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PILOT TEST CASE TRIAL ANALYSIS

JELSINGRAD FMU (KOTOR VAROS, RS)

USAID FOSTERING AN INVESTMENT AND LENDER-FRIENDLY ENVIRONMENT (FILE)

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BiH NEW BANKRUPTCY AND LIQUIDATION LAWS

Program for Bankruptcy Pilot Cases

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JELSINGRAD FMU

(Kotor varos, RS)

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INTRODUCTION

Jelsingrad FMU, Kotor Varos, was a producer of small machine tools, eccentric presses, metal packaging machines (canning equipment), screw caps, crown lids and other metal products and services. The Company was founded in 1984 but since February 2003 it has been a joint stock company, 65% state-owned. From its founding the company was export oriented, pointing toward the Soviet market. When it operated at full capacity its annual revenues were approximately KM 7 million.

The loss of demand from its traditional market followed by wartime disruption have left it with only a remnant of its former business.

Although the Company tried to establish new markets in Serbia and Montenegro, these markets were lost as well due to the further disruption resulting from the NATO bombing. The Company's situation continued to worsen thereafter. Production ceased on Dec.31, 2001.

Ninety per cent of the equipment has been written off, damaged, or stolen by disaffected workers. These losses apparently include a good part of its office equipment and business records, complicating any potential bankruptcy adjudication.

Approximately 100 workers are on permanent lay-off status. Only seven workers are "employed," working solely to protect the property which is still there.

The privatization process failed because no strategic investor was interested in the company.

The Company's management subsequently submitted a proposal for the opening of a bankruptcy procedure to the competent Ministry and the R. S. Agency for Privatization. By then the company was clearly unable to meet its obligations to employees, suppliers, banks and other creditors. Apparently, the Ministry only referred this proposal to the relevant commercial court in Banja Luka, which has not yet taken any further action.

The Company is undeniably a candidate for bankruptcy and could be acceptable as a Pilot Case. The continuing deterioration in its “going-concern” value (if it has any) and the value of its property could be arrested in a bankruptcy adjudication.

PRODUCTS AND FACILITIES

The Company produced small machine tools, canning and metal packaging equipment and the like.

Although Jelsingrad has a relatively new facility with a modern plant, the facility is idle, and its maintenance has been neglected, both inside and outside.

Worse, disaffected workers stole from the factory, and a significant amount of equipment and inventory has gone missing.

MARKET AND SUPPLIER RELATIONSHIPS

The Company produced metal packaging equipment for the Soviet market. That market has been lost – apparently, irretrievably – and there is no known conception of where and how it can find a replacement market.

MANAGEMENT

Although operrations have ceased cooperative and experienced managers still seem to be concerned about the Company's fate and be available to provide some limited assistance, if necessary. The General Manager of Jelsingrad recently confirmed that he was unsuccessful in obtaining government assisstance to revive the business. Following that, the Management Board then formally recommended that the company initiate a bankruptcy.

FINANCIAL STATUS

Total liabilities (as of Dec.31, 2002) were in the amount of 2.6 Million KM.

Inventories were valued at 610,000 KM, and receivables were 0.6 Million KM. The fixed assets were “booked” at 6.5 Million KM. These valuations cannot be viewed as reliable, however, both because of “shrinkage” and due to market conditions which may make “book” values totally unrealistic.

More important, a part of the Company’s property is mortgaged to support bank loans summing to KM 340,000, an indebtedness which the Company cannot service. As the actual, market value of the pledged Property is unknown, the effect of this mortgage on a bankruptcy of the Company is unclear.

APPLICATION OF THE SELECTION CRITERIA

The First Twelve Screening Criteria.

The first three Criteria ask whether the case would be significant and positive enough to reinforce our training plans, provide a good learning experience, and have a significant impact towards advancing our overall goal of initiating a fully-implemented bankruptcy system in BiH.

Specifically, the Criteria are:

1. Would the process of adjudicating the proposed case serve as a good example, which would reinforce our training plans and other implementation activities?

2. Specifically, consider whether the *process* would provide a good learning experience, which would benefit, especially, the trustees, bankers, and business professionals involved.

3. Would an adjudication of the proposed case ultimately have a *significant* and positive enough impact to help build confidence in and encourage a broad implementation of the bankruptcy system?

The impact of a Jelsingrad bankruptcy adjudication would be more modest than significant.

Because production has ceased and so much of its equipment has gone missing there is not much of an opportunity to sell assets on a "going-concern" basis or to reorganize the Company on any terms.

Nevertheless, the case could provide a good example of how a bankruptcy could be handled when there are unusual difficulties and insufficient assets to provide for a dividend to the creditors. If done well, with a good result, and not too many mishaps, it could produce a "good example."

Accordingly, the application of these first three Criteria to Jelsingrad yields an inconclusive result.

The Fourth Criterion asks whether Jelsingrad can be a "government/government" Privatization, where it is a government owned company ("SOE") where the *controlling* creditor interests are also government held debts. In this case the controlling creditor interests are not government held debts. The predominating debts are those owed to workers, suppliers and privatized banks. Accordingly, government decision-makers cannot be expected to provide controlling direction to the bankruptcy proceedings.

The Fifth Criterion provides a critical, objective financial test, asking simply whether there are sufficient assets (liquid or realizable at reasonable market values) to pay the costs of the proceedings, pay the priority and secured creditors, and still allow for the payment of a dividend or other consideration to the general creditors.

This critical Criterion is probably met, because of the inherent value of the Company's immoveable property, but, unfortunately, it is a close question. Inventories were valued at 610,000 KM, and receivables were 0.6 Million KM, while fixed assets were "booked" at 6.5 Million KM. However, the market value of the Company's fixed assets is not known, now, to any degree of certainty. No credence can be given to the purported values of the receivables and inventory, so the key question is whether or not the fixed assets can be realized at a sum sufficient to pay the costs of the proceedings.

If Jelsingrad remains under serious consideration as a Pilot Case candidate, further consideration must be given to this Fifth Criterion: Asset valuations and reasonable estimates of professional's fees must be closely scrutinized.

Criteria Six through Eight ask one to consider the possibility of "streamlining" the case and its likely time constraints. Those that can be "streamlined," e.g., where pre-packaged Plans are feasible, clearly have an advantage over other cases that may be unavoidably or unexpectedly contentious or time-consuming.

Specifically these Criteria ask:

6. Can the case be adjudicated under a pre-packaged Plan?

7. If a pre-packaged Plan is impracticable, are deadlines/time schedules flexible and favorable?

8. Irrespective of whether or not a pre-packaged Plan is feasible, it is necessary to consider whether the proceedings can be executed in a timely and efficient manner so that a final adjudication and asset or dividend distribution and/or Plan consummation can be accomplished within six to 18 months.

The application of these Criteria appear to favor the selection of Jelsingrad as a Pilot Case.

A pre-packaged, liquidating Plan should be feasible, unless intense opposition comes from the workers or workers' unions.

Deadlines and time schedules should be not problematic. The case has not been filed yet, although it has been «proposed.» The Bankruptcy Judge sitting in Banja Luka has not yet taken any action on the case and he reportedly has no intention of doing so in the immediate future. Accordingly, one can be nearly certain that time-schedules and deadlines will not present a significant impediment to a «Pilot Case» adjudication of Jelsingrad.

The Ninth Criterion only asks whether the debtor Company meets an appropriate insolvency test, so that a bankruptcy filing is legally appropriate. Clearly, Jelsingrad meets this test. As of Dec.31, 2002 its current ratio of current assets to current liabilities was 0.46 and should be significantly lower now due to decreased assets and increased liabilities. The Company belongs in bankruptcy.

The Tenth Criterion focuses on an issue which often can be a critical stumbling block: That is, whether debts owed former or redundant workers for wages are likely to be a significant obstacle to an orderly liquidation or reorganization, considering not only the amounts owed, but also the ages, attitudes and sophistication of the workers and their representatives and whether there is likely to be future employment for them.

More information about the workers should be gathered before reaching a firm conclusion on this issue. The most recent, available information indicated that there were 102 employees as of July 2003 but that the overwhelming majority were on lay-off status or had left the Company completely. Because the workers' situation is so far gone, the workers probably should be aware that a bankruptcy adjudication of the Company could not hurt them any more, but could help revive some business in the area.

The Eleventh Criterion asks whether the debtor company's assets are heavily liened and whether or not it can service its secured obligations.

The Company has mortgaged a part of its property to support bank loans summing to KM 340,000. Jelsingrad cannot service this secured debt. As mentioned above, the actual, market value of the Property pledged as collateral is questionable.

This makes it questionable as to whether or not the secured creditors would simply take control of the Company's assets in a bankruptcy liquidation, leaving nothing for general creditors, and making the "Pilot Case" somewhat hollow.

Further evaluation under this Criterion is necessary, but at first look the indication is that this is another factor which weighs against the selection of Jelsingrad as a Pilot Case.

The Twelfth Criterion is subjective. It asks whether an adjudication of the Company would present other unavoidably sensitive complications. At this point, aside from above-mentioned issues we are not aware of any other specific complications and it is not likely that there are any.

Accordingly, we will consider that Jelsingrad meets this Criteria.

CONCLUSION

Further diligence and a more subjective examination of Jelsingrad in light of the Criteria discussed is necessary before one can reach a firm conclusion as to whether or not Jelsingrad could be a good Pilot Case. On the information evaluated thus far, Jelsingrad appears to be an acceptable candidate for our Bankruptcy Pilot Case Program.

Is Jelsingrad a good candidate for the Bankruptcy Pilot Case Program?

Criterion to be evaluated	Degree at which the Case meet the Criterion					Score points
	Does not meet at all	Does not meet	Neither meets nor does not meet	Meets	Completely meets	
1			X			0
2			X			0
3			X			0
4		X				-1
5			X			0
6				X		1
7				X		1
8				X		1
9				X		1
10		X				-1
11					X	2
12				X		1
					Case Total Score	*+5*