

FIGHTING RECESSION AT THE EXPENSE OF ACCESS TO JUSTICE - THE CASE OF CROATIAN FINANCIAL OPERATIONS AND PRE-BANKRUPTCY SETTLEMENTS ACT

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Summary

It is hard to remember when the last time was that one legal document raised as much controversy among legal and economic experts, entrepreneurs and wider public as it is the case with the Act on Financial Operations and Pre-Bankruptcy Settlements (AFOPS). As stated by the Croatian Government at the time of its delivery, the primary aim of the pre-bankruptcy (or insolvency) settlement proceedings was to help troubled companies to revitalize their businesses, keep jobs and to help creditors to recover their claims in a larger proportion than it would be possible if standard bankruptcy proceedings were applied to troubled companies. The fact that two different organs, one professional and one juridical have been conducting pre-bankruptcy settlement proceedings in different stages gives rise to different questions in relation to the right to a fair trial and access to courts as guaranteed by the European Convention for Protection of Human Rights and its related case law. In particular, we shall discuss whether PBS committees constituted "tribunals" in the Conventional context and whether European Convention allows the prior intervention of professional bodies in disputes over civil rights and obligations. Last, but not least, we need to check the powers and the role of commercial courts in confirming the settlement agreements, bearing in mind that only if the access to a court with full jurisdiction is ensured, the lawfulness of the procedure is provided and secured.

Keywords: *Act on Financial Operations and Pre-bankruptcy settlement, European Convention on Human Rights, full jurisdiction, the right to a fair trial and access to courts.*

1. INTRODUCTION

Pre-bankruptcy settlement proceedings present a procedural form that can be characterized as quasi-collective proceedings under the supervision of a court or an administrative body that give a debtor in financial difficulties the opportunity to restructure at the pre-insolvency stage and to avoid the commencement of insolvency proceedings in the traditional sense.¹ An overview of the latest developments in the field of pre-insolvency procedures across Europe suggests that the economic crisis has motivated a number of European states to reform and improve their laws aimed at improving restructuring options, among other things by encouraging pre-bankruptcy (or pre-insolvency) settlement proceedings.² It can be argued that the development of such or similar proceedings is the result of the fact that existing legal framework for bankruptcies did not meet the challenge of the economic crisis which calls for achieving better economic results than those that might be achieved under liquidation process, immanent for traditional bankruptcy.³ There is little doubt that Chapter 11 of US Bankruptcy Code, which is frequently referred to as a “reorganization” bankruptcy, has served as a model for European countries to modernize their laws.⁴

Similar to the economies of some other European states, Croatia’s economy has been seriously affected by the economic crisis. From 2008 onwards the already high level of illiquidity has been showing signs of constant growth, thus remaining as the one of Croatia’s main economic problems. In order to address this problem, Croatian government in 2012 decided to introduce a new legislation that will force businesses facing financial difficulties to settle their liabilities by applying for the first stage of pre-bankruptcy settlement proceedings with one of the government controlled agencies.⁵

- 1 See Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the application of Council Regulation (EC) NO 1346/2000 of 29 May 2000 on insolvency proceedings, COM(2012) 743 final.
- 2 See <https://www.lw.com/thoughtLeadership/insolvency-reforms-europe-2012> (last consulted January 2017.). Encouraging and promoting the rules regulating restructuring plans and related procedural laws have a crucial role in creating conditions for successful restructuring in insolvency proceedings. That is why the EU has paid a special attention to the situation faced by many companies in Europe. See also McCormack, G.; Keay, A.; Brown, S. and Dahlgreen, J.; Study on a new approach to business failure and insolvency Comparative legal analysis of the Member States’ relevant provisions and practices Gerard McCormack, Andrew Keay, Sarah Brown and Judith Dahlgreen, January 2016., particularly part 6. which puts an accent to different issues concerning Commission’s new approach to business failure and insolvency (p. 218-281). The study is available at: http://ec.europa.eu/justice/civil/files/insolvency/insolvency_study_2016_final_en.pdf (last consulted January 2017.).
- 3 See Parry, R. in: Katarzyna Gromek Broc and Rebecca Parry (eds.), *Corporate Rescue. An Overview of Recent Developments from Selected Countries in Europe*, The Hague / London / New York: Kluwer Law International, 2004., p. 2.
- 4 See more about reorganization under the USA’s Bankruptcy Code in *Bankruptcy Basics 2010* (<http://www.uscourts.gov/uscourts/FederalCourts/BankruptcyResources/bankbasics.pdf>, last consulted January 2017), p. 29-41.
- 5 Croatia used to have the legislation that regulated the institute of so-called “forced settlement”. The Act on Forced Settlement, Bankruptcy and Liquidation was adopted in 1989, in the time

As it can be read out from the explanatory memorandum of the Draft of the Act on Financial Operations and Pre-Bankruptcy Settlement, Croatian Government's main intention was to enable certain debtors to restore their liquidity and solvency. As envisaged by the Government at the time of its delivery, the Act on Financial Operations and Pre-Bankruptcy Settlement (hereinafter: the AFOPS) should result in better cash flow between enterprises. The idea was also to give a boost to the market by pressing companies to enter pre-bankruptcy settlement proceedings and to ensure continuation of business activity for successful businesses.⁶ Lastly, the expectations of Croatian government while drafting the AFOPS were that it would save many jobs and maybe even finally change bad trends on the job market.⁷

While considering the model of pre-bankruptcy proceedings introduced in Croatia, we have to take into account that in Croatia, for many reasons, standard bankruptcy proceedings tend to be very inefficient. It suffices to say that in one case the Croatian Constitutional Court stated that even a nine-year bankruptcy was not too long due to the lack of the buyer's interest and complexity of the case in question.⁸ At the same time, the model of restructuring within bankruptcy has turned out to be very inefficient. Available information suggests that there are only several companies that successfully carried out restructuring within bankruptcy proceedings since the enactment of the Croatian Bankruptcy Act in 1996. The inefficiency of Croatian bankruptcy proceedings has a strong impact on different "doing business" indexes computed by international institutions. According to the World Bank study, at the time of announcement of the AFOPS Croatia was ranked 94th according to the speed and ease of bankruptcy proceedings.⁹

when Croatia was still part of the Yugoslavia. It served as the relevant source of bankruptcy law until 1996, when the new Bankruptcy Act was adopted (Official Gazette 44/1996). The Bankruptcy Act which is now in force dates from 2015 (Official Gazette 71/15). According to the new Bankruptcy Act, the pre-bankruptcy proceedings are now almost entirely conducted by the courts and the FINA's role diminished.

- 6 All companies that failed to agree with their creditors on restructuring plan were automatically redirected to bankruptcy proceedings.
- 7 See Final Proposal of the Amendment to the Act on Financial Operations and Pre-bankruptcy settlement of June 2013.
- 8 See Decision of the Croatian Constitutional Court no. U-III A - 2978 / 2009. The fact that in practice bankruptcy proceedings last very long has been also recognized in the legal analysis of the Member States' relevant provisions and practices in the field of bankruptcy laws. See Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States' relevant provision and practices, INSOL Europe, 2014, p. 107.
- 9 Ibid. See also 2012 Doing Business Report available at: http://www.bfc-see.org/upload/Document/File/2013_03/Doing_Business_2012_Croatia.pdf (last time consulted January 2017). One particularly interesting fact is Croatian ranking in the 2015 World Bank's Doing Business report. According to the Study, Croatia has improved significantly. Namely, the 2015 study placed Croatia on 56th position when different indicators such as time, cost, recovery rate, reorganization proceedings index etc. were jointly taken into account. It is also interesting that the Study granted Croatia with maximum of 3 points with respect to reorganization proceedings index. Obviously, the adoption of the AFOPS influenced and improved Croatia's ranking. This may open certain doubts about the methodology of the benchmarking in the World Bank study because it is still in question to what extent the delivery of the AFOPS has fostered fight against

Bad results arising from the application of the 1996 Bankruptcy Act in combination with worst ever economic decline and crisis deeply influenced by illiquidity, bad debts and tax non-payment served as a good reason for the Government to introduce the law which would change the concept of restructuring and creditors' satisfaction.

The AFOPS was introduced in October 2012.¹⁰ It was in large part amended several times; two times with the Governmental regulation and once in a regular legislative procedure.¹¹ Although the vast majority of political parties and businesses greeted the AFOPS at the time of its delivery because there was a firm belief that it will save jobs and stimulate economy by giving a "second chance" for re-initiating sustainable business activities, different data about the current state of business in Croatia show only poor signs of progress.¹² Although some might say that it is still too early to come out with some final conclusions, information from various sides suggests that now we have many confirmed settlement agreements that have failed to perform due to different problems with subsequent debtor's business operations.¹³ To that point, it seems that feasibility of a settlement reached in the course of pre-bankruptcy proceedings under the AFOPS depended primarily on the quality of financial and restructuring plans offered by the debtor and adopted by the creditors. A similar standpoint about importance of quality restructuring plans can be found in the Recommendation of the EU Commission on a new approach to business failure and insolvency of 12 March 2014. In the Recommendation it is clearly expressed that Member States should ensure that courts can reject restructuring plans which clearly do not have any prospect of preventing the insolvency of the debtor and ensuring the viability of business.¹⁴ If these plans are of bad quality, it is highly likely that debtors will face difficulties while performing obligations arising from the settlement.¹⁵

illiquidity and nonpayment between enterprises in Croatia.

- 10 The Act on Financial Operations and Pre-Bankruptcy Settlement (*Zakon o financijskom poslovanju i predstečajnoj nagodbi*), Official Gazette no. 108/2012.
- 11 See Official Gazette no. 144/2012 (Regulation on amendments to AFOPS), 81/2013 (Act on amendments to the AFOPS), 112/2013 (Regulation on amendments to the AFOPS). If compared to original text it becomes clear that the total number of amended articles approximates to over 50%!
- 12 See Convergence Programme of the Republic of Croatia for the Period 2014-2017 of April 2014, p. 41. Accordingly, it has been stated that the influence of the pre-bankruptcy settlement proceedings on a total reduction of insolvency in the Republic of Croatia since 1 October 2012 has been visible in the amount of HRK 9,8 billion (approx. 1,3 billion €). Other data show that to March 14, 2014, 6,323 applications to initiate pre-bankruptcy proceedings have been filed with a total debt level of HRK 56,2 billion and a total number of 48,084 employees. Until March 14, 2014, 918 settlements have been confirmed in the total debt amount of HRK 16.5 billion.
- 13 See The Report for 2015 of the Chief State Attorney to the Parliament of the Republic of Croatia in which it is clearly stated that there is number of enterprises that have failed to perform their obligations under the settlement, p. 163 (the report is available online: <http://www.dorh.hr/Default.aspx?sec=645>, last time consulted in January 2017).
- 14 See Recommendation on a new approach to business failure and insolvency of the EU Commission, Brussels, 12. 3. 2014., C(2014) 1500 final, p. 8-9.
- 15 About problems faced by auditors while expressing opinions about restructuring plans see, for

However, the AFOPS did not receive too much criticism because of its still unclear and possibly damaging economic effects (many settlements still need to be performed in years to come), but because of certain legal issues that were central to many debates among legal professionals. These issues relate to a number of questions about the constitutionality of the Act and its compliance with the European Convention on Human Rights,¹⁶ particularly with Art. 6/1 which reads as follows; in the determination of his civil rights everyone is entitled to a fair trial and public hearing with a reasonable time by an independent and impartial tribunal established by the law.

What solutions have caused so much debate and problems during the application of the AFOPS? While the answer to this question is easy – the main problem was the lack of proper governance over the admission of claims,¹⁷ explanation of its legal background might be problematic and hard to understand for those who have no background knowledge about the pre-bankruptcy settlement proceedings at all, or, if nothing else, about pre-bankruptcy as it was regulated in Croatian law. Therefore, one of our main problems while working on this paper was to find a proper path to address the problem without going into in-depth elaboration of all the features of the Croatian system. Commenting some unusual solutions from the AFOPS can easily take us the wrong way and distract us from the important issues we want to focus on and challenge. In order to avoid interpreting different provisions, we decided firstly to shortly describe the system and explain how it used to work in practice. After doing so, we will discuss the role of the FINA's settlement committees in the context of the conventional concept of a "tribunal", after which we will turn to the role and position of commercial courts under the AFOPS.

In spite of the fact that the legal regime of pre-bankruptcy proceedings under the AFOPS changed completely, we find that certain solutions and to date accumulated experience deserve attention not only of Croatian lawyers, but also of the wider European legal community.

2. ABOUT THE CROATIAN TWO-STAGE MODEL OF PRE-BANKRUPTCY PROCEEDINGS UNDER THE AFOPS

The basic idea of the AFOPS was that the debtor proposes to the creditor a restructuring plan in which different ways of fulfilment of its obligations are suggested. The restructuring plan needed to involve all types of creditors, including not only

instance, Brkanić, V., *Revizorski aspekti postupka predstečajne nagodbe*, in Barbić, J. (ed.), *Hrvatsko insolventijsko pravo (The Croatian Insolvency Law)*, Zagreb, 2014, p. 81-99.

16 About the constitutionality of the AFOPS and its amendments see, for example, Dika, M., *O ustavnosti pravnog uređenja instituta predstečajne nagodbe*, in Barbić, J. (ed.), *Hrvatsko insolventijsko pravo (The Croatian Insolvency Law)*, Zagreb, 2014, p. 51-68. See also Uzelac, A., *Je li uređenje predstečajnog postupka u Republici Hrvatskoj bilo sukladno s Ustavom? Post festum analiza više neriješenih procesnih i ustavnih problema*, in *Izbrani vidiki ustavnega, civilnoga in gospodarskega prava, Liber amicorum Lojze Ude*, Ljubljana, 2016., p. 535-574.

17 Trends in corporate restructuring - Croatia and Serbia examined and contrasted, Law in transition online. See: www.ebrd.com/downloads/research/law/lit114f.pdf (last consulted January 2017).

private creditors and the financial sector, but also the state as the tax authority.¹⁸ By giving an opportunity to impose restructuring plan even to those creditors who dissent, the AFOPS enabled debtors to address their financial difficulties within a procedure that is less formal than traditional bankruptcy.

The first stage of proceedings consisted of the review of conditions to initiate the PBS and creation of the restructuring plan, voting and its adoption. This stage was under the jurisdiction of the professional body – the company owned and controlled by the State - Croatian Financial Agency (hereinafter: FINA¹⁹) and its settlement committees. FINA's settlement committees comprised three members appointed by the Ministry of Finance. All members of the committees had to hold academic degrees in law or economics while the president of the committee had to hold *master juris* degree in law. Besides being responsible for conducting and supervising the first phase of PBS, the members of the committee appointed a pre-bankruptcy trustee from a list of certified bankruptcy managers. The trustee was obliged to supervise all debtors' affairs, to verify the trustworthiness of the reported claims and also to report all irregularities he may find during the proceedings to the committee.²⁰

Under the AFOPS, the first stage of proceedings before the FINA's settlement committee had to be completed within 120 days. In practice, the PBS proceedings have turned out to be not that quick, although when compared to ordinary bankruptcy proceedings it must be stated that available data suggest that FINA has been rather efficient while conducting proceedings. Once proceedings started, the committee published a decision about the opening of proceedings on FINA's website. Afterwards, the creditors used to have 30 days to file their claims.²¹ There was no obligation to provide creditors with any type of formal notice.²²

During the proceedings, the debtor was obliged to prepare and present the financial and operational restructuring plan to the creditors. He remained in possession of all his assets but was limited on how he may dispose with it.²³ In the restructuring plan (which had to include a positive auditor's report and opinion), the debtor was compelled to provide an overview of acknowledged and disputed claims, a debt repayment plan and/or a proposal to convert the creditors' claims into equity.²⁴ In practice, in order to reach a settlement, the creditors usually had to write off part of their claims and/or to agree to receive payments in installments.²⁵

18 See Study on a new approach to business failure and insolvency – Comparative legal analysis of the Member States' relevant provision and practices, INSOL Europe, 2014., p. 70.

19 FINA is the company with coverage on a national scale with wide set of responsibilities, including but not limited to the supervision of different state-run projects, payments and financial transactions. See more about the FINA at: <http://www.fina.hr/Default.aspx?sec=1134> (ast consulted in January 2017).

20 See Art. 33-36 of the AFOPS.

21 See supra note 17.

22 Ibid.

23 See INSOL 2014, p. 51.

24 Ibid.

25 According to the Art. 45 para 2 of the AFOPS, if the debtor makes a proposal to repay its debts in the reduced amount within a maximum of four years, such an offer to the creditors cannot amount to the less than 30% of the claim in question. On the other hand, if a debtor makes a

Under the AFOPS, there were three basic groups of creditors: public authorities and state companies (a), financial institutions (b) and all other creditors (c). As a rule, creditors' votes were weighed in proportion to the amount of their admitted claims. In order for financial and restructuring plan to be approved, at least 50% of votes needed to be counted in each category, or, alternatively, more than two-thirds of vote of all claims if considered jointly.²⁶

If the creditors approved the plan, an outline of the settlement was prepared and submitted to the commercial court of jurisdiction. This is the point when the second stage starts. After receiving a draft of the settlement the commercial court had to verify that all procedural requirements set out in the AFOPS have been satisfied. Afterwards the creditors were summoned for voting and signing of the settlement by which the pre-bankruptcy settlement proceeding came to an end.

2.1. Understanding the PBS from the practical point of view

Sometimes the best way to explain and understand how the system works in practice is to resort to case studies. Moreover, proper understanding of different situations regarding acknowledgement of claims will help us to understand concerns with respect to the position and powers of the FINA's settlement committees under the AFOPS.

Let us think about a football player who was not paid by his club according to the contract. Meanwhile, his club initiates the pre-bankruptcy proceeding. Later on, the debtor reports the player's claim to the settlement committee, the committee establishes the claim and the player and other creditors successfully vote on the adoption of the restructuring plan. The case is then transferred to the Commercial Court and the Court approves the settlement. According to the settlement, the player is paid in installments over a 2-year period, but only 50% of the claim in question.

Like with anything else, legal proceedings may take different directions. An important feature of Croatian model of the PBS under the AFOPS was that if, by any chance, creditors miss the deadline for reporting claims, the settlement could be imposed upon them without their approval and participation. The latter could happen only if a debtor reported the claim to the settlement committee. We could argue that imposing the settlement upon the creditor who did not report his claim turns out to be a much better option than losing the claim entirely. This "losing the claim entirely" scenario could occur if no one, neither the player nor the debtor, reported the player's claim to the settlement committee. In that case Art. 81/2 of the AFOPS applied and the player was prevented to initiate enforcement or any other subsequent procedure with respect to the claim that came into existence before the PBS was commenced.

Next scenario covers the situation when the debtor disputed the claim that is reported to the committee by the player. If not acknowledged by the debtor, it is possible that the reported claim will drop out of the list of claims established by the committee. The problem here relates to the fact that a debtor was empowered to

proposal to repay his debts within a period that is longer than four years, a minimum of 40% of the claim has to be offered.

26 See Art. 63 of the AFOPS.

acknowledge claims reported by creditors, except those that were already established before the PBS proceeding commenced. It is, however, questionable whether this kind of action was in the best interest of the debtor, at least for two reasons. The first is that the pre-bankruptcy proceedings under the AFOPS presented a unique chance for the debtor to restructure by reducing the rights of the player (and other creditors) below the sum that was previously agreed. Another reason lies within the fact that the player was able to take his case to court after (and if) the settlement becomes approved.²⁷ The point here is that a new litigation after successfully finalized restructuring can hardly work as a viable option for any debtor.

To sum up; apart from the claims that were already established and presented in the form of enforceable documents, only the claims on which the debtor and creditor would agree could be considered as established. All other decisions concerning the claims that drop off the list of claims as drawn up by the committee could be challenged by the creditor within the PBS proceedings, or litigated after the PBS ended.

As follows, one of the main legal consequences of the PBS concerned the fact that PBS caused a stay of enforcement proceedings in which the debtor was the defendant. Furthermore, it was not possible to initiate any other legal proceedings aiming to secure or enforce a debt. The stay of proceedings remained in effect until the pre-bankruptcy was terminated or until the settlement was approved. In case of termination of the PBS proceedings, full bankruptcy proceeding needed to be initiated over the debtor by the FINA *ex officio*.

3. FINA'S SETTLEMENT COMMITTEES – INDEPENDENT AND IMPARTIAL TRIBUNALS OR JUST THE LONG ARM OF THE STATE?

Art. 6/1 of the European Convention guarantees everyone the right to have any claim relating to his “civil rights and obligations” brought before an independent and impartial tribunal established by the law. Although this has not been expressly laid down, Art. 6/1 embodies the right of access to justice, that is, the right to submit a civil claim to a body that has full jurisdiction which means competences to judge both on the facts and on the law as a basis for its determination.²⁸

While it is evident from the case law of the European Court for Human Rights (hereinafter: the ECHR) that the claims reported to the settlement committees correspond to the concept of “civil rights and obligations”,²⁹ it is far less clear if the settlement committees have been showing the features immanent for courts and tribunals as explicated by the ECHR.

27 In practice, the creditors have quickly learned that regular checking of FINA's website may be vital for their future business. On the other hand, the debtors responsively learned that timely reporting of claims is also in their best interest because the pre-bankruptcy proceedings provided them with an opportunity to propose a repay of the debt in a significantly lower amount(s).

28 See Van Dijk, P. et. al., *Theory and Practice of the European Convention on Human Rights*, 4th Edition, Intersentia, 2006., p. 557-561.

29 About autonomous meaning of civil rights and obligations, see more in Van Dijk et. al. 2006. (supra note 29), p. 516-538.

In *Campbell and Fell* the Court stated that the word “tribunal” should not be necessarily understood as signifying a court of law of the traditional kind, integrated within the standard judicial machinery of the country.³⁰ The tribunal may be set up to deal with a specific subject matter that can be appropriately administered outside the ordinary court system. What is important is to ensure compliance with the guarantees arising from Art. 6/1, both substantive and procedural.³¹

So far, in the Court’s case law different bodies have been recognized as having the status of a “tribunal” within the meaning of Article 6/1 of the Convention. For instance, in *Sramek v. Austria* the status of a tribunal was given to the regional authority that deals with real-property transactions, in *Gustafson v. Sweden* the tribunal status was acknowledged to the criminal damage compensation board while in *Argyrou and Others v. Greece* the status of a tribunal was awarded to the forestry disputes resolution committee.³² It follows that the autonomous concept of tribunal should be viewed primarily in the substantive sense. Essentially, this means that a power to give a binding decision, which may not be altered by a non-judicial authority to the detriment of an individual party, is inherent in the very notion of “tribunal”.³³ The power to issue only advisory opinions without binding force is not sufficient to grant certain authority the status of a “tribunal”.³⁴

As mentioned earlier in the text, FINA is a professional and state controlled enterprise entrusted with different powers. Beside it was and still is involved in a number of important state projects such as pension and payment system reform, one of its primary responsibilities included supervision over payments within enforcement proceedings (this includes freezing of the defendant’s bank accounts) and *via* settlement committees, conducting of the first stage of pre-bankruptcy proceedings.

Indeed, what was the settlement committee’s function?

When conducting the first stage of the pre-bankruptcy proceedings, the settlement committees acted like administrative bodies authorized to review the conditions for initiating the PBS proceedings and also to carry out all other actions with respect to the elaboration of the restructuring plan and voting. Although there were some provisions that opened doubts as to the level of jurisdiction of settlement committees, in practice the role of the settlement committees was limited to the fulfillment of various procedural requirements. These are the review of conditions for commencement of proceedings, publishing decisions on the FINA’s website, the appointment of a pre-bankruptcy trustee and supervision of his work, supervision over all disbursements during the proceedings, compiling the list of reported claims, supervision of the trustee as well as carrying out all other actions with respect to creation of the restructuring plan and voting. However, the central issue concerned the settlement committees’ powers to decide on the fact and on the law concerning reported claims. In the *Ringeisen and Beaumartin* Case the ECHR recognized that only

30 See *Campbell and Fell v. the UK* (Judgment of 28 June 1984), para 76.

31 See *Rolf Gustafson v. Sweden*, (Judgement of 1 July 1997), para. 45.

32 See *Practical Guide to Article 6 – Civil Limb*, Council of Europe /European Court of Human Rights 2013, p. 19.

33 See *Van de Hurk v. the Netherlands*, (Judgement of 19 April 1994), para 45.

34 See *Bentham v. the Netherlands*, (Judgement of 23 October 1985), para 40.

an institution that has full jurisdiction (and satisfies a number of other requirements, such as independence of the executive and also of the parties), merits the designation “tribunal” within the meaning of Art. 6/1.³⁵

From the wording of the AFOPS it is not completely clear whether the settlement committees had the right to decide on the claims. Literal translation of the art. 60/5 reads as follows; “The settlement committee shall compile a special list of examined claims in which it shall determine for each of the claims the proportion to which the claim is established or contested.” Besides, we should not forget that the AFOPS empowered the debtors to acknowledge and deny claims. The main objection was that some dishonest debtors influenced other entities to file false claims before the FINA in order to enable out-voting of minority creditors on the pre-bankruptcy settlement plan.³⁶ If the honest creditor realized that there is a doubtful claim pending, he was prevented to dispute that falsified claim because creditors could appeal before the Ministry of Finance only decision in their own legal matter.³⁷

The settlement committees did not render a decision about the approval of the settlement (confirmation of the settlement was under the jurisdiction of commercial courts), neither were they required to examine the fairness and the quality of the restructuring and payment plan. In a certain sense, although the committees could exercise the power to establish facts concerning reported claims, in practice, during the first phase of proceedings they performed strictly administrative function (they only compiled the list of claims). It is evident that the lack of jurisdiction to issue a final decision concerning claims confront conventional requirement that only an institution that has full jurisdiction, i.e. the power to bring a decision that may not be altered by a non-judicial authority deserves to earn the notion of a “tribunal”.

Settlement committees also failed to pass tests concerning other key components immanent for the concept of a “tribunal”; the requirement of independence and impartiality.

Essentially, while the term “impartiality” requires that one body’s members are not biased with regard to the decision to be taken, the term “independence” presents a procedural safeguard that calls for independence of a tribunal *vis-à-vis* the political organs of government.³⁸ This does not mean that the executive branch of government cannot appoint judges or members of different bodies that decide on civil rights and obligations, but that once appointed, those who deliver decisions and exercise different powers within the procedure concerning civil rights and obligations should act free of any kind of pressure or influence.³⁹

35 See *Beaumartin v. France* (Judgment of 24 November 1994), para. 38 and *Ringeisen v. Austria* (Judgment of 16 July 1971), para. 95

36 See *supra* note 17.

37 If the debtor contested the reported claim, the same would subsequently fall out of the list of claims compiled by the PBS committee. Afterwards, the dissatisfied creditor could contest that decision before the Ministry of Finance and the administrative court.

38 In *Ringeisen v. Austria*, (Judgment of 16 July 1971) the Court held that the Regional Commission could be regarded as a “tribunal” as it was “independent of the executive and also of the parties”.

39 Practical Guide to Article 6 – Civil Limb, Council of Europe /European Court of Human Rights

If the conventional criteria for assessing independence is applied in the case of the FINA's settlement committees⁴⁰ we can see that all parameters, such as the manner of appointment of its members (they were appointed directly by the Minister of Finance⁴¹), the duration of their term of office (members of the committees were FINA's employees) as well as the duration of their mandate were not clearly defined in the AFOPS⁴² and therefore may all be put into question.

In addition, the AFOPS did not have any provision about the independence and autonomy of the settlement committees, the tenure, professional misconduct, responsibility and removal from the office etc. In practice, the tax authority (which was under the direct control of the Ministry of Finance) often played the role of a majority creditor which simply out-voted other classes of creditors. Therefore, we conclude that there are more than just a few doubts as to the independence and impartiality of the PBS committees.

The main problem with impartiality appears in the form of outside pressure on committee members. Nevertheless, as it follows from the *Piersack Case*, the establishment of a personal bias is difficult.⁴³ It is, therefore, always much easier to approach the problem with objectivity criteria and to determine hierarchical links between the persons acting as committee members and other parties to the proceedings.⁴⁴ The mere fact that FINA's employees are sitting on a tribunal should not necessarily mean that they are biased, particularly if we take into account that committee members have to be well-educated persons and that the president of the committee has to hold a law degree. Still, as the ECHR ruled in the *Langborger Case*, specialized experience and good qualifications to participate in the adjudication of disputes do not exclude the possibility that someone's independence and impartiality is open to doubt.⁴⁵ Altogether, strong hierarchical ties between the FINA, the Ministry of Finance and the tax authorities resulted with serious doubts as to the prior position of committee members and their immunity from the instructions of the Minister and other public authorities.

2013. (*infra* quoted as Council of Europe 2013), p. 27.

40 Concerning the criteria for assessing independence, see *Campbell and Fell v. the UK* (Judgment of 28 June 1984), para. 78. See also *Langborger v. Sweden* (Judgment of 22 June 1989), para 32.

41 The manner of appointment of a body's members has been raised as to the intervention of the Minister of Justice in *Sramek v. Austria*, *Brudnicka and Others v. Poland*, *Clarke v. UK* etc. See Council of Europe 2013, p. 28.

42 In the case law of the ECHR it can be read that the absence of a formal recognition of the irrevocability of a body's members during their terms of office does not imply a lack of independence as long it is recognized in fact and the other necessary guarantees are present. See *Campbell and Fell* (Judgment of 28 June 1984, para. 80).

43 *Van Dijk et. al. 2006* (*supra* f. 29), p. 616. In *Piersack v. Belgium* (Judgment of 1 October 1982), the Court said that it is possible to conclude that a judge is biased only when this is evident from his attitude during the proceedings or from the content of the judgment.

44 About situations in which the question of a lack of judicial impartiality may be at stake, see Council of Europe 2013 (see *supra* note. 40), p. 29-31. See also *Van Dijk et. al. 2006* (f. 29), p. 614-623.

45 See *Langborger v. Sweden*, (Judgment of 22 June 1989), para. 34.

4. COMMERCIAL COURTS – RUBBER-STAMPERS OR JUDICIAL BODIES OF FULL JURISDICTION?

At first sight, it seemed that the system of pre-bankruptcy settlement proceedings had fundamentally denied access to justice for those who had reported their claims during proceedings. Notwithstanding the fact that the settlement committees cannot be regarded as “tribunals” according to the Convention, it is important to observe that in *Le Compte, Van Leuven and De Meyere* the ECHR held that Art. 6/1 does not oblige the States to submit “contestations” (disputes) over “civil rights and obligations” at each of its stages before “tribunals” meeting the requirements of Art. 6/1 (independence, impartiality, full jurisdiction).⁴⁶ That is to say, demands of flexibility and efficiency which are fully compatible with the protection of human rights may justify the prior intervention of administrative or professional bodies and, a fortiori, of judicial bodies which do not satisfy the said requirements in every respect.⁴⁷ In *Albert and Le Compte*, the ECHR clarified that the Convention calls for at least one of the two following systems; either the jurisdictional organs themselves comply with the requirements of Art. 6/1, or they do not comply but are subject to subsequent control by a judicial body that has full jurisdiction and provides the guarantees of Art. 6/1.⁴⁸ As pointed out by Van Dijk *et. al.*, this means that the situation where appeal against administrative action lies with an administrative body does not necessarily conflict with Art. 6/1, provided that there is in the last resort access to review by a court with full jurisdiction.⁴⁹

Interestingly, this kind of an approach, according to which only the last stage of the proceedings has to fulfill the requirements of Art. 6/1 is clearly favored by the European Commission. In the Recommendation on a new approach to business failure and insolvency the EU Commission defines that the wording “courts” include any other body with competence in matters relating to preventive procedures to which the Member States have entrusted the role of the courts, and whose decisions may be subject to an appeal or review by a judicial authority.⁵⁰

Let us recollect; creditors could appeal FINA’s decision on the exclusion of the claim from the list of claims before the Ministry of Finance (Independent Sector for the 2nd Instance Administrative Proceedings). If the Ministry of Finance had confirmed the decision delivered by the settlement committee, unsatisfied creditor could still challenge that decision before the administrative court.⁵¹ However, the problem was

46 See *Le Compte, Van Leuven and De Meyere* (Judgement of 23 June 1981), para. 51.

47 *Ibid.*

48 See *Albert and Le Compte v. Belgium* (Judgment of 10 February 1983), para. 29.

49 Van Dijk *et. al.* 2006 (f. 29), p. 568.

50 See Recommendation on a new approach to business failure and insolvency of the EU Commission, Brussels, 12. 3. 2014., C(2014) 1500 final., chapter 5 (Definitions), p. 6. The Commission holds that promoting efficiency is of crucial importance because it results with less delays and lower costs. Therefore, national preventive restructuring frameworks should include flexible procedures that will limit court formalities only to where they are necessary and proportionate in order to safeguard the interests of creditors and other interested parties (see p. 4 para. 17 of the Recommendation).

51 See Art. 16-22 of the Law on Administrative Disputes (Official Gazette no. 20/2010, 143/2012,

that the AFOPS prescribed that the pre-bankruptcy proceedings are urgent and that they must complete within 120 days from the day of its official commencement. Even if this period was extended it was practically impossible that the proceedings before the administrative court end before the settlement goes to the commercial court for an approval.⁵²

The analysis of the relevant provisions of the AFOPS suggests that the commercial courts had only narrow competences while deciding on the confirmation of the pre-bankruptcy settlement plans. They were only required to analyze whether the proposal of the pre-bankruptcy settlement corresponds with the restructuring plan that was previously accepted. If so, the commercial court summoned the parties and if majority creditors voted in favor of the adoption of the restructuring plan, the court approved the settlement.⁵³

4.1. Approval of the PBS and legal remedies against the decision of the court on approval of the pre-bankruptcy settlement

The analysis of the AFOPS indicates that the courts were empowered to approve the settlements, not the restructuring plans.⁵⁴ The effects of a court settlement are the same as those of *res judicata* and the subject matter of the court settlement cannot be raised again in a new litigation.⁵⁵ Also; if it's a court settlement – than no appeal could be brought against the decision.

In practice there were some doubts as to the legal nature of the court's approval.

What we can see if we take a closer look at the documents uploaded on the FINA's website is that sometimes the courts were granting the right to appeal against decisions on the approval of the PBS! In 2014 the High Commercial Court accepted one appeal on the basis that every decision may be challenged by an appeal unless the relevant law does not permit appeal at all.⁵⁶

152/2014).

52 If the debtor and majority creditors fail to agree on settlement and restructuring plan during the 1st stage of proceedings, the PBS proceedings will be suspended and the classic bankruptcy proceeding initiated.

53 See Art. 66 of the AFOPS.

54 See Art. 66/9 of the AFOPS. According to the Commission's 2014 Recommendation on a new approach to business failure and insolvency, the court's confirmation of a restructuring plan is necessary to ensure that the reduction of the rights of creditors is proportionate to the benefits of the restructuring and that creditors have access to an effective remedy, in full compliance with the freedom to conduct a business and the right to property as enshrined in the Charter of Fundamental Rights of the EU. According to the EU Commission, the court should therefore reject a plan where it is likely that the attempted restructuring reduces the rights of dissenting creditors below what they could reasonably expect to receive in the absence of a restructuring of the debtor's business.

55 See Art. 323 of the CPA and Art. 66 p. 13 of the AFOPS. If the parties to a settlement want to contest the settlement, essentially they will have to bring a new action - application for setting aside and therefore initiate completely new proceeding. In traditional litigation, when parties to the proceedings reach a court settlement, the court is required to examine the legality of the parties' actions in terms of their contrariness to *ius cogens* and the rules of public morality.

56 See decision of the High Commercial Court of the Republic of Croatia no. Pž-1983/14-3

It is questionable whether we would have an inconsistency had the AFOPS prescribed that the court confirms a restructuring plan, not a settlement. If that was the case the creditors would definitely have the right to appeal against the court's decision.

It appears to us that such a legal ambiguity and disorientation is a consequence of two facts. Firstly, the courts were improperly interpreting procedural provisions of the AFOPS which did not explicitly prescribe the (procedural) nature of the court's decision on the approval of the PBS. The second fact relates to the courts' reluctance to react *ex officio* (or even on the motion of the parties to the settlement) if they would realize that some claims were not genuine, but simply false claims, reported by the companies affiliated to the debtor, admitted by the debtor and acknowledged by the settlement committees during the first stage proceedings.

On a few occasions the courts to which a dubious settlement proposals were submitted justly found that voting rights cannot be exercised with respect to false claims.⁵⁷ Surely, it would be wrong to impose a pre-bankruptcy settlement upon the debtors who had no opportunity to contest the claims of questionable quality.⁵⁸

It is our impression that the issue of false claims reporting directly relates to the issue of full jurisdiction. As it was pointed out in *Terra Woning B.V.*, the refusal of a court to rule independently on certain issues of fact that are crucial to the settlement of dispute may amount to a violation of Art. 6/1.⁵⁹ In *Tsfayo* Case the ECHR concluded that a violation of Art. 6/1 may also occur if the court does not have jurisdiction to determine the central issue in the dispute.⁶⁰

The power of commercial courts was obviously limited by the AFOPS. The courts had very limited jurisdiction as to the establishment of facts. Also, the fact is that in vast number of cases, the courts only examined whether procedural requirements to approve the settlements are satisfied. Among judges, there was a general impression that the courts have only limited competences in the pre-bankruptcy proceedings. The widespread belief was that their duty was to only check whether the proposal for establishing the pre-bankruptcy settlement is submitted within the 15-day time limit, whether the proposal of the pre-bankruptcy settlement with its essential elements and attached documents corresponds to previously accepted restructuring plan and finally, the court's responsibility was to summon the parties for voting and to approve the

together with Art. 378/1 of the Civil Procedure Act.

57 See, for instance, ruling of the High Commercial Court of the Republic of Croatia No. Pž-8613/13-4 of November 25, 2013.

58 The problem with non-existing claims emerged right after the AFOPS was amended, not through the parliamentary procedure but with government's regulation. The amendments allowed the joint debtors of the main debtor to report claims based on guarantees and joint indebtedness. To put it differently, the amendments gave the voting rights to the guarantors – joint debtors of the main debtor notwithstanding the fact that they did not settle the claims, or even worse - that the claims were “created” after the initiation of the pre-bankruptcy proceedings. See Ruling of the High Commercial Court of the Republic of Croatia No. Pž-8613/13-4 of November 25, 2013. This Ruling is available in English at the web page of the Zagreb Stock Exchange: <http://zse.hr/userdocsimages/novosti/eZst6EHqgDkyXX2Y3OI2dg==.pdf> (last consulted in January 2017).

59 Ibid.

60 Ibid.

settlement.

If we take a look at the relevant case law of the ECHR, it turns out that such, very light form of judicial control over pre-bankruptcy settlements can be compatible with Art. 6/1 only if it is ensured that in the prior (administrative) proceedings all requirements and guarantees of the Art. 6/1 are duly respected.⁶¹ Therefore, were the creditors provided with quality safeguards against abuses concerning the establishment of claims, even a lighter form of judicial control would suffice to comply with the conventional requirements.⁶²

Lastly, it can be argued that in only few cases the courts were acting like the courts or full jurisdiction having competence to reject the proposed PBSs, while in all other cases they were only rubber-stampers of the settlements agreed before the FINA's settlement committees. To put it simply, the commercial courts, although satisfying the requirements of Art. 6/1 immanent for a "tribunal" have deprived themselves of jurisdiction to examine the facts that were crucial for the determination of the lawfulness of pre-bankruptcy settlement proposals.⁶³

5. CONCLUDING REMARKS

In the time of crisis, every state has a special interest to support and maintain continuation of businesses. One way to help debtors and creditors to address their financial problems at an early stage, when the debtors are still capable of restructuring and recovering is to introduce the legislative framework for pre-bankruptcy (insolvency) settlement proceedings. These proceedings give a debtor an opportunity to restructure and to avoid traditional bankruptcy by negotiating and changing the conditions of repayment, the structure of assets, the conversion of the debts into equity and similar.

The model of pre-bankruptcy settlement proceedings that was in 2012 chosen by the Croatian Government is a complex one. One of its main characteristics was the division into two separate stages; the first one which was conducted before a professional body under the direct control of the state, and the second which was under the jurisdiction of commercial courts. While in force, the system received strong criticism from various sides, mainly because of allegations that it allowed reporting of false claims, while at the same time it did not explicitly require the settlement committees and subsequently the courts to carry out an effective review as to whether the claims reported were genuine.

Allowing prior intervention of professional bodies in disputes over civil rights and obligations may be a feasible solution if the court system is slow, inefficient and costly. The system which allows intervention of professional bodies such as the FINA has the potential to comply with Art. 6/1 of the European Convention on Human Rights only if series of requirements are properly met. As pointed out by the ECHR, demands of flexibility and efficiency may justify the prior intervention of professional

61 See *Bryan v. the UK* (Judgment of 22 November 1995), para. 47.

62 Cf. *ibid.*

63 See *Terra Woningen B.V. v. the Netherlands* (Judgment of 17 December 1996), para. 54-55.

bodies and, *a fortiori*, of judicial bodies which do not satisfy the requirements arising from Art. 6/1 in every respect if the case is finally subjected to subsequent control by a tribunal - a body that has full jurisdiction and is free of any kind of political interference.

In its prior legal solution, the Croatian legislator had virtually accepted the standpoint of the EU Commission that calls for promotion of efficient national restructuring mechanisms that include flexible and low cost procedures, limiting court formalities only to where they are necessary. Unfortunately, the commercial courts that were finally approving settlements rarely acted like the tribunals of full jurisdiction. There are only few reported situations when the courts carried out an examination of the trustworthiness of claims reported during the first stage of proceedings. Basically, the courts were only verifying different procedural requirements before delivering a decision on approval of the settlements.

Former Croatian system of pre-bankruptcy proceedings shows that limiting court powers to the verification of different procedural requirements may work as a viable option only if the creditors enjoy procedural safeguards during other phases of procedure. As it can be interpreted from the ECHR's case law, if the professional bodies comply with the requirements of Art. 6/1, even a lighter form of subsequent judicial control may be justified.

Experience from Croatia also shows that in situation when we have professional bodies alike the FINA involved in the process of establishing of facts in the course of administrative or quasi-judicial proceedings, a matter of the utmost importance is to precisely determine very strict rules concerning the qualifications, appointment, tenure, professional misconduct, responsibility and removal from office of persons that have the power to decide on civil rights and obligations of the parties to the proceedings. Therefore, impartiality and independence of the bodies to which the adjudicating is conferred play a major role.

Theoretically, there would be nothing wrong with Croatia's model had it provided creditors with guarantees that the claims are established fairly, by independent and impartial committees. Although aforementioned guarantees did not exist in Croatian case, this still does not mean that the idea of the two-staged PBS proceedings is incapable of ensuring fundamental rights protection.

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Sažetak

OSVRT NA STRUKTURU PREDSTEČAJNIH POSTUPAKA IZ ZAKONA O FINANCIJSKOM POSLOVANJU I PREDSTEČAJNOJ NAGODBI

Teško je prisjetiti se kada je jedan zakonski tekst iznjedrio više kontroverzi od Zakona o financijskom poslovanju i predstečajnoj nagodbi. Intencija zakonodavca je bila jasna; pomoći trgovačkim subjektima u problemima da revitaliziraju svoje poslovanje, njihovim vjerovnicima da naplatu svojih potraživanja ostvare u većim iznosima nego što bi to bilo moguće u klasičnom stečajnom postupku te u konačnici, smatralo se da će predstečajni postupci doprinijeti očuvanju radnih mjesta.

U radu se analizira struktura postupka predstečajne nagodbe te se propituje je li rješenje iz kasnije dijelom anuliranog hrvatskog propisa, prema kojemu je u prvoj fazi postupak provodilo posebno tijelo s administrativnim ovlastima, a u drugoj nadležni trgovački sudovi, u skladu s tumačenjima jamstva prava na pravičan postupak iz prakse Europskog suda za ljudska prava.

***Ključne riječi:** Zakon o financijskom poslovanju i predstečajnoj nagodbi, Europska konvencija o ljudskim pravima, sud pune jurisdikcije, pravo na pravično suđenje i ostvarivanje prava na pristup sudovima.*

Zusammenfassung

KAMPF GEGEN DIE REZESSION UND VERLETZUNG DER GARANTIE DES RECHTS AUF ZUGANG ZUR RECHTSPFLEGE – ÜBERPRÜFUNG DER STRUKTUR DES VORINSOLVENZVERFAHRENS AUS DEM GESETZ ÜBER FINANZGESCHÄFTE UND VORINSOLVENZREGELUNG

Es ist schwer, sich daran zu erinnern, wenn ein Rechtstext mehr Kontroverse als das Gesetz über Finanzgeschäfte und Vorinsolvenzregelung erregt hat. Die Absicht des Gesetzgebers war klar: Handelssubjekte in Problemen zu unterstützen, ihre Geschäfte zu beleben, ihren Gläubigern die Auszahlung ihrer Forderungen in größeren Mengen zu ermöglichen, als es in den klassischen Konkursverfahren möglich war; und letztendlich wurde geglaubt, dass die Vorinsolvenzprozesse zur Erhaltung von Arbeitsplätzen beitragen würden. Dieser Artikel analysiert die Struktur des Vorinsolvenzprozesses und überprüft, ob die Entscheidung des späteren teilweise annullierten kroatischen Vorschrift, anhand welches der Verfahren in der ersten Phase ein spezielles Gremium mit administrativen Rechten durchgeführt hat und in

der zweiten Phase zuständige Handelsgerichte im Einklang mit der Auslegung des gewährleisteten Rechts auf ein faires Verfahren vor dem Europäischen Gerichtshof für Menschenrechte.

Schlüsselwörter: *Gesetz über Finanzgeschäfte und Vorinsolvenzregelung, Europäische Menschenrechtskonvention, das Gericht der vollen Zuständigkeit, das Recht auf ein faires Rechtsverfahren, das Recht auf Zugang zum Gericht.*

Riassunto

LA LOTTA ALLA RECESSIONE A SCAPITO DELLA TUTELA DEL DIRITTO ALL'ACCESSO ALLA GIUSTIZIA: UNO SGUARDO ALLA STRUTTURA DEI PROCEDIMENTI PREFALLIMENTARI NELLA LEGGE SULLE OPERAZIONI FINANZIARIE E SUL CONCORDATO PREVENTIVO

E' difficile riportare alla mente in quale occasione un testo di legge abbia generato un numero di dispute maggiore rispetto a quelle sorte in seno alla legge sulle operazioni finanziarie e sul concordato preventivo. L'intento del legislatore era evidente: aiutare i soggetti commerciali nei problemi riguardanti la rivitalizzazione della proprie attività, aiutare i loro creditori affinché riuscissero a soddisfare i propri crediti in somme maggiori rispetto a quelle recuperabili nel procedimento fallimentare classico. In sostanza, v'era la convinzione che i procedimenti prefallimentari avrebbero contribuito alla conservazione dei posti di lavoro.

Nel lavoro si analizza la struttura del procedimento di concordato preventivo e si pone l'interrogativo se la soluzione successiva derivante dalla legge poi in parte abrogata (che stabiliva che il procedimento in una prima fase venisse condotto da organi amministrativi, mentre in una seconda fase da tribunali commerciali competenti) fosse rispettosa del diritto al giusto processo sancito dalla giurisprudenza della Corte europea dei diritti dell'uomo.

Parole chiave: *Legge sulle operazioni finanziarie e sul concordato preventivo, Convenzione europea per la salvaguardia dei diritti dell'uomo e delle libertà fondamentali, tribunale di piena giurisdizione, diritto al giusto processo e realizzazione del diritto all'accesso alla giustizia.*

