REORGANIZATION OF THE UNDISCHARGED BANKRUPT

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Abstract: *The issue of bankruptcy legislation and defining the key concepts analyzed and observed in this regard, are particularly important for the transitional countries. Establishing and termination of businesses in these countries is at everyday level. It is important to say that contemporary approach to regulation involves reorganization of the undischarged bankrupt, and, thus, may lead to the continuation of its operations. Author, with this paper provides an overview of the key facts regarding reorganization of the undischarged bankrupt, as a modern system of solving company crises.*

Keywords*: business, bankruptcy, reorganization, bankruptcy plan*

1. INTRODUCTION

For a long time in the international context there is a trend that results in a significantly changed approach to the problem of bankruptcy. In times of strong economic growth and credit expansion were present belief that the overall function of bankruptcy is to be reduced to the cleaning of non-competitive markets and for-profit entities. Their place would soon retrieve new or existing actors and the system continued to function smoothly, with the strengthening of credit activities on the one side, and increasing indebtedness of businesses, evident in the growth of liabilities in the balance sheet liabilities, on the other. In such circumstances there was no awareness of the need to review and provide bankruptcy and other functions except those that serve only as an instrument of collection of receivables from the debtors unable to fulfill their obligations, and as a result to their liquidation. The consequences that bankruptcy has on the social conditions in society were not taken into account, which are certainly not negligible. Generally, it was not understood the need for an effective bankruptcy system, or it was largely ignored. Today, however, economic conditions in the world have changed considerably.

2. REORGANIZATION - A MODERN APPROACH TO BANKRUPTCY PROBLEMATIC

The reorganization of the undischarged bankrupt leads to the continued operation of that entity. In order to successfully implement the reorganization process, it is necessary to propose a reorganization plan, which will include forms of reorganization, which should take the lead, and the settlement of claims of creditors, and to continue the activity by the

debtor. The reorganization of the undischarged bankrupt depends on the plan, which means that it must make probable effectiveness and efficacy of these forms, which should lead to a continuation of the debtor. Implementation of the plan depends on the debtor and creditors. Its legal nature is based on contract, although there are elements of forced characters that come to the fore in the event of default.[1]

First, it should be noted that the reorganization is an attempt to prevent bankruptcy or liquidation of a subject that falls into a state of insolvency, or in a state where he cannot meet his obligations. Question, when the state of insolvency is coming is not uniformly regulated in the world practice, criteria by which to determine insolvency, bankruptcy reasons, the existence and the bankruptcy proceedings, can vary from several jurisdictions.[2] Even international institutions dealing with trade law, and the bankruptcy legislation, have no clear view which of the indicators of insolvency is most appropriate for practical application. As some of them referred to, for example, balance sheet test, which takes into account the value of the ratio of total liabilities and mid-market values of assets, the cash flow test and the ability to identify the potential (prospective) insolvency.[3]

In addition, when considering this question, it is taking into account obligation denominated in foreign currency (in case of depreciation), contingent liabilities etc. Advantages and disadvantages of each of the above criteria must be considered when drafting the legislation on bankruptcy procedure set. As an example, one can cite the fact that Germany has suspended the application of the balance sheet test to businesses in the former East Germany, which are owned by the privatization agency, until the debt equity ratio does not lead to a level that is standard in the Western economies. All these issues are closely related to the issue of implementation and the chances of success of the reorganization process. If we consider that reorganization was an attempt to prevent bankruptcy and financial recovery by the debtor, who should continue to work, pay debts (in full or reduced amount) and eventually become profitable and solvent business entity, then we should not ignore the moment and state that leads to formal bankruptcy proceedings.

Financial position in any of the debtor at the time of the bankruptcy proceedings will directly affect the ultimate outcome of reorganization if it was possible then. The legal criteria that define the entry to insolvency and bankruptcy will largely affect only the behavior of economic entities, and their relationship to their own debts, and generally create a level of financial discipline in the economic system. The proper approach to this issue as well as other relevant factors may represent a good incentive to provide the basis for a successful reorganization.[4]

Instead of the term the reorganization, some jurisdictions use terms such as rehabilitation, "reconciliation", "administration", "pre-composition", "restructuring," "remodeling" and the like, but they all represent what is in our legislation, called the reorganization. Common to all these procedures is that they want to achieve better economic effect of the bankruptcy reorganization of the debtor than it would be to force its liquidation and shutdown. However, this does not automatically mean that the debtor will continue its operations in the same manner and to the participants in the bankruptcy proceedings, such as for example; owners and creditors, after the completion of the reorganization proceedings will be in the same legal and economic position as before the bankruptcy proceedings.[5] As a result of many external and internal factors, the reorganization process can be very dynamic and

[1] Baltić, M., "Načela evropskog stečajnog prava sa posebnim osvrtom na evropsku regulativu o stečajnim postupcima", Revija za evropsko pravo, 1-3/2003, p.45

[2] Velimirović Mihailo, "Sadržaj i dejstvo stečajnog plana", Pravni život br. 11/2003. godine, str. 201

[3] Čolović, V.,"Stečajno pravo", Banja Luka, 2010, str. 85

[4] Falke M., "Insolvency Law Reform in Transition Economies", Berlin, May 2003, str. 123

[5] Jovanović, Zattila, M., Čolović, V.,"Stečajno pravo", Beograd, 2007, str. 23

turbulent, and thus lead to numerous changes in ownership and debtor-creditor relationships, location of employees and current management, the sphere and scope of business of the debtor, organizational structure, etc.

3. CRITERIA OF MOVEMENT THROUGH BANKRUPTCY PROCEEDINGS

The most important criterion for the "moving" through bankruptcy reorganization and the conduct of the proceedings should be maximizing value for all participants and the economic system as a whole. The reorganization of the undischarged bankrupt is not always possible but also it is not the best solution in every situation. Often you can get to a situation in which is unenforceable in a reasonable manner, any of the measures that would prevent the liquidation of the debtor. Companies that have no business prospects, as well as large-scale generator of insolvency, should not bail out at any cost, if not in the best interests of the majority of creditors. The plan of reorganization that has no objective chances for success would be merely an extension of the agony, and delays the decision. This situation can be seen here. Try to pile and huge internal debt between economic entities reduced by write-offs in a multilateral basis is good but if the level of debt after a certain time were returned back to the old level, you should consider bankruptcy as the only possible alternative,[6] of course, with proper caution and objective review of the impact that would occur in that case. However, on the other hand, there are circumstances that favor greater favoring reorganization under the bankruptcy proceedings. If we look at the economic and financial situation of the typical country in transition, we can see some facts to indicate that the reorganization would be acceptable option for most cases. For example, what will happen in the event of the bankruptcy proceedings against a large commercial entity that has huge debts, but on the other hand owns the land, real estate, machinery, equipment, vehicles and other assets is relatively high value? Not to mention the huge number of economic and technological redundancy that is characteristic of transition economies. The big question is whether the market in these countries, due to the still low level of economic development (even more difficult situation would be if there is stagnation or decline in production and gross domestic product), is able to absorb and productively use so many resources occurring in sale of assets during the insolvency proceedings. Will these funds be utilized in a more productive way? It can occur and the situation that many creditors disadvantaged and without perspective.

4. POSITIVE OUTCOMES OF REORGANIZATION

Some claims will be charged to help overcome a number of problems, but some simply will not "know what to do" with these funds and it may only prolong the impasse in which they are. Once again, what to do with the huge number of people who lose their jobs? This scenario does not have to be achieved but is realistic and feasible, and the consequences may be greater in a system of general illiquidity and insolvency when the real threat of bankruptcy for many businesses. If the main goal is to maximize the total value then it will certainly not be the case under these circumstances. Reorganization process appears as a possible solution in such or similar circumstances. The reorganization is primarily planned

[6]Velimirović, M., Čolović, M., Spasić, S., Miljević, N.,"Aktuelna pitanja stečajnog prava", Udruženje pravnika Republike Srpske, 2008, str. 103.

process with final effects and results can be seen more clearly than the consequences of selling assets of the debtor and its liquidation. The implementation of the reorganization plan to the debtor primarily provides respite and time necessary to stabilize the business. A variety of measures of economic, financial, legal and organizational nature provides many more features and options to the debtor to emerge from the crisis and meet its creditors in an acceptable manner. During this time the possible reorientation of the new manufacturing and service program, the introduction of more modern technologies cost more rational, finding better ways of supply, creating a more efficient organizational structure, and many other processes whose number is limited only by the question, whether they are legally allowed. One must mention the possibility that during the reorganization process to find domestic or foreign strategic partner or owner to which substantial financial resources are available, modern technology, marketing systems, market, etc.[7] This is of course just a cursory overview of some options for each particular situation requires a much deeper analysis and evaluation of whether the reorganization process is enforceable and whether there is any purpose to start it up. We should mention some cases in which reorganization has far greater advantages over the sale of assets and liquidation of the bankruptcy proceedings.

One good example is the bankruptcy proceedings of companies that have high levels of so-called, intangible assets (goodwill). Lately, you can often times that are sometimes very successful company, because of changed conditions in the global market (falling demand, rising costs, inability to use economies of scale), got into financial crisis and in danger of being shut down but still have a recognizable commodity brand and high quality of its products (Bentley, Rolls Royce). It is clear that in these cases a simple asset sale and liquidation were extremely impractical and harmful to a solution that benefits the debtor sells or re-organization as a whole more than the obvious. Another example of the smaller companies that deal with the new type of service (Internet) where most of the business potential form the expertise, knowledge, skills and ideas of employees while on the other side they have the basic equipment and means relatively small total amount of rapidly obsolete (computers and other electronic equipment). The question is whether the sale of these assets through the bankruptcy processes the creditors in general to settle the amount that would be acceptable to them. The rules governing the liquidation through bankruptcy proceedings (bankruptcy here), also in large measure may encourage the parties to the bankruptcy proceedings to start the reorganization process. When the liquidation is efficient, quick, certain and accessible in some way to give impetus to the decision, especially the debtor to prepare and propose a plan and go with the process of reorganization. It can be formal, in the course of the bankruptcy proceedings, or informal, before the bankruptcy proceedings or even before the very creation of legal conditions defining insolvency if it is certain that it will perform in the near future.[8] In addition, the ability to easily transition from the regime of reorganization in bankruptcy proceedings, (called unique processes) prevents abuse of process of reorganization by which to gain time. In comparative law there are examples of the liquidation and reorganization procedures regulated separately (different laws) and therefore there is a possibility that the reorganization comes easily, without any real intention to terminate the whole process the right way.[9] In this way, the entire management process is expensive, requires more time be, mainly inefficient and largely prevents the practice of showing all the advantages of the reorganization process. Lately,

[7]Dika, M.,"Insovencijsko pravo", Pravni fakultet Zagreb, 1998, str. 89

[8]Novak, B.,"Poslovne teškoće i menadžment zaokreta trgovačkih društava", Znastvene rasprave o savremenim finansijskim temama, Ekonomski fakultet Osijek, 2006. godine, str. 129

[9]Velimirović, M.,"Stečajno pravo", Stylos Novi Sad, 2004, str. 93

because of these reasons in the world and make regulatory changes to the whole process was regulated at one place and eliminate the aforementioned disadvantages.
Earlier we have been told that the sale of the subject as a whole (going concern) during the bankruptcy proceedings can be seen as a form of reorganization. This is partly true, because in this way, at least at this point, preventing the liquidation and termination of the debtor. He continues to work with the new owner (s) until the creditors are paid from the amount of the sale proceeds. However, except for legal change of ownership of this process is not applied to other measures specific to the process of reorganization. Whether a business reorganization measures will be applied later, it probably will but it is no longer a question regarding bankruptcy and reorganization in the formal sense. On the other hand, during the reorganization process may not occur until the legal changes of ownership, but there will certainly influence the position of the owners and shareholders in some way. Creditors are mainly those who acquire ownership of the debtor during the reorganization, but it depends on what the proposed plan of reorganization is and how the whole process is designed. Research shows that the value achieved by selling the debtor as a whole generally smaller than a real market value, due to lack of time be the deficit of information on the activities and characteristics of the entity being sold, but it was still higher than the value that is obtained by selling part of bankruptcy debtor. The management and owners tend to have more preference toward reorganization, managers because the sale of the debtor generally cannot maintain the existing position and the owners and shareholders regarding the reorganization are more likely to retain ownership of the rights and return the funds invested at least in the long run. Regarding the position of creditors, they can vary considerably with each other because the quality and type of their claims and their characteristics are also very different.

5. RESUME

If company, due to mismanagement, insolvency and other circumstances come into a situation of bankruptcy, it is often taken the action of reorganization. Reorganization is nothing more than finding opportunities to continue operating the observed society, although it is against it, but bankruptcy proceedings. In the reorganization is especially obvious that the bankruptcy plan is a document of this procedure. Thus, the bankruptcy plan of reorganization is the essence of the procedure set out, and of its content depends on whether the debtor will continue operations or the bankruptcy proceedings continue.
There are objections that the reorganization plan distorts the market value of the debtor, because of the different bargaining power and position of the parties, and that because of that it should favor the sale of the debtor as a whole because it faithfully reflect market conditions. We saw, however, that practical research refuted these claims.
In any case, the existence of all these options in the bankruptcy law provides the possibility of finding the most appropriate solution in this specific situation, and legislator should strike a balance between them, taking into account all these characteristics.

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