

Serbian Corporate Restructuring:

Reaching an Inflection Point?

Serbia has two complementary legislative tools that facilitate corporate restructuring by balancing the competing needs of struggling debtors, unpaid employees, impatient or exasperated creditors and the tax authorities. Both procedures generally allow debtor management to stay in place (potentially with little oversight nor historical reckoning) and can be taken in sequence, if necessary.

1. **Law on Consensual Financial Restructuring (LoCFR):** voluntary and consensual approach for businesses with liquidity problems or risking insolvency. Mediation takes place at the Serbian Chamber of Commerce and Industry (CCIS). Less formal, quicker, cheaper, confidential.
2. **Law on Bankruptcy (LoB):** revised in Dec 2017, court supervised procedure to approve a pre-packaged restructuring plan (PPRP); key advantage is majority creditor consensus with cramdown of dissenting minority creditors¹. Useful approach if unable to reach out of court consensual restructuring. Essentially a hybrid workout structure.

Serbia has now been granted an Accession Date for joining the European Union (expected over the next 4-7 years), a long held but sometimes controversial desire within Serbia and the wider Balkan region. Bringing Serbian law into compliance with EU directives will have a positive impact in many respects, including the ability to complete corporate restructurings. This article will analyse:

1. Highlights from major corporate acquisitions and ongoing restructuring events in Serbia
2. The EU Draft Directive on Corporate Restructuring
3. Overview of the Revised Law on Bankruptcy (LoB)
4. Highlights from The Key Serbian Restructuring Laws
5. Summary and Conclusion

Highlights from major corporate acquisitions and ongoing restructuring events in Serbia

Historically there have been relatively few major acquisitions in Serbia by western investors, as this country of 7.11M sat outside the EU, the Eurozone and was encumbered with a post Yugoslavia legal system that could best be described as “developing”. Nor has there been many significant corporate restructurings, as previously the law did not permit the efficient distribution of assets. Nonetheless, Western investors have begun making significant investments in the last several years as the legal system continues to mature. Some highlights include:

Table 1 Historical Major Corporate Acquisitions and Ongoing Restructuring Events in Serbia

Dates	Case or Issue	Resolution or current status
July 2011	Delhaize Group (Belgium) acquires Delta-Maxi supermarket chain in Serbia for \$1.3B enterprise value	Reportedly looking for additional investment targets in Serbia. Now operates 210 supermarkets, 12 Tempo hypermarkets, 253 Shop&Go convenience stores. In 2014 opened 70,000 pallet logistics center near Belgrade.
April 2012	Law on Consensual Financial Restructuring (LoCFR) introduced	Designed for businesses with liquidity problems and/or risking insolvency to encourage voluntary out of court restructuring. Introduced independent, 3 rd party voluntary mediation by Serbian

Dates	Case or Issue	Resolution or current status
		Chamber of Commerce & Industry (CCIS). Goal was an institutional and credible alternative to court led restructuring process.
Oct 2013	Acquisition of SBB/Telemach by KKR; acquired from Mid-Europa Partners; FT reported €1B valuation.	Regional Pay TV provider to 1.5M households across former Yugoslavia; company has continued to expand across the region, reporting LTM revenues of €540M from 3.62M RGUs (revenue generating units). This transaction raised the profile of Serbia, marking it as an emerging investment region for western investors.
April 2017; taken into Extraordinary Administration by Croatian government	Agrokor	<p>Croatian food service company with significant assets in Serbia. Employs 60,000 across 5 regional countries. Annual revenues of €6.5B equivalent to 15% of Croatian GDP. Has amassed €3.5B debt to creditors and another €2.2B to suppliers. Croatia created a law specific to Agrokor to protect systemic enterprises. Presently looking for a cash injection, with restructuring to follow once Agrokor is stabilized. Founder Ivica Todoric arrested in London as authorities in Zagreb probe the debt crisis. Agrokor has echoes of Parmalat, the Italian food and dairy group which went bankrupt in 2003. Creditors have agreed to swap debt for equity; legal deadline of 10 July 2018 to complete restructuring. Russian state-owned banks Sberbank and VTB are owed €1.1B and €300M respectively. Together they would reportedly hold 44% of new equity. All of Agrokor's assets will be transferred to a Dutch based company owned by creditors. The debt settlement must be finalized and then approved by the Croatian Commercial Court. Two thirds (67%) of creditors need to adopt the settlement by the 10 Jul deadline. Sberbank will become the largest shareholder in the Dutch TopCo.</p> <p>Within Serbia, Banca Intesa has brought enforcement actions against Agrokor and its local subsidiaries which had been guarantors.</p>
October 2017 – present	Victoria Group; agribusiness	3 rd attempt at restructuring started in Oct 17; banks accepted offer from local oligarch but restructuring transaction has still not closed as of early June 2018.
2013-2017	Law on Bankruptcy (LoB): Summary Use of Pre-Packaged Reorganization Plans (PPRP)	EBRD article reports ~160 PPRPs were filed over 4 years, involving claims of €1.5B. Time required 4.7 months on average; costs ~2.6%

Dates	Case or Issue	Resolution or current status
		of total claims. Law on Bankruptcy was revised in Dec 2017.
2017-present	Revised Law on Bankruptcy (LoB)	Effective 25 Dec 2017. Updated relevant data not yet available.

Notes: Agrokor is included as it has a major impact across the wider Balkan region. Although the focus has been Croatia given the company's genesis and corporate history, separate legal efforts have begun in Serbia.

Sources: Innovation Brain research; FT; Wall Street Journal.

The EU Draft Directive on Corporate Restructuring

There is already a wide diversity of insolvency regimes across the EU28, and not surprisingly this diversity is seen as a barrier to foreign investment. Serbia is no different. Some level of harmonization of insolvency laws is thought to be essential to the success of the EU's Capital Markets Union. While the EU has attempted to harmonize insolvency laws in the past, it has heretofore foundered because:

- different cultural philosophies embedded in each country
- according to Ashurstⁱⁱ, some regimes regard transaction avoidance as a restorative tool

Nonetheless, starting in Nov 2016 there was a renewed push by the EU with the publication of a draft directive proposing minimum standards for restructuring legislation in each EU member state. Those standards were to include:

Table 2 Comparison of EU Draft Directive Standards with Revised Serbian Law on Bankruptcy

EU Draft Directive Standards	Serbia's Revised Law on Bankruptcy (LoB) (effective 25 Dec 2017)
1. A temporary creditor stay of 4-12 months for debtors negotiating a restructuring plan	Addressed and implemented in several different articles in the law; some stays have strict timelines and deadlines (§88). Recognition of a foreign main proceeding (§191) prohibits compulsory executions and disposals against debtor assets.
2. A reorganization plan voted on by classes and approved by a court	§155-172 address Reorganization Plans extensively, although there are some peculiarities. The plan must be voted on by separate classes and approved by the court.
3. The possibility of cross class cram down of junior impaired classes	A majority within each creditor class must vote in favour of the restructuring plan. However, this makes it unlikely that a junior, out of the money class would agree to a cram down that left them with little or nothing.
4. Protection ensuring executory contracts may not be terminated or performance withheld by creditors during the stay	§94 gives the Bankruptcy Administrator the right of choice in bilaterally binding contracts, essentially allowing him to execute the contract and demand the other party fulfil its obligations. This provision is rarely applied. Separately, §157 allows the cancellation or reformulation of contracts, and §77 permits termination of employment.
5. Rescue financing protection measures	The Bankruptcy Administrator may obtain unsecured credit or incur debt secured by assets that are part of the bankruptcy estate. We believe this would in effect be similar to Super-Senior DIP financing. In practice, we have not seen these measures utilized.

Source: Ashurst: *Restructuring Landscape in Europe – Keeping up with the Competition, Non-Performing Loans*, 9 Apr 2018. Essential supplier/executory contracts are aimed at ensuring that some (or possibly all) on-going suppliers may not terminate or withhold

performance on grounds of insolvency or restructuring measures so long as they are paid for the supplies provided during the period the measures are in place.

Some of these proposed EU standards are quite big policy steps for member states (including Serbia) with relatively underdeveloped insolvency regimes. The European Commission is keen to finalize the draft directive in 2018. We believe Serbia's new law from (Dec 2017) is a good first step in satisfying these standards.

Overview of the Revised Law on Bankruptcy (LoB).

Bankruptcy proceedings, within the meaning of the law, shall be reorganization and compulsory liquidation. The aim is attaining the highest possible value for creditors from the debtor or its assets, in the shortest possible time at lowest cost. Bankruptcy proceedings shall ensure equal treatment and status of creditors of the same payment rank and creditors of the same class in reorganisation. These principals have been applied since 2009. One focus of Serbia's revised law was to improve the position of secured creditors and to provide clarity to certain provisions that caused conflicting interpretations in practice. Changes from this law will apply only to bankruptcies initiated after 25 Dec 2017. In practice, the new law has resulted in some conflict, repetition and uncertainty.

Other highlights include:

- Bankruptcy proceedings may be initiated by petition from the debtor, a creditor or liquidator. The petitioner may be obliged to pay an advance for advertisements, notify creditors, cost of engaging a Bankruptcy Administrator, etc. In large cases we assume this could be a non-trivial amount. (§59)
- Once opened, bankruptcy proceedings are conducted by a court ex officio (e.g. judge). When a Bankruptcy Judge receives a petition for bankruptcy, he/she can within 3 days render a decision initiating the preliminary bankruptcy procedure (§60).
- Suspensions or interruptions are not allowed.
- All proceedings will be transparent and published in the public domain (business or official secrets have an exemption).
- Proceedings against banks or insurance companies are covered by separate laws.
- The location of the company's registered office will generally be the location of any legal proceedings. If the registered office is not in Serbia, then the jurisdiction of the debtor's centre of main interest applies.
- The Bankruptcy Judge shall rule on the initiation of bankruptcy proceedings; appoint & dismiss the Bankruptcy Administrator, determine his pay, reward (as % of the estate) and approve his/her expenses; approve expenses and liabilities of the estate before they are paid; consider the draft plan of reorganization, confirm its adoption or failure; render a decision on the final distribution of the bankruptcy estate; and other duties as required.
- The Bankruptcy Administrator will manage the business of and represent the debtor. His/her selection will be on a random basis, he must be a Serbian citizen with a second level degree and must pass a licensing examination. He is expected to take all measures to protect the property of the estate and within 30 days of appointment, create a plan including estimated expenses and a time schedule. He will submit expenses and liabilities to the judge on a monthly basis, and report quarterly (but potential also monthly if requested) in writing to the Creditors Committee.
- The Bankruptcy Administrator may obtain unsecured credit or incur debt secured by assets that are part of the bankruptcy estate. We are yet to see this occur in practice. (§27)
- With the consent of the Bankruptcy Judge, the Bankruptcy Administrator may retain (and supervise) professional individuals.
- The Bankruptcy Administrator may take actions that have significant consequences for the bankruptcy estate, such as obtaining credit, raising a loan, acquiring high value equipment,

- granting a lease, etc. (these are actions of Special Importance), after having notified the Bankruptcy Judge thereof and having obtained the consent of the Creditors' Committee.
- The Bankruptcy Administrator must notify the judge in writing at least 15 days prior to taking actions of Special Importance, as well as seek consent from all the members of the Creditors Committee. Exceptional urgency may shorten these deadlines to no less than 3 days (e.g. if the goods could quickly spoil).
 - The initial Creditors Assembly will be held within 40 days and will discuss the administrators prognosis for a reorganization. Creditors who hold more than 50% of all claims can push for the estate to be put into immediate liquidation. (Bankruptcy)
 - The Creditors Assembly shall elect the Creditors Committee from its ranks. Secured Creditors may participate and elect one member from their ranks, and also to the extent their claims are uncovered by secured assets (e.g. hence becoming an unsecured creditor).
 - The Creditors Committee gives its consent on actions of Special Importance, advises the Bankruptcy Administrator on the manner of selling debtor assets, gives consent on continuing debtor business operations, and approves final accounts of the debtor. They are entitled to appeal the decision of the Bankruptcy Judge, file written complaints against the Bankruptcy Administrator, propose his replacement and a new appointment and provide their opinion on his final award.
 - The bankruptcy estate shall comprise all assets of the bankruptcy debtor in Serbia and abroad on the day of opening of bankruptcy, as well as assets acquired by the bankruptcy debtor during the bankruptcy. (§101)
 - Creditor claims must be filed to the competent court within the Bankruptcy Judge's deadline, but NLT 120 days after the official gazette announcement. The Judge then forwards all received claims to the Administrator who determines the grounds, scope and payment rank. (§113)
 - Contested claims may be resolved through mediation (§114). Verified and contested claims may be subject to transfer. (§117a)

The Pre-Packaged Plan of Reorganization (PPRP; §156)

The reorganization plan may be filed concurrently with the petition for bankruptcy (hence known as a pre-packaged reorganization plan (PPRP)), or after the opening of bankruptcy (simply Reorganization Plan). A reorganisation plan may be filed by the Bankruptcy Administrator, secured creditors holding at least 30% of the secured claims in relation to total claims against the debtor, bankruptcy creditors holding at least 30% of the unsecured claims in relation to total claims against the debtor, as well as persons owning at least 30% of the debtor's capital, if a bankruptcy ruling was not made at the first creditor's hearing. (§161)

Should a creditor file for insolvency, and the insolvency debtor files for pre-packaged reorganization plan (PPRP) before the court renders a decision on initiating insolvency proceedings, the motion for the PPRP will have priority. However, in case the PPRP motion is denied, and the debtor submits a new motion for a PPRP, the motion for initiation of insolvency proceedings will have priority.

The reorganization plan has a number of components (§161), including:

- Short introduction and explanation of the circumstances leading to financial difficulty.
- Detailed list of measures and means to execute the plan, along with deadlines.
- Detailed list of creditors divided into classes, criteria of their classes and their claims.
- Asset sale procedures along with list of assets to be sold.
- List of all members of managing bodies and experts to be retained, and their compensation.
- Clear statement that adoption of the plan shall result in redefinition of all creditors rights and duties.

- The independent expert that will monitor the implementation of the restructuring plan in the interest of all creditors.
- Last 3 years financial reports.
- Financial projections for the restructuring period, which is not to exceed 5 years.

A pre-packaged restructuring plan should also include:

- A signed, non-binding statement by the majority of creditors that they will support and vote for the plan.
- A statement from an auditor or licensed professional confirming the feasibility of the plan.

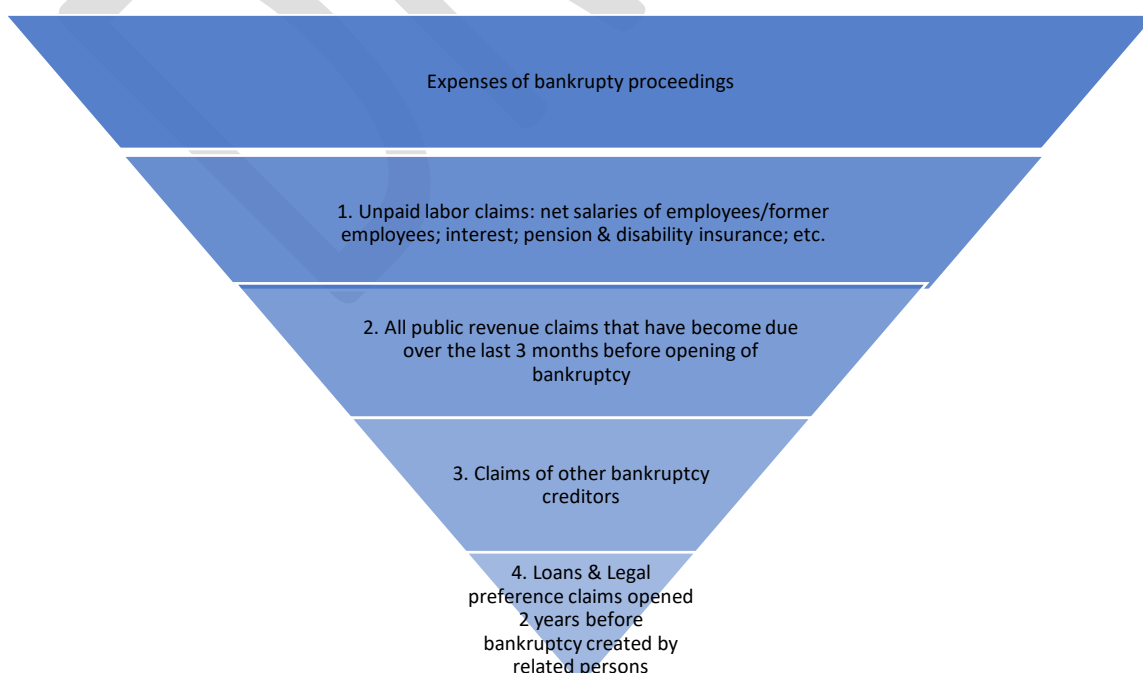
All creditors shall be eligible to vote on the plan in proportion to the amount of their claims. Where a claim has been contested or remained unexamined, the bankruptcy judge shall estimate the claim for purposes of voting. Voting shall be done on a class basis. Creditors' claims shall be divided into classes based upon secured and priority rights (payment ranks) of their claims. For the purpose of exercising voting rights of secured creditors, the Bankruptcy Judge assesses the likelihood of settlement of their claims from the encumbered assets. (§165)

The reorganization plan is deemed adopted in one class of creditors if the creditors, who hold the simple majority of claims in respect to aggregate claims of creditors in that class, have voted for the reorganization plan. Those creditors whose claims should be fully settled in cash before the beginning of the implementation of the plan will not vote. The reorganization plan is deemed adopted if it is duly accepted by all classes that vote about the plan. (§165a)

Payments Waterfall Under Revised Serbian Law on Bankruptcy (LoB)

Figure 1 provides an overview of the payment waterfall to creditors. Expenses of bankruptcy proceedings shall be settled from the bankruptcy estate as a matter of priority. Bankruptcy creditors, depending on their claims, shall be classified into ranks. The bankruptcy creditors of lower rank can only be satisfied after the creditors of higher rank. Bankruptcy creditors of the same rank shall be satisfied in proportion to the amount of their claim. §54

Figure 1 Payments Waterfall under Revised Serbian Law on Bankruptcy (LoB)



Source: Article §54 Rank of Bankruptcy Claim Satisfaction. Bankruptcy creditors classified into ranks; lower ranks can only be satisfied after higher ranks.

Highlights from the Key Serbian Restructuring Laws

Table 3 provides a summary and comparison of some of the key issues of the two primary restructuring laws currently in use in Serbia.

Table 3 Highlights from Serbian Legislation

Issue	Comments
Legislative framework	CFR: Law on Consensual Financial Restructuring (LoCFR; April 2012) LoB (aka PPRP): Law on Bankruptcy (LoB; revised Dec 2017)
Grounds for initiating the procedure	CFR: voluntary basis, no specific financial difficulties PPRP: <ol style="list-style-type: none"> (1) Permanent insolvency (unable to pay debt within 45 days; completely ceased all payments for a consecutive 30 days); (2) Pending insolvency (apparent that debtor cannot pay when debts due); (3) Over indebtedness (liabilities greater than assets); (4) Failure to comply with adopted reorganization plan, or plan put into effect in fraudulent or unlawful manner. §11
Parties able to initiate the procedure	CFR: the debtor or creditors PPRP: the debtor, creditor or liquidator §55
Effect of procedure on creditor enforcement rights	CFR: parties can execute standstill agreement to give time and space for negotiations; moratorium on debt payments and enforcement possible PPRP: after PPRP filed, bankruptcy judge may prevent enforcement against secured and unsecured assets of the debtor
Appointment of Insolvency Office Holder?	CFR: none PPRP: Bankruptcy judge may appoint Bankruptcy Administrator or retain other experts to verify the accuracy of the PPRP data and proposal; can also control payments from debtors accounts §19
Parties able to propose a restructuring plan or agreement	CFR: Does not have a cramdown provision. Restructuring can not be imposed on minority dissenting creditors. PPRP: cramdown limited to a minority of creditors within each class of creditors. A restructuring plan requires all creditor classes to vote in favour. Consenting creditors must represent in aggregate > 50% of creditor claims within each class. §165-165a
Other requirements for confirmation of the restructuring	CFR: none. Voluntary, out of court restructuring. PPRP: requires court approval of the plan approved by creditors

Source: adapted from EBRD: Law in Transition (online). Trends in corporate restructuring – Croatia and Serbia examined and contrasted. Luke Vukelic and Martina Prpic (Croatia), BlazoNedic, Branko Radulovic and Luke Andric (Serbia).

Summary and Conclusion

With the Dec 2017 revision to Serbia's Law on Bankruptcy, debtors, creditors and liquidators now have a modern set of tools to address corporate restructuring needs. A Consensual Financial Restructuring (CFR) can be confidentially initiated by filing with the Serbian Chamber of Commerce & Industry (CCIS), the official mediation institution. With at least two banks participating, an individual mediator is assigned and meetings between debtor and creditors begin. The debtor usually submits a restructuring proposal which is discussed amongst participating creditors. A formal standstill agreement (which would be private) could be agreed but is apparently rarely done in practice. Participants may withdraw at any time. A successful CFR Agreement (or multiple bilateral agreements) will be relatively quick, cheap and can remain confidential. Because no public disclosure is required, reputational and public confidence concerns are mitigated for the debtor. Should some creditors not agree with the CFR approach, then a pre-packaged restructuring plan (PPRP) may become necessary, as there is no ability to cramdown minority creditors under CFR.

PPRP is a hybrid workout procedure supervised by a court. A stay imposed by the court will prevent creditors from taking enforcement actions to protect the debtor's assets. The debtor submits a pre-negotiated restructuring plan, it is put to a vote and then accepted or rejected by creditors. Creditors are segmented into classes depending on their status (secured, unsecured, legal position, priority, magnitude, etc.). Judicial oversight appoints a Bankruptcy Administrator to help manage the debtor's business and preserve the estate and value. The Bankruptcy Judge examines the legality of the restructuring plan, the formation of classes, treatment of creditors, creditor rights and supervises the voting process. If approved by creditor majorities, the plan is confirmed by the court and becomes an enforceable instrument. The PPRP combines a formal and informal approach, and debtor management remains in place for the duration of the proceedings.

Combined, we believe these legislative options should provide the necessary tools to restructure corporate debt in Serbia.

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ⁱ EBRD: Law in Transition (online). *Trends in corporate restructuring – Croatia and Serbia examined and contrasted*. Luke Vukelic and Martina Prpic (Croatia), BlazoNedic, Branko Radulovic and Luke Andric (Serbia).

ⁱⁱ Ashurst: Restructuring Landscape in Europe – Keeping up with the Competition, Non-Performing Loans, 9 Apr 2018.