BDK Newsletter

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Advokati / Attorneys at Law

No. 5/2012

SERBIA: INSOLVENCY & RESTRUCTURING

The Constitutional Court of Serbia declares automatic bankruptcy unconstitutional

In its decision dated 12 July 2012 ("Official Gazette of Republic of Serbia" no. 71/2012), available at http://www.stecaj.biz/index.php?option=com_content&view=article&id=49:odluka-ustavnog-suda-o-ukidanju-automatskog-steaja&catid=31:pravna-regulativa&Itemid=29, the Constitutional Court of Serbia held that the provisions of the Serbian Insolvency Act (Zakon o stečaju, "Official Gazette of Republic of Serbia" no. 104/2009) ("**Insolvency Act**") providing for automatic bankruptcy of companies that are unable to meet their liabilities in a period longer than 12 months and confiscation of the insolvent's assets are unconstitutional. Specifically, the provisions of Articles 13 paragraph 3 and 150-154 of the Insolvency Act were struck down.

According to Article 13 of the Insolvency Act, if the assets of the insolvent are insufficient to cover the costs of the proceedings, the court shall close the proceedings and order the bankruptcy administrator to liquidate the assets of the insolvent in order to cover the costs. Should it turn out that there is a surplus after the costs are covered, Article 13, paragraph 3 of the Insolvency Act provided that such surplus were to be transferred to the Republic of Serbia without any compensation to either shareholders or the creditors of the insolvent.

Articles 150-154 of the Insolvency Act stipulated that any company whose bank accounts had been blocked for more than a year were subject to the so-called automatic bankruptcy. The National Bank of Serbia would forward a list of insolvent companies to the commercial courts on a monthly basis. The competent commercial court would then initiate preliminary bankruptcy proceedings against the companies from the list *ex officio,* determining an advance of costs to be paid by the insolvent or any of its creditors interested in pursuing full-scale insolvency proceedings. No personal notification of the creditors was required but the resolution on preliminary insolvency proceedings was deemed notified when published on the court's notice board. If neither the insolvent nor any of its creditors paid the advance, the court would open the insolvency proceedings and immediately wind them up, while any assets of the insolvent would be transferred to the state without any compensation to either the shareholders or the creditors of the insolvent. While the law absolved the state from the liability for the debts of the insolvent, it allowed the state to step into the shoes of the insolvent in its capacity as creditor.

The Constitutional Court of Serbia found that the nationalization rule embodied in Article 13, paragraph 3 and Articles 150-154 of the Insolvency Act breaches the constitutionally guaranteed right to property and the constitutional provision that property cannot be expropriated except in public interest and subject to compensation at market value.

The Constitutional Court of Serbia also found that the provisions on *ex officio* initiation of insolvency proceedings, found in Articles 150-154 of the Insolvency Act, violate the constitutionally guaranteed right to fair trial and legal remedy, since insolvency proceedings get initiated and develop without personal notification to the creditors, which deprives them of a meaningful opportunity to participate in the proceedings. The Constitutional Court also found that the provisions on effective nationalization run contrary to the constitutional guarantee of equality of state and private ownership.

The provisions on automatic bankruptcy ceased to be in force as of 25 July 2012.

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