affected by the plan (Article 146.1).

Presumably, these requirements may be satisfied by including in the substantive section of the plan a preliminary discussion of the various measures to be undertaken to increase the debtor's profitability and draw in additional funds, including any changes in legal status; financial projections and the assumptions underlying these projections, including references to the documentation attached to the plan; and an analysis of the outcome in the event of a liquidation; followed by the specific treatment proposed for the creditors within each class.

4. Classification of Creditors; Release (Discharge) of Debtor

In defining the specific treatment of various creditors, the substantive section of the plan must classify distinct kinds of creditors in separate classes. Article 147.1. The basic pattern for classifying the creditors in this section of the plan is the priority scheme set out in Articles 30-42, which ensures that different creditors are not lumped together but are classified in separate classes according to the identity of their economic interests. Article 147.2. See, generally, Section 5A of this Manual, which discusses the priorities of creditors' claims.

The law specifically provides that certain creditors whose claims are inherently different must appear in a distinct class, such as affected secured creditors, Article 147.1.1; employees who are bankruptcy creditors, Articles 147.3 and 33.2; and creditors of lower priority whose claims survive, Article 147.1.2. On the other hand, creditors who are similarly situated, with claims that reflect similar economic interests, may be classed together in a single class, though the criteria used to classify them together must be explicitly stated in the plan. Article 147.2. Thus, all unsecured creditors of a general payment priority, Article 32, may presumably be classed in one class; on the other hand, suppliers who are indispensable for the continued operation of the business (and who might otherwise refuse to supply the business) might arguably be classified separately. In any case, all creditors in a single class must be treated the same, unless each of the creditors in the class consents otherwise in writing and their consent is attached. Article 151. Moreover, any agreement with specific creditors to obtain their votes or any other agreement related to the bankruptcy not disclosed in the plan is null and void. Article 151.3.

The purpose of these provisions is to prevent the proponent of a plan of reorganization from improperly obtaining approval of a plan by gerrymandering the classes, artificially dividing or merging distinct classes in the plan to isolate dissenting creditors and avoid an unfavorable vote by a majority of the creditors in a class, or by any other indirect means. These provisions reflect how jealously the bankruptcy law guards the integrity of the process of approving a plan of reorganization and the fairness of the result.

In treating each separate class of creditors, the plan must describe precisely how the particular class will be affected. If the plan impairs the rights of secured creditors to be satisfied from their collateral, the plan must state how the secured debt will be satisfied, how long satisfaction may be delayed, and any other provisions affecting the secured interest. Articles 148 and 147.1.1. For unsecured creditors above the lower priority, Articles 32-33, the plan must disclose by what percentage the claims in the class are reduced, when they will be paid, any security provided, and any other provisions affecting the creditors in the class. Article 149. For lower priority unsecured creditors, Article 34, it is presumed that their claims have ceased to exist once the plan is confirmed, unless the plan expressly provides otherwise. Article 150.

After the plan of reorganization has been consummated and the creditors provided for in accordance with the terms of the confirmed plan, the debtor is released from any remaining obligation to its creditors and, with one narrow exception, discharged from all debts. Article 152.1. This discharge extends also to the personal liability of the members of a corporation, partnership, association, or other legal entity. Article 152.2. Compare Article 150.3 (excepting fines and equivalent obligations). It is this promise of renewal, of course, that is the chief incentive for the debtor.

5. Additional Documentation

The law requires that certain supporting documentation be attached to the substantive section of a plan of reorganization if payments will be made from future income of the debtor, if management will be retained or the ownership or structure of the debtor will be changed, or if title to real estate is affected.

If, as is often the case, the plan of reorganization provides that creditors will be paid from the debtor's future income, the plan must include:

- a complete statement of assets and liabilities, valuing each itemized asset and identifying each liability, with a list of all the liabilities to be satisfied through the confirmed plan of reorganization,
- a statement of projected income and expenses over the period of time that the creditors are to be paid under the plan, specifying the order and timing of the funds coming in and going out during this period, thereby establishing the feasibility of such a schedule of payments.

Article 154. Needless to add, the statements of assets and liabilities and of income and expenses are the two most fundamental financial documents and represent the underpinnings of most plans of reorganization. Special care should therefore be taken to ensure that this data is complete, accurate, and objective. The assets must be valued at their actual market value (not book value), the amount that the sale of these assets might realistically be expected to yield in the present marketplace for such assets, with some explanation of how these values were arrived at. The income and expenses must be projected based on the actual track record of the business over a specified period of time (*e.g.*, the past six months, the past year), seasonally adjusted if necessary, and explicitly disclosing all assumptions on the basis of which the projections are more favorable than actual past performance. As always, it is better to be conservative and cautious, rather than losing credibility with the Court and the creditors by exaggerating the debtor's prospects.

Under certain circumstances, a statement of consent of interested parties affected by the plan of reorganization must be attached to the plan, including:

- If the Trustee (rather than the debtor) files a plan of reorganization that calls for the debtor to continue to manage the business, the statement of the debtor itself and of all its personally liable members that they are willing to continue operating the business in accordance with the plan must be attached to the plan. Article 155.1.
- If certain creditors will receive shares in, become members of, or acquire rights in the debtor, the written statements of consent of these creditors must be attached to the plan. Article 155.2. Similarly, if a third party will assume the debtor's liabilities to its creditors, this party's consent must be attached. Article 155.3.
- If the plan of reorganization proposes to alter the debtor's legal status or structure, the consent of all other entities involved in these changes must be attached. Article 155.4.

- If the plan of reorganization proposes changes to the ownership of or title to property, statements of consent by all affected parties and the documents required for the cadastre or other public registry must be attached to the substantive section of the plan. Article 153.

C. Filing the Plan

The Trustee (and the debtor) may file a plan of reorganization before the final hearing. Article 143.1. At the request of the Trustee, the Court may stay the liquidation and distribution of the bankruptcy estate, unless it creates a risk of significant harm to the property of the estate. Article 158. If the creditors' assembly directs the Trustee to prepare a plan, he must file this plan with the Court within 30 days of the assembly, which time may be extended in appropriate circumstances another 30 days. Article 143.2.

Before a plan of reorganization may be presented to the creditors, however, the Bankruptcy Judge must first review this plan for compliance with the law and minimal feasibility. The Judge is required to reject the plan outright if:

- the plan violates provisions of law on the right to file or the contents of a plan and these defects cannot be or have not been corrected in a reasonable time set by the Judge,
- there is obviously no hope that the plan will be accepted by the creditors or confirmed by the Court,
- it is obviously impossible to satisfy the claims in accordance with the substantive section of the plan, but only if the plan was filed by the debtor,
- the debtor has already filed a plan that was not accepted by the creditors, was not confirmed by the Court, or was withdrawn by the debtor itself after being notified of the hearing on the proposed plan, if the Trustee (with the creditors' consent) requests the rejection of the plan.

Article 156. The party that has filed the plan may appeal the decision rejecting it. Article 156.3.

If the Bankruptcy Judge has not rejected the plan of reorganization outright for one of the foregoing reasons, then the Court will solicit within 30 days the opinion on the plan of the following parties:

- the creditors' committee, if one has been impaneled, and
- the debtor, if the Trustee filed the plan, or
- the Trusteee, if the debtor filed the plan, and
- in the Court's discretion, governmental agencies and the chamber of commerce.

Article 157. These opinions, along with the two sections of the plan of reorganization itself and the required attachments to this plan, must be filed with the Court for inspection by all parties. Article 159.

D. The Hearing, Voting, and Confirmation of the Plan

The Court will set a hearing to consider and vote on the proposed plan of reorganization. This hearing must be held within 30 days from the date it is set to allow the parties time to review and comment on the plan. The notice of the hearing indicates that the plan and the opinions and responses received are available for inspection at the Court. The Trustee, bankruptcy creditors who filed claims, secured creditors, and the debtor must be personally notified. This notice must include either a copy of the plan or, if required by the Court, a summary of the plan. Article 160.

Although this hearing to vote on the plan may not be held before the claims examination hearing, Article 112, these two hearings may be merged together. Article 161. See also Section 5.C.3 of this Manual. In this event, the hearing on the plan of reorganization replaces the reporting hearing, which may also be merged with the claims examination hearing. Articles 47.2. Notice that this schedule would require the Court to give notice of the hearing at or shortly after its decision to open the bankruptcy proceeding. Articles 28.1 and 47.1.

Creditors may vote on the proposed plan of reorganization in accordance with the right to vote in the creditors' assembly as defined by Article 28, which essentially provides that the undisputed bankruptcy creditors may vote their approval by a majority in number and a majority in the amount of the claims. Article 162.1. See also Section 6.A of this Manual. Secured creditors may vote as unsecured bankruptcy creditors. Articles 28.2, 39, 110.5, 114.1, 120.1, and 162.1. Creditors who are unimpaired, whose rights are not affected by the plan, may *not* vote. Article 162.2.

Secured creditors may only vote as secured creditors if their security interest is affected by the plan and if the Trustee, the other secured creditors, or the bankruptcy creditors do not contest their right to vote. See Article 147.1.1. If the secured creditor's right to vote is disputed, then the provisions of the law concerning the voting rights of such creditors apply. Articles 163.1 and 28.3. Of course, as with any other creditor, a secured creditor whose rights are not affected, who is unimpaired by the plan, is *not* eligible to vote.

After the deliberations at the hearing, the Bankruptcy Judge will compile a list of all the creditors eligible to vote. Article 164. Each class of creditors identified in the plan of reorganization votes separately as a class on whether to approve the plan. Article 168. Note the discussion on creating these classes in Section 10.B.4 of this Manual.

At the hearing, after the deliberations and before the creditors vote, the proponent of the plan may amend certain provisions to take these deliberations into account and may propose an amended plan. Article 165. Any changes in an amended plan must be specifically identified. Article 166.1. The Bankruptcy Court may decide to set a separate hearing in no more than 30 days for the sole purpose of voting on the plan of reorganization. All creditors who are in the list of eligible voters and the debtor must be invited to this hearing. Article 166. At the earlier hearing to consider the proposed plan, the Bankruptcy Court must distribute voting ballots to these creditors. To be counted, these ballots must be submitted to the Court at least three days before the

hearing to vote takes place, about which the creditors must be informed at the deliberative hearing. Article 167.

The creditors have accepted the plan of reorganization if the majority in number of eligible creditors *and* the majority in amount of the claims of eligible creditors in each class votes to accept the plan. Article 169.1. Under certain circumstances, however, a class may be deemed to have accepted the plan, even without the required majority. Article 170. Colloquially, this is known as a "cram-down" of a dissenting class of creditors. As the violence of such language suggests, it is a very powerful option.

Specifically, a class is deemed to have accepted the proposed plan if:

- the creditors in this class suffer no loss or harm compared to their position without the plan,
- the creditors in this class receive, to some reasonable extent, the economic benefits afforded in the plan to other parties, which is presumed if
    - none of the other creditors will receive a benefit or other consideration worth more than the full amount of its claim,
    - no creditor of a lower priority, if there were no plan, nor the debtor nor a person with equity in the debtor will receive a benefit,
    - none of the creditors of the same priority, if there were no plan, is placed in a better position than the creditors in this class.
- the majority of voting classes vote for the plan.

In effect, as a practical matter, if the proponent of a plan of reorganization avoids discriminatory provisions in the treatment of the various classes of creditors, a proposed plan may be approved by the majority of voting *classes* with a majority within each such class. Needless to add, this may be a useful, even decisive, provision in preventing obstructive or dissenting creditors, individually or as a class, from vetoing a proposed plan that is fundamentally fair.

In addition, the law may presume consent. A class of creditors has consented to the plan if none of the creditors in that class has voted. Article 171.3. Creditors who are unimpaired, whether secured or unsecured, may not vote. Articles 162.2 and 163.2. As for the creditors of lower priority with post-petition claims for interest and costs of participating in the bankruptcy, Article 34, these classes are deemed to have accepted the plan if the plan releases the debtor of these obligations, or they are released by Article 150, or the principal claims of these creditors will not be paid in full. Article 171.1.

The debtor (including its stockholders, equity-holders, and holders of other founders' rights) is deemed to have consented if it failed to oppose the plan in writing, at the latest, at the hearing, Article 172.1, or even if the debtor timely opposed the plan, is treated no less favorably than without the plan and none of the other creditors receives a benefit or consideration exceeding the amount of its claim, Article 172.2.

The final decision to confirm a plan of reorganization rests with the Bankruptcy Court. After the creditors vote to accept the proposed or amended plan and the debtor has consented or been deemed to consent, the Court must hear from the Trustee, creditors' committee, if one was impaneled, and the debtor before deciding whether to

confirm the plan. Article 173. The Court's decision confirming or rejecting the plan must be announced at the hearing at which the creditors vote for the plan or at a special hearing within 15 days of this vote. Article 177.1.

Mandatory grounds for the Court to deny confirmation are set out in the law:

- If the plan itself requires certain measures instituted or actions accomplished before confirmation and, after a reasonable time set by the Court, these pre-conditions to confirmation have not been fulfilled. Article 174.
- If provisions regulating the content and form of a plan or its acceptance by the creditors or debtor have been substantially violated and not cured. Article 175.1.
- If the plan was improperly accepted, especially if it improperly favors certain creditors. Article 175.2.
- If, on motion of a creditor that has opposed the plan in writing or at the hearing, the creditor establishes the probability that it has been placed in a less favorable position than without the plan. Article 176.

Once the Bankruptcy Court has confirmed a plan of reorganization, it must serve a copy of the plan or summary of its contents on the creditors who filed claims and on the secured creditors with a notation that this plan has been confirmed. Article 177.2. The decision of the Court confirming or denying confirmation of a plan may be appealed by the creditors or the debtor. Article 178.

E. Legal Effect of Plan Approval

Confirmation of the plan of reorganization is comprehensive, definitive, and final. A confirmed plan binds all parties, including the bankruptcy creditors who have not filed claims and the parties who opposed the plan. Article 179.1. Any changes in the rights of parties to property, the transfer of shares or stock, or redefinition of the legal status of the business are deemed legally proper. Article 179.1. After satisfaction of the creditors in accordance with the terms of the confirmed plan, the bankruptcy debtor and its owners and principals are discharged of their liability to the creditors. Article 152.

A confirmed plan of reorganization necessarily protects only the debtor, however, not co-obligors. The confirmed plan cannot affect the rights of creditors against co-debtors or guarantors or against property that was not in the bankruptcy estate, though the debtor itself is relieved (discharged) of its own obligation to the co-debtors, guarantors, and others entitled to recourse. Article 179.2.

Nor can the terms of a plan providing for payment to creditors over time or requiring creditors to defer execution bind these creditors if the debtor fails to perform according to these terms despite written notice of default from the creditor granting at least 15 days to cure. Article 180.1. Should a new bankruptcy proceeding be opened against the debtor after such a default, these terms or the percentage of payment on the claims will not be binding on the creditors in the new proceeding. Article 180.2. For secured and disputed creditors whose claims have not been finally determined, the debtor will only be considered in default if it fails after a final determination to

provide for the claim consistent with the Court's decision or fails to make up the difference in payment after written demand by the creditor granting at least 15 days to pay. Article 181. In any event, if the debtor defaults, bankruptcy creditors with filed, undisputed or resolved claims may initiate enforcement proceedings against the debtor. Article 182.1. Similarly, if the debtor delays in consummating the confirmed plan, an unsatisfied creditor may enforce its rights under this plan if it shows that the debtor received proper notice and the additional time has elapsed. Article 182.3.

After the creditors have approved the plan of reorganization, the Bankruptcy Court has confirmed the plan, and the Trustee has paid the undisputed claims against the bankruptcy estate and provided security for the disputed claims, the Court must announce its decision to conclude the bankruptcy proceeding, stating the grounds. The Trustee, the debtor, and the members of the creditors' committee must be notified 15 days before the effective date of the conclusion of the bankruptcy. Article 183. After the bankruptcy is concluded, the authority of the Trustee and the members of the creditors' committee expires and the debtor recovers the right freely to manage the bankruptcy estate, unless there is provision for supervision. Article 184.

F. Supervision of the Implementation of the Plan

The Court's decision confirming the plan of reorganization may provide for supervising the consummation of the debtor's obligations to creditors under the plan after the conclusion of the bankruptcy proceeding, including the creditors with claims against any legal entity newly created after the opening of the bankruptcy to assume or continue the debtor's business operation or physical plant. Article 185. This decision must be announced with the decision concluding the bankruptcy proceeding, and should include the list of transactions requiring the Trustee's consent, the estimated new debt structure, and whether supervision applies to the debtor's successor. Article 192. The debtor or its successor must bear the costs of this supervision. Article 194.

As provided in the plan, the Court, Trustee, and creditors' committee retain their authority and exercise such supervision after the conclusion of the bankruptcy. During supervision, the Trustee must submit annual reports to the Court and, if there is one, to the creditors' committee, describing the prospects of consummation. Article 186. If the Trustee establishes that required payments have not been or cannot be paid, he must immediately notify the Bankruptcy Court and all creditors with vested rights against the debtor or a successor entity. Article 187.

The substantive section of the confirmed plan of reorganization may include other terms applicable during supervision, such as a provision that the debtor or a successor entity must obtain the prior permission of the Trustee before undertaking certain legal actions, subject to the provisions of Articles 15 and 52-53 if these actions are taken without the Trustee's consent. Article 188.

The substantive section of the plan may also provide for the debtor or its successor to take on new debt during the period of supervision, granting a higher priority to these creditors than to the bankruptcy creditors. The total amount of such post-confirmation debt may not exceed the value of the borrower's property. Article 189.1. Claims under contracts entered into before supervision will enjoy a lower

payment priority than the claims for debts incurred during supervision. Article 190. These priorities of, first, the claims for debts incurred during supervision, then, contracts undertaken during this period, over the bankruptcy creditors apply only in bankruptcy proceedings opened after the suspension of supervision. Articles 191 and 189.2.

The Bankruptcy Court must issue a decision terminating supervision after:

- the claims in supervision have been paid in full or adequate security for payment provided, *or*
- 3 years have passed since the conclusion of the bankruptcy and there has been no new petition to open a new bankruptcy.

Article 193.1.