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Amendments to the regime of pledges in Bulgaria effective as of 30 December 2016 – are creditors in a better position now?

Material amendments to the Special Pledges Act became effective on the last business day of 2016. The amendments apply also to pledges created prior to 30 December 2016.

The stated aim of the amendments is to strengthen the protection of all parties concerned, create legal certainty, overcome certain ambiguity and discrepancies in the existing regulation and lower the risk of bad faith acts affecting creditors.

But do the amendments really improve the situation for secured creditors?

While the amendments do improve certain aspects for secured creditors, they also raise certain new risks for them.

This memo does not attempt to be exhaustive on all aspects of the amendments or provide legal advice on any specific mater. It suggests a view on certain aspects that are likely to have practical effect on creditors.

Disposal of pledged assets

The amendments make explicit the rule, which arguably existed before the amendments implicitly, according to which a pledgor cannot dispose of the pledged assets unless the disposal is within its ordinary course of business or with consent of the pledgee. After the amendments the consent must be given with notarised signature and be registered in the relevant register where the pledge has been recorded.

If no consent is given the pledge will continue to encumber the pledged assets after the disposal (outside ordinary course) and will bind the transferee thereof as if it was the pledgor. However, it is now explicitly stated that the pledge will not bind any subsequent transferee of the pledged assets if it proves that it acted in good faith in acquiring those.

These rules create a risk of the secured creditor being unable to enforce its pledge if the original pledgor disposes of the pledged assets without consent of the secured creditor and the transferee also disposes of the asset to another transferee acting in good faith (i.e. not knowing that his counterparty had acquired the assets encumbered with a pledge and without consent from the secured creditor).

The last transferee would be able to sustain that it acted in good faith in acquiring the assets since the pledge was not recorded in the name of its transferor in the relevant public register and so the transferee could not become aware of the pledge.

This risk is especially higher where disposal of the pledged assets does not require any registration in a public register which makes tracing the chain of ownership practically more

cumbersome and dependent on representations by the transferor (e.g. movable assets other than vehicles). Thus, the secured creditor would not be able to oppose its rights to such third party.

Concurrent proceedings

The amendments introduce the principle that if a third party (e.g. an unsecured creditor or the state) starts enforcement over the pledged asset in a general enforcement procedure the secured creditor cannot stop such enforcement and carry out instead a private enforcement of its pledge (which was possible in certain circumstances under the previous regime). Although the pledgee will retain its ranking in the pledged assets the downside of this is that it will not be able to control the sale process, the sale process might be more expensive (due to various statutory costs of an enforcement through a bailiff, etc.).

Insolvency

Prior to the amendments a creditor secured with a special pledge was able to enforce its pledge even after the opening of insolvency proceedings against the pledgor regardless of whether the secured creditor had commenced enforcement over the pledged assets prior to opening the insolvency proceedings of the pledgor. The amendments change this and the secured creditor will no longer be able to carry out a private enforcement over the pledged assets after the opening of insolvency proceedings of the pledgor if it had not registered the commencement of enforcement of the special pledge prior to the opening of the insolvency proceedings. This reduces the flexibility of creditors secured with a special pledge to decide to carry out a private enforcement even after insolvency proceedings of the pledgor have been opened. Creditors secured with a special pledge should therefore be advised to commence private enforcement as soon as they are on notice of an insolvency petition against the pledgor.

Distraint over pledged receivable

If an unsecured creditor of a pledgor imposes a distraint over receivables pledged by the pledgor before a creditor secured with a pledge over such receivables commences enforcement over them, the secured creditor would not be able to commence private enforcement of its pledge over the receivables but will receive satisfaction in the enforcement proceedings started by the unsecured creditor. This would allow any unsecured creditor to prevent a creditor secured by a pledge over receivables from private enforcement of its pledge, which is another disadvantage compared to the previous regime.

Prohibition for lower ranking creditors to enforce

Prior to the amendments any creditor secured by a special pledge (e.g. a second or lower ranking creditor) could commence enforcement of the pledge. The amendments introduce the rule that only the first ranking creditor may commence enforcement of the pledge over the pledged asset. Creditors with lower rankings pledges may start enforcement only with the consent of the prior ranking secured creditors or after having satisfied their claims.