CROATIA

Financing Options Under the Croatian Bankruptcy Act

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Companies in financial difficulties are regularly faced with challenges in seeking fresh financing – an injection necessary for financial consolidation and to overcome financial difficulties. Such challenges become even greater when a company formally enters pre-bankruptcy or bankruptcy proceedings. In a large number of cases, the companies are in such difficult and irreversible circumstances that potential creditors are usually discouraged from providing new financing, which is sought by the companies unable to provide any indication of success. However, there are situations in which creditors may be willing to provide fresh capital despite the debtor's difficult situation – most commonly, because they already have an outstanding exposure against the debtor. Existing creditors considering new financing may see an opportunity to exit the existing creditor-debtor relationship less "harmed." In such cases, the main questions involve the position the creditors can obtain by granting fresh financing and whether the legislative framework regulating pre-bankruptcy proceedings is sufficiently sensitized to their specific position.

In the past year, the Croatian legislator has recognized this issue and taken a step forward in addressing it by amending the Croatian Bankruptcy Act to introduce new borrowing options for financing in pre-bankruptcy proceedings. The amendment, which entered into force on November 2, 2017, provides, among other things, a new concept of financing as one of the significant innovations in the Croatian bankruptcy system. This new concept of financing is well known in some foreign jurisdictions as *debtor-in-possession financing* ("DIP Financing"), and it is used by insolvent companies faced with financial difficulties. Such financing is tailored to the situation of the debtor and usually gives priority status over old(er) debts of a company.

It seems that this latest amendment to the Bankruptcy Act was inspired by the Act on the Special Administration Proceeding in Companies of Systemic Importance for the Republic of Croatia, enacted in Croatia in April 2017. This regulation, commonly referred to as "Lex Agrokor," was the first to explicitly introduce the possibility of DIP Financing in Croatian legislation. The intention of Lex Agrokor was to create a special administrative proceeding – an alternative to the existing bankruptcy proceedings – which would address the potential bankruptcies of companies large enough to significantly impact the Croatian economy.

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In general, under the new amendment, the Bankruptcy Act allows a company in pre-bankruptcy proceedings to enter into new financing only with the prior written consent of the creditors who hold two thirds of acknowledged claims in those proceedings. The purpose of such new financing is defined as "the continuation of business operations," without any other details. Such new financing, in case of a later bankruptcy proceeding involving a debtor, is given seniority status in the settlement of claims, with the exception of the first higher-ranking creditors.

However, although inspired by the Lex Agrokor, there are differences in how new financing is treated under the most recent amendment to the Bankruptcy Act, and a different priority ranking exists in the settlement of claims. Unlike in Lex Agrokor's special administration proceedings, the financing provided in the pre-bankruptcy proceedings has a slightly lower ranking in settlement in later (potential) bankruptcy proceedings. The creditors of the new financing granted in the pre-bankruptcy proceedings will not be considered creditors of the bankruptcy estate, and the creditors of the first higher ranking will hold seniority status over them in the settlement of claims.

It should be noted that the pre-bankruptcy proceedings were introduced in the Croatian legal framework in 2012 to fast-track a company's return to solvency through restructuring, as well as by allowing creditors to settle their claims more favorably than in bankruptcy proceedings. The introduction of the new DIP Financing option seems to be the logical continuation of that general purpose. However, we note that this option has still not been implemented in the bankruptcy proceedings.

This legislative amendment provides companies with an additional means of revival in pre-bankruptcy proceedings. A legislative framework has been created which provides parameters for the new financing and its destiny in the bankruptcy proceeding. Practice will show whether the past legislative framework was the core issue and whether the concept of new financing in the pre-bankruptcy proceeding is here to stay.

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