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Varazdin Development and Entrepreneurship Agency
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ABSTRACT

In recent years, which are characterized by the crisis in the whole world, inconsistent government policies of EU member states ranged from the proclaimed liberalism to ad hoc interventionism. Doctrinal analyses indicate that this is a result of non-compliance of the state economic powers and its existing obligations towards its citizens and other economic subjects. Furthermore, they indicate that states are trying to fulfil their expected social, economic and political function by rescuing big companies, which they perceive as the "backbone" of the national development (economic and social) policy, from liquidation bankruptcy. In this context, it is the purpose of this paper to identify the paradigm for such relationship. This issue will be contemplated based on the analysis of a case study of bankruptcy/privatization/change in the status of the Institute of Immunology, Inc. Working thesis is that the modalities of bankruptcy are a necessary part of a market economy and that they can ensure the safety and options for the creditors, giving them a modus operandi for the recovery of subjects with financial difficulties through bankruptcy plan or quick restorations of blocked funds on the market through the process of bankruptcy liquidation.

Keywords: *bankruptcy, interventionism, intellectual capital, case study.*

1. GENESIS OF THE PROBLEM

In 1302, when the Ammanti Bank in Italy became insolvent and when its branch in Rome was closed, there was a panic among its creditors. The main debtors were in Spain, England, Portugal, Germany and France and creditors were desperately looking for the intervention and help from Pope Boniface the VIII. Since much of the financially injured parties were from the clergy, Pope banned the disposal of property by bank owners (Sajter, 2008, p. 43). Yet state intervention as an interference in economic and legal relations is a phenomenon that was a particular characteristic of the 1920's and 1930's. The USA policy of Roosevelt's New Deal marked a new direction for the biggest capitalist power of the modern world, but also created a model of state interventionism in the country which advocated principals of economic liberalism (Tufano, 1997, pp. 1-40). On the other hand, the situation was similar in Europe, with the exception that state intervention was limited in scope, in a way that it was more restrictive intervention rather than one justified by the aim of "public benefit". *Exempli causa*, during the Nazi period, the German and Austrian banks and insurance companies were obliged to buy a large number of government bonds, which became worthless after the Second World War. In the end, all of them were bankrupt, but the state couldn't allow the collapse of the entire economy, which led to various forms of state interventionism (Weber, 1985, pp. 123-141). In the former state of Yugoslavia the situation wasn't different. In 1931 there were 536 bankruptcies and 835 compulsory settlements. Already in 1932 the usage of the interventionism as a model for saving insolvent subjects declined, which lead to bankruptcy of 11 banks, 117 industrial and institutional companies and 514 wholesale trade operations (Bilandžić, 1973, p. 212). In other words, the crisis that led to a collapse of the concept of liberal economy also brought about measures of state intervention. In fact, the market deficiencies were often used as economic, legal and political arguments for the activity of the state and for its intervention in all areas of economy and law.

2. INTERVENTIONISM AND BANKRUPTCY REGULATIONS UNTIL 1997 AND THE ADOPTION OF MODERN BANKRUPTCY ACT IN 1997

Doctrinal analysis indicates that the legislative regulation in the economic field, which certainly encompasses bankruptcy, was, at least until 1997 and the adoption of the first modern Bankruptcy Act, inadequate in legal (and nomotehnical) terms (Bodul, *et al.*, 2013, p. 911. *et seq*.; Falke, 2003, p. 43). This allowed for free interpretations and often misinterpretations by the national authorities, at the expense of business factors. The doctrine also indicates that the former bankruptcy law didn't recognize bankruptcy plan as a model of bankruptcy proceedings, but only an institute of compulsory settlement. This procedure of compulsory settlement aimed at creating positive equity for firms in bankruptcy, in terms of accounting, but didn't seek to identify and address the essential reasons which had created the conditions for the initiation of bankruptcy proceedings. Of course that these accounting and technical combinations did not result in rehabilitation of companies. On the contrary, in a very short period, after the formal exit from the bankruptcy, the companies would again be in the zone of negative value of equity and compulsory settlement proceedings would have to be renewed. It should be noted that in many companies this procedure was done several times and that compulsory settlement proceedings practically lasted over ten years (Dika, 1988). It is perhaps needless to talk about the practical negative consequences of this approach if we know that the very laws were not being applied and that the state and politics had taken the role of "arbitrator" who had a decisive influence on all economic relationships. Moreover, in some former socialist countries, the state went so far that it prohibited initiation of bankruptcy process, *exempli causa*, in Russia (Lambert Mogiliansky, *et al.*, 2003). Yet the adoption of the Bankruptcy Act in Croatia in 1997, modelled after the German insolvency law (*Insolvenzordnung*) from 05. December 1994 (Bundesgesetzblatt 1994, I, p. 2866; last change Bundesgesetzblatt, 2011, I, p. 2854.) and the termination of the Law on Forced Settlement, Bankruptcy and Liquidation (Official Gazette, 53/91 and 54/94) represented a radical change in the way bankruptcy proceedings were conducted in Croatia.

3. WAS THE IMPLEMENTATION OF THE (MODERN) BANKRUPTCY ACT IN 1997 A TURNING POINT?

Theory indicates that the legal framework for the organization and operations of the business entities, first set by the Enterprise Act, and later by the Companies Act was, to some extent, acceptable for the transition period. On the other hand, bankruptcy legislation and practice are an example of resistance of the political structures towards modern bankruptcy law. This systematic way of resolving business problems of insolvent companies through socialization of their losses has logical repercussions on the micro level where business entities lose their motivation to behave economically rationally by identifying business problems that can be overcome by the restructuring process. Furthermore, the fact that the Bankruptcy Act was passed in 1997 (Official Gazette, 44/96) showed "fear" of strict enforcement of bankruptcy reasons for the commencement of bankruptcy proceedings on a huge number of state-owned enterprises, thus leading to the formal termination of thousands of fictively employment contracts. In the opinion of the author, among a large number of novelties which were implemented by a new Bankruptcy Act (1997), perhaps the most important one was a credibility of bankruptcy reasons on which the court can and must make its decision to open bankruptcy proceedings (Dika, 1996, pp. 1-35, Dika, 1996, pp. 114-117).

3.1. A brief overview of the development of bankruptcy legislation (and the interventionism) from 1997th to 2016th

The adoption of the Bankruptcy Act in May 1996, whose implementation started on January 1st 1997, improved the bankruptcy process by decreasing its duration. However, statistical data showed that bankruptcy process in Croatia was considerably longer and more expensive than an equivalent procedure in the average European country. Our view of the problem of functioning bankruptcy system is based on the analysis of indicators of efficiency of the bankruptcy proceedings, as follows: (1) duration of bankruptcy process, (2) the degree of satisfaction of creditors' claims (3) the cost of conducting bankruptcy proceedings. These indicators are also the best way of monitoring the fulfilment of the objectives of bankruptcy proceedings (Tomas Žikovic, et al., 2014, pp. 318-351). Therefore, in order to overcome the "acute" problems in practice and to improve the system of bankruptcy protection, by accelerating and reducing the cost of bankruptcy proceedings, the legislators amended the Bankruptcy act eight times (Dick, 1996, pp. 60-64.). In reality problematic system of legal remedies, the passivity of creditors, the ineffectiveness of the enforcement of court orders, insufficient control over the work of the bankruptcy administrator and the inconsistent application of the law, as well as many other institutional factors lead to a perception that the bankruptcy is a "death" of the subject. As an anachronism of the socialist system, whose ideology did not recognize a failure of business enterprises, the bankruptcy regulations wasn't radically changed, and paradoxically, the result is not an excessive number of the bankruptcy proceedings, but the fact that, due to the actual state non-intervention, there are still thousands of business entities that were obliged to open bankruptcy proceedings but did not do so. Moreover, the analyses indicate that only 5% of insolvent legal persons opened bankruptcy proceedings on time, while for others it has been tolerated to operate in deep insolvency, although it is legally considered a criminal offense (Sajter, 2007, pp. 31-42.). For the market, it was a socialization of losses, by covering insolvency of individual companies through many forms of budget funding.

However, frequent financial crisis caused the need for a radical reform of the bankruptcy legislation. The impetus for further reforms, not only in Croatia, but also in the whole of Eastern Europe, was the process of joining the EU, because in order to became a member one must meet the so-called "Copenhagen and Madrid criteria" which implies the harmonization of legislation and practices of a candidate country with the *acquis communautaire* of the EU (e.g. functioning market economy, effective protection of civil rights, the rule of law, political stability). Since the techniques of conducting bankruptcy didn't result in progress and that a bankruptcy liquidation was a rule, (there was no reorganization plan), there was a need for the implementation the new law, the Law on Financial transactions and pre-bankruptcy settlement (Official Gazette, 108/12, 144/12, 81/13, 112/13, 71/15 and 78/15 - heir and after: ZFPPN). The first aim was, based on the models of European bankruptcy legislation (Bodul, *et al.*, 2013), to force creditors to make, within a reasonable time, the key decisions about the fate of the debtor. The second, but equally important aim was to have only bankrupt companies which have exhausted all other possibilities of rehabilitation and have failed to reach an agreement with creditors, go into bankruptcy liquidation procedure. But the problem was the body of the pre-bankruptcy procedure, the so-called Pre-bankruptcy Council. This body consisted of two members and the president of the council. The idea was that the pre-settlement procedure which was carried out before the Financial agency (heir and after: FINA) will fully depend on the willingness of creditors and debtors to settle. We also have to bear in mind that the Pre-bankruptcy Council has only a formal role in the process of the pre-bankruptcy settlement, e.g. it is not up to the Pre-bankruptcy Council to decide whether the parties will reach pre-settlement agreement, because the Council only has a role of a responsible mediator to create conditions and lead the process in which the debtor and creditor will be able to negotiate and reach an

agreement. On the other hand, appointments of the Pre-bankruptcy Council by the Minister of Finance is also controversial mainly because the members of the Council are generally employees of the Ministry of Finance and they could be potentially subjective and bias in conducting the process of pre-bankruptcy settlement in which Ministry is regularly on the side of the creditors as a party in the process. Moreover, in the process of appointment of the members of the Pre-bankruptcy Council the candidates were not required to pass any certification exam. *Exempli causa*, since the requirements for the position of the Pre-bankruptcy Council member depend entirely on the discretion of the Minister of Finance, there are no obstacles for the trainees of these bodies to be appointed to the function (art. 33. ZFPPN). In addition, the author cannot overlook the fact that the State, as a party to the pre-settlement proceedings, is normally the biggest creditor and it is, thus, reasonable to raise the question of objectivity and impartiality of the persons who are members of the Pre-bankruptcy Council. The members of the Council are appointed by one of the parties in the case, i.e. the State, who is often the creditor with the largest rights on the property of a pre-bankruptcy debtor. Accordingly, the application of certain norms of ZFPPN may represent state aid in cases where the creditor is as State, local and regional governments and companies in state ownership. There is also the danger that Pre-bankruptcy Council concludes that this is not a state aid, which afterwards can be proven false. Such funds allocated by the state are considered illegal state aid on the basis of the State Aid Act (Official Gazette, 47/14.) The Agency for Protection of Competition (CCA) then must order a recovery of state aid plus the reference rate and the basis points. Any state aid granted without the authorization of the CCA shall be considered an illegal state aid (Janes, 2012, p. 44). This indicates that the efficiency of the Pre-bankruptcy settlement process cannot be measured by the number of initiated proceedings. Even the viability of a business through the bankruptcy plan or the pre-bankruptcy settlement cannot be a valid measure, since it may show only the results of the government subsidies which are often illegal (Bodul, Vuković, 2016, pp. 12-14.). Although the adoption of ZFPPN in 2012 has significantly altered the way the bankruptcy proceedings are conducted in the Republic of Croatia, in its three-year practical application a number of problems were noted in the interpretation and effects of certain provisions of the institute, which the government will try to eliminate by adopting the new Bankruptcy Act (Official Gazette, 71/15 – here and after: BA). Perhaps the biggest legislative change were the provisions on the pre-bankruptcy settlements that have been taken from ZFPPN into the new Bankruptcy Act and renamed a pre-bankruptcy proceedings (Chapter II (art. 21 to 74)). The bodies of pre-bankruptcy proceedings are the judge and the commissioner (art. 21) while FINA became a technical and administrative service of the court (art. 44). The pressure for such reforms and for a stronger role of the court in conducting pre-court settlements came from Art. 6, no. 1. of the European Convention for the Protection of Human and Fundamental Freedoms (Official Gazette, 18/97, 6/99, 14/02, 13/03, 9/05, 1/06 and 2/10.) (*Right to a fair trial: 1. In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgment shall be pronounced publicly but the press and public may be excluded from all or part of the trial in the interests of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the private life of the parties so require, or to the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice*). This resulted in an alteration of the legislative solutions according to which FINA *de facto* and *de jure* decided in the pre-bankruptcy settlement procedures. Along with a number of innovations brought about by the new BA in the domain of basic legal effects of the procedure, it is certainly important to consider those related to the position of tax claims or the position of the state and its tax claims in pre-bankruptcy and bankruptcy proceedings. Furthermore, no practice is necessary to raise awareness and call for

caution since the modes of forgiveness of tax debt as an instrument of State aid are part of a very detailed and complex system of state aid rules (Regulation on the conditions, manner and procedure for disposal of claims with titles in the pre-tax debt and bankruptcy procedure (Official Gazette, 122/15)).

Certainly we consider important to mention The Law on Securing Workers' Claims in the event of bankruptcy of the employer (Official Gazette, 86/08, 80/13 and 82/15). The workers who have legitimate claims against the company where they worked and which found itself in bankruptcy, have a possibility to receive a certain amount of unpaid salaries, outside and before the bankruptcy proceedings, and regardless of the fate of the bankruptcy estate. Their claims are taken over by a (newly) established Insurance Agency for workers' claims. Moreover, in addition to the existing system of protection of the substantive rights of workers in case of bankruptcy of the employer, the latest amendments protect the livelihood of workers and payment of minimum wages by the Agency in case that the employer is unable to cover the salaries (Chapter II, art. 4c, 4d and 4e.). Furthermore, this system is financed from the state budget, therefore, from taxpayers. So, the question remains – Is this legal structure a good solution? On the one hand, unlike in the normal capitalist economy, in which the claims of the employees to the company in which they work cannot exceed one month gross salary, in (post)transition economies these claims can be perennial, so it makes sense, for social reasons, to intensify and accelerate payment for these claims. On the other hand, the doctrine suggests that the mentioned problem is a current issue and that it doesn't make sense to address a temporary problem with a permanent solution which will remain in force after the normalization of economic markets. In addition, we do not see why the taxpayers, many of which live below the poverty line, should finance the payment of private claims of private persons for their private bankrupt companies. For, the budgetary financing debts in bankruptcy is a classic example of economic interventionism (Bodul, *et al.*, 2013, pp. 525-560.).

Furthermore, although the anecdotal evidence suggests that the desired objectives for functionalization of bankruptcy law protection have not yet been reached, the legislators have the new / old task - to implement the institutes of consumer bankruptcy through the Bankruptcy Consumer Act (Official Gazette, 100/15 - heir and after: BCA). The aim is to solve the social problems through the institute of bankruptcy. For now it is too early to evaluate the success or failure of such solutions, however, the anecdotal evidences show that the German consumer bankruptcy proceedings, whose solutions had been transplanted into BCA, have a low success rate of resolved bankruptcy cases (2-3%) while procedures lasted up to 11 years (Lechner, 2011, pp. 59-81.). In March of 2006, a proposal for the discussion entitled "Draft law on exemption of debts for people without any means and on amendments to insolvency proceedings for consumers" was forwarded to the members of the working group of the Bund-Länder by the German Federal Ministry of Justice (Reform des Verbraucherinsolvenzrechts, 2005.). This paper is still a proposal.

4. CASE STUDY OF THE INSTITUTE OF IMMUNOLOGY, INC. ZAGREB

The Institute of Immunology, Inc. Zagreb (hereinafter: the Institute) is substantially determined by three components: 1) monopoly position in the Republic of Croatia in the production of viral vaccines, 2) own "know-how" as an intellectual property in the broad sense and 3) the company's strategic importance for Croatia (Decision on establishing the list of companies and other legal entities of strategic and special interest for the Republic of Croatia (Official Gazettes, 120/13, from 27 September of 2013). However, despite the obvious comparative advantages, in accordance with the Bankruptcy Act (Official Gazettes, 44/96, 29/99, 129/00, 123/03, 82/06, 116/10, 25/12, 133/12, and 45/13) the Commercial court, with its Decision no. 3rd St-1719 / 2013-6 from December 20th 2013, initiated the bankruptcy proceeding and the bankruptcy judge appointed a preliminary bankruptcy trustee. However, not long after, a

proposal for opening a bankruptcy proceeding was withdrawn by its applicant? The reasons for such action remain unknown because the information is not accessible to the interested scientific and professional community. For now, everything indicates that this has been done because of the state interventionism. The base for the present thesis on state interventionism is found in the provisions of our bankruptcy legislation in the part related to the suspension of the bankruptcy proceedings. The suspension of the bankruptcy proceedings occurs due to the inadequacy of the bankruptcy estate, and that certainly is not the case in bankruptcy proceedings against the Institute which has assets (bankruptcy estate) of high monetary value. Specifically, in Chapter V subsection 4 (art. 203 to 212) BA deals with the matter of suspension of the bankruptcy proceedings. The suspension is possible if there are following reasons for the suspension: 1) suspension due to the lack of bankruptcy mass to cover the costs of the bankruptcy proceedings (art. 203); 2) The suspension due to insufficiency of the masses for the fulfilment of other obligations of the bankruptcy estate (art. 204); 3) suspension for subsequent disappearance of the reason for bankruptcy (art. 208) and 4) suspension with the consent of creditors (art. 209). Suspension ad. 1) and 2) refer to the suspension of the bankruptcy proceedings against the debtor legal entity, while the suspension ad. 3) and 4) relate to the suspension of the bankruptcy proceedings against the property of the individual. In the BA there are no other reason for suspension of an already initiated bankruptcy reason, so it is a closed circle of reasons for the suspension (*numerus clausus*). In essence, there are two very similar suspension procedures. Yet the Government, regardless of the existence of grounds for bankruptcy reasons, tried to privatize the Institute. The main idea was that the resources owned by the state should be transformed into a more efficient form of ownership - private ownership, in order to create a clear ownership structure, and indirectly to force investors to take risk in the attempt to preserve and improve the funds that they have invested. However, it is important to note that the privatization is a fundamentally different procedure, both from the standpoint of the nature of the procedure and the reasons for its initiation, and finally from the aspect of responsibilities and positions of the participants in the process. But after the failed privatization during which the government rejected what was seen as an unsatisfactory offer to buy the state portfolio in the Institute, it was decided that the Institute shall be transformed to a facility for carrying out activities related to health. It will be the property of the state and under the jurisdiction of the Ministry of Health, which will, along with the State office for state property management, be in charge of its legal transformation (Regulation on the establishment of the Institute as a Public health Institution which is of strategic and general economic interest for Republic of Croatia (Official Gazettes, 91/2015)).

5. COMPARATIVE EXPERIENCE WITH COMPANIES IN BANKRUPTCY AND MODELS OF INTERVENTIONISM

In 2002 the board of British Energy, which is a private company, decided that it will stop the delivery of supply of electricity to the Great Britain unless it receives emergency financial aid from the British government. On one hand, the government could choose between respecting market laws, which would leave this company to market sanctions, bankruptcy, and, by extension, millions of citizens would be left in dark, or, on the other hand, it could approve the requested loan of one billion Euros. The British government chose the second solution and gained control of 65% of shares (Bujišić-Petrovic, 2006, pp. 281-288.).

Similar action was taken by the French government in order to rescue a private company Alstom. If the government had not intervened, the potential loss of banks, French and foreign, would have amounted to around 17 billion euros. In this case too, the state was obliged, in accordance with the proclaimed liberal principles, to leave the private corporation to market sanctions, but the consequences of that bankruptcy would have been unforeseeable for the state and its citizens (Bujišić-Petrovic, 2006, pp. 281-288.). It is interesting to mention that during

this process Siemens gave an offer to bail out banks, but it was estimated that for the stability of the French economy it was important to keep French "nationality" of Alstrom and certain banks. When it intervenes to preserve the "nationality" of domestic companies, the state does so mainly in order to keep companies which are important pillars of the development policy, employment and regionalization on their territory (Bujišić-Petrovic, 2006, pp. 281-288.).
Here we can point out to the positive example of General Motors, which managed to overcome the crisis thanks to restructuring, which was realized with the help of the state. Thus the government bought most of the capital stock which helped to restore this capital and led to the restructuring of GM. In this case, the state, Government of the United States, became the majority shareholder which ultimately led to the rescue of that motor giant (Roe, *et al.,* 2013).

6. CONCLUDING REMARKS

We have to be aware that often the economic categories do not coincide with the legal categories. In mentioned examples, the subjects and their businesses were practically structuring the fabric of the country by employing hundreds of people, gathering highly qualified experts, carrying out innovation activities. Thus, if these companies had been taken over by foreign owners, the state policy in all areas would have remained without the support and it would have been significantly more difficult, and in some cases even impossible, to conduct it. Therefore, the ability to conduct social and economic policy development, which is still considered to be under the jurisdiction of the country, is significantly narrowed. On the other hand, while analysing these cases *de lege lata* we have to stress out that the bankruptcy proceedings can offer two possible solutions for the conclusion of the bankruptcy proceedings: a) liquidation and b) the bankruptcy plan. The liquidation shall be carried out after all of the debtor's bankruptcy estate is sold and divided among the creditors, while the bankruptcy plan is a modus of rescuing company by implementing series of measures of economic, financial and legal nature. From this simple definition, we can see the physiognomy of bankruptcy proceeding. The only reason for opening bankruptcy proceeding is that the subject is not able to pay the claims, while the aim of the bankruptcy proceedings is to satisfy creditors' claims in the best possible way. For companies whose activities are of strategic (national) interests, which is certainly true in the case of the Institute, we could *de lege ferenda* prescribe that the bankruptcy is forbidden and that its founders and members are jointly liable for its obligations. The alternative is for the bankruptcy to be impossible in case of a person whose activities are of national interest, unless there is a prior consent of the ministry in charge. If the ministry doesn't withhold its approval, within 30 days it is considered that the consent is given. If the ministry refuses to give its consent, the obligations of the debtor are matched by a State.

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