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Proposed amendments to the Bulgarian Commerce Act

In March 2014 the European Commission published Commission Recommendation on a new approach to business failure and insolvency (the "**Recommendation**"). The objective of the Recommendation was to ensure that viable enterprises in financial dificulty had access to national insolvency frameworks which enable them to restructure at an early stage with a view to preventing their insolvency. The Recommendation invited Member States to implement its principles within 12 months as of its publication.

Bulgaria has prepared (with a delay) a draft law amending the Commerce Act. The aim of the law is to implement the Recommendation and introduce additional amendments to the Commerce Act. The amendments are still in draft and have not been approved by Parliament.

<u>Amendments implementing the Recommendation</u>

The proposed amendments introduce new stabilisation (restructuring) proceedings for companies facing financial difficulties. Similar proceedings existied historically in Bulgarian law prior to 1952 but were abolished thereafter. In 1993, after the adoption of the Commerce Act, which restored the company and business law in post-communist Bulgaria, a draft of a new Law on the Voluntary Bankruptcy Arrangements was prepared but its adoption failed in Parliament.

In compliance with the Recommendation, the proposed new legislation envisages measures to prevent the opening of insolvency proceedings of a company through reaching an agreement between the company and its creditors on how company's debts will be restructured and repaid.

Stabilisation proceeding may be opened in respect of a company, which is not insolvent, but under an imminent threat of insolvency. Pursuant to the proposed amendments, an imminent threat occurs where the debtor, with a view to the maturity of its debts within six months after the date of filing the stabilisation petition, would be unable to meet these debts or is likely to stop paying them. Debts which may result in an imminent threat of insolvency are the ones, which may result in insolvency if not paid upon their maturity - matured monetary obligations due under, or in relation to, a commercial transaction (including its validity, performance, non-performance, termination, invalidation or dissolution), or public law obligations to the state or municipalities related to its commercial activity, or private law obligations to the state. The imminent threat of over-indebtedness, which is the case where the assets of a limited liability company, a joint-stock company, or a partnership limited by shares, are insufficient to cover its liabilities, is not envisaged by the draft law as a reason for opening a stabilisation proceedings, though the occurrence of such event is a reason for opening insolvency proceedings.

The proposed new rules set out a list of cases in which stabilisation proceeding is not to be opened:

- If the company has failed to submit in time to the Commercial Register its annual financial statements for the last three years prior to the submission of the petition for opening stabilisation proceedings;

- If prior stabilisation proceedings have been opened in respect of the company within the last three years;
- If a petition for opening of insolvency proceedings has been filed before the submission of the petition for opening stabilisation proceedings;
- If over one-fifth of the debts of the company are to related parties or persons who, in the last three years, have acquired such debts from persons related to the company.

Stabilisation proceedings are inapplicable to banks, insurance companies and some public undertakings.

The law envisages mandatory recordation of all acts submitted and/or issued in relation to the stabilisation proceeding with the Commercial Register.

A petition for opening of stabilisation proceedings may be filed only by the company, not by a creditor. The petition is reviewed by the district court at the seat of the company. The petition must contain, inter alia, a detailed stabilisation plan with a specific proposal on the manner, time limits and the conditions for repayment to the company's creditors, as the creditors which are related to the company may be repaid in full only after all the other creditors are repaid in full.

Participants in the stabilisation proceedings are all creditors of the company, including those to which the company has given security on debts of third parties. The law introduces two specific participants in the proceedings, trustee and verifier. The trustee is an individual, an auxiliary body to the court, and must have a degree in law, as well as meet requirements for a trustee in insolvency proceedings. The functions of the trustee include the power to propose the list of creditors for approval by the court, supervise the activity of the company, support the company and the creditors in clarifying the proposed stabilisation plan. The verifier must be a registered auditor. Its role is to report to the court and the creditors if the stabilisation plan corresponds to the financials and property of the company. The appointment of a verifier is mandatory in case the stabilisation plan envisages transformation of the company or conversion of debt into equity.

Where the court has established that the required grounds exist, the court opens stabilisation proceedings, appoints a trustee and, if necessary, a verifier, may impose attachment or other security measures, and schedules a public session to examine and approve the proposed stabilisation plan within three months as of the opening of the proceedings. As of the recordation of the court ruling on opening stabilisation proceedings, the company is not allowed to repay debts arisen prior to the submission of the petition for opening the proceedings (some exceptions exist). The court ruling also restricts the activity of the company as it will continue operating under the supervision of the trustee, or, the court may rule, only the trustee will be entitled to manage the operations of the company.

Each creditor of the company may object to the inclusion or non-inclusion of a creditor on the list of creditors. On the basis of all evidences received, including the opinion of the debtor, the trustee drafts the final list of creditors, which is subject to approval by the court. Only creditors included in the final list approved by the court have the right to vote on the proposed stabilisation plan. The plan is voted by classes of creditors and approved or rejected by the court. The court ruling is subject to appeal before the Supreme Court of Cassation by the company and by any creditor affected by the plan. After its approval, the plan becomes mandatory for the company and its creditors, including creditors who voted against it, but the plan has no effect with regard to creditors who have not been included in the list of creditors or have been prevented from voting the plan. Upon approval of the plan the enforcement proceedings against the debtor shall be suspended.

The advantages of stabilisation of viable companies in difficulty before they become insolvent are indisputable, and the expectations of the effect of the proposed stabilisation proceedings are, in general, positive. Unfortunately, this is not the case with other amendments to the Commerce Act, proposed along with the new stabilisation proceeding.

<u>Other amendments to the Commerce Act</u>

Justifying these amendments as prevention of "companies' theft", i.e. criminal acts, usually performed using forged documents, and resulting in disposal of assets, or changes in the owners and managers, of companies, the Council of Ministers proposed that more complicated form for validity of some commercial documents is introduced. Such documents are:

a) contracts for sale of a going concern;

b) contracts for sale of shares in limited liability companies;

c) resolutions of the General Assembly of limited liability companies about:

    i) admitting/expelling partners;

    ii) transfer of shares to a new partner;

    iii) appointment of a manager of the company;

    iv) sale, purchase and other disposal of real estate.

The proposal is these documents, which at this time are executed just in writing (the documents as per item (c) above) or with a certified by a notary signatures of the parties thereof (the documents as per items (a) and (b) above), in future to be executed with simultaneous certification by notary of the signatures of the parties and of the contents of the document. Pursuant to Bulgarian law, when such simultaneous certification is done, the notary shall keep a copy of the certified document, and, according to the proposal, such copy will be used for verification purposes when the certified document is filed for announcement with the Commercial Register or used for completing of a real estate deal.

The Supreme Bar Council has issued an official letter opposing to the proposed amendments. Negative opinions on the proposal of many attorneys-at-law have also been made public. In summary, the main arguments against the proposal, are:

- The General Assembly will not be able to adopt resolutions in absence (where all partners state in writing their consent to the resolution).

- The simultaneous certification of the signatures and of the content is a specific provision of Bulgarian law and, most probably, not practiced, and may be even allowed, in other countries, therefore, the adoption of the proposal would necessarily require certification only/mainly in Bulgaria.

- Many practical difficulties, which will result at least in delays for the business, are expected with regard to the proposed verification of the documents presented to the Commercial Register with the copy kept by the notary.

- The proposal is not well justified, as it deals mainly with limited liabilities companies, and not with other types of companies, such as joint-stock companies. Also, such administrative and burdening measures are not the proper way of fighting criminal acts.

- Last, but not least, the adoption of the proposal may leed to the European Commission initiating proceedings against Bulgaria, as it is likely that the new measures limit the free movement of capital within the EU.