KAMBOUROV & PARTNERS
ATTORNEYS AT LAW

ANNEX No 1.1
to

Legal Opinion Regarding the Enforceability of Close-Out Netting and the Validity and Enforceability of the EFET General Agreement Concerning the Delivery and Acceptance of Electricity and its Collateral Arrangements (Bulgaria)

1.1. Short overview of Bulgarian insolvency proceedings, laws and relevant terminology applicable to Party A

1.1.1. General legal framework

The general legal framework of insolvency proceedings in Bulgaria is provided by Part IV of the Commerce Act, called 'Insolvency'[1] (*'Nesustoiatelnost'*). Part IV regulates the whole insolvency procedure – from the necessary conditions for opening of insolvency proceedings against a debtor (commercial undertaking) through the composition procedure until the distribution of the debtor's assets which have been converted into cash and the termination of the insolvency proceedings. In particular:

(i) Opening (institution) of insolvency proceedings

The necessary pre-conditions for the opening of insolvency proceedings against a debtor - commercial undertaking (trader) (referred to hereunder as the 'company' or the 'debtor') are:

(a) The company is <u>unable to pay its debts</u>. This means that a company cannot pay a due monetary debt under a commercial transaction, or a public liability towards the State or the municipalities, related to its business, or a debt under a private state receivable, or an obligation to pay wages to at least one third of the employees, which has not been discharged for more than two months. Inability to pay debts is presumed when the debtor has ceased payments. According to the latest amendments to the Commerce Act, it shall be presumed that the trader is unable to meet any due obligation, if, prior to filing of the application for institution of the insolvency proceedings, the trader has not applied for announcement in the Commercial Register of its annual financial statements for the past three years.
or
(b) <u>Over-indebtedness</u> of a private limited company, public limited company or a partnership limited by shares. A company is in the situation of over-indebtedness if its assets do not suffice to cover its monetary debts.

[1] Hereunder 'insolvency' is used as a synonym of 'bankruptcy' (i.e. *Insolvenz, Konkurs* in German). The pre-condition for insolvency is referred to as 'inability to pay debts' (*Zahlungsunfähigkeit* in German).

The insolvency proceedings are opened upon a request in writing submitted to the district court at the seat (registered office) of the debtor[2] by the debtor itself[3] (i.e. by its directors or managers), by its liquidator (if the company is in a liquidation procedure), by a creditor under commercial transaction, by the National Revenue Agency or by the General Labour Inspectorate Executive Agency. The court shall assess on the grounds of the collected evidence whether all the necessary pre-conditions for opening of the insolvency proceedings are available. If the court comes to the conclusion that the debtor is unable to pay its debts or is in over-indebtedness, the court shall pass a judgement by which it[4]:

- declares the debtor's inability to pay its debts, respectively the debtor's over indebtedness, and determines their initial (commencement) date;
- opens the insolvency proceedings;
- appoints a temporary insolvency receiver;
- imposes security measures over the debtor's assets;
- appoints the date for the first creditors' meeting (not later than one month after the judgement's date).

The judgement does not automatically terminate the contracts concluded by the debtor. The insolvency receiver may terminate any contract, unless it has been already performed (article 644 of the Commerce Act; this is the insolvency receiver's 'cherry-picking right' under the Bulgarian law).

One of the crucial issues in this stage is the determining of the initial date of the debtor's inability to pay its debts. From this moment starts the so called 'suspect period'. Some transactions concluded and payments made within this period can be challenged by the insolvency receiver, respectively by the creditors of the debtor (see below item (ii)). The lack of a backward limit proved problematic in practice as the court had the discretionary power to date the commencement of the debtor's inability to pay its debts really long time backward – for instance two or three years, which contradicts in our view to the common principle of a secure and stable business life.

That is why in February 2013 rules were introduced into the Commerce Act that limited the date back in time until which certain transactions can be challenged as null and void (for more details see below).

When the insolvency proceedings have been opened, the debtor continues its activity under the supervision of the insolvency receiver. It may enter into new transactions only with the receiver's preliminary consent. If the court comes to the conclusion that with its actions the debtor threatens the creditors' interest, the court may deprive the debtor of the right to manage and dispose of its assets and to render this right to the insolvency receiver. Performance of obligations towards the debtor may only be made against the insolvency receiver.

(ii) Complementing the insolvency estate

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[2] Pursuant to Article 3(1) of the EU Insolvency Regulation No 1346/2000 (which has direct application in Bulgaria as from 1 January 2007) the competent district court is determined by the centre of the debtor's main interest. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary.

[3] A debtor who becomes unable to pay its debts or falls in over-indebtedness shall submit a request for opening of insolvency proceedings to the competent court within 30 days.

[4] We do not elaborate on the special scenarios envisaged in the Commerce Act in which the court ascertains that the debtor's assets are not sufficient to cover the insolvency proceedings related costs.

This section of Part IV of the Commerce Act regulates the different possibilities that the insolvency receiver, respectively the debtor's creditors have in order to challenge transactions entered into and payments made by the debtor prior to and after the date of the judgment on opening of the insolvency proceedings. In particular:

Article 645 regulates the admissibility of **set-off** (this provision should be taken into account when the set-off / close-out netting provisions of the General Agreement are assessed in the light of Bulgarian legislation):

Any creditor may set-off his claim to the debtor against his debt to the debtor, in case (a) prior to the date of the judgement for institution of the insolvency proceedings both debts (b) existed and (c) were counter and (d) of the same kind and (e) the creditor's claim was due. In case the claim has become outstanding in the course of insolvency proceedings or as result of the judgement on institution of the insolvency proceedings, and as well as in case both debts have become of the same kind as a result of such a judgement, the creditor may set-off only after the claim becomes outstanding, respectively of the same kind. The statement for set-off shall be sent to the insolvency receiver.

The set-off may be declared null and void with respect to the insolvency creditors, in case (a) the creditor has acquired the claim and the debt to the debtor prior to the date of the judgement for institution of the insolvency proceedings, but (b) he knew as at the time of acquiring the claim or debt that (b1) inability to pay debts, respectively over-indebtedness, has occurred in respect of the debtor or that (b2) a petition for opening of insolvency proceedings has been filed.

A set-off effected by the debtor after the initial date of the inability to pay debts, respectively the over-indebtedness (i.e. within the suspect period) - but not earlier than one year prior to the lodging of the request for opening of the insolvency proceedings - shall be null and void with respect to the insolvency creditors, except for the part that the creditor would acquire after the distribution of assets converted into cash, regardless of the time of occurrence of both counter debts.

Article 646 regulates the voidness of certain actions and transactions:

First of all, null and void with respect to the insolvency creditors are certain actions and transactions effected after the date of the judgement for institution of the insolvency proceedings and not in compliance with the procedure established thereby, such as: performance of an obligation that has occurred prior to the date of the judgement for institution of the insolvency proceedings; pledging or mortgaging rights or assets included in the insolvency estate; transactions with rights or assets included in the insolvency estate.

Next, the following actions and transactions carried out by the debtor after the initial date of the inability to pay debts, respectively the over-indebtedness (i.e. within the suspect period) - but not earlier than within certain time periods prior to the lodging of the request for opening of the insolvency proceedings - may be declared null and void with respect to the insolvency creditors:

- performance of a debt that is still not due and payable regardless of the way of performance (made within 1 year prior to the lodging of the request for opening of the insolvency proceedings);

- establishing a pledge or a mortgage for the securing of a debt that has not been secured so far (made within 1 year prior to the lodging of the request for opening of the insolvency proceedings);
- payment of a due and payable debt, regardless of the manner of performance (made within 6 months prior to the lodging of the request for opening of the insolvency proceedings).

If the creditor knew that the debtor was unable to pay its debts or over-indebted, the above time periods shall be respectively two years / two years / one year. The creditor's knowledge shall be assumed where: (a) the debtor and the creditor are related parties, or (b) the creditor was aware or was in a position to become aware of circumstances, based on which a justified assumption could be made of the existence of inability to pay debts or over-indebtedness.

The above rules regarding the payment of debts (first and third bullet) shall **not** apply where the performance falls within the usual operations of the debtor and where: (a) it had been effected in accordance with the agreement between the parties together with the provision of an equivalent good or service to the benefit of the debtor or up to 30 days following the due date of the debt, or (b) following the execution of the payment the creditor has actually provided to the debtor an equivalent good or service.

The above rules regarding the establishing of a pledge or a mortgage (second bullet) shall **not** apply where the pledge or mortgage had been established (a) prior to or at the time of the extending of a loan to the debtor; or (b) to replace another property security, which cannot be declared null and void in accordance with the rules of this section; or (c) to secure a loan extended for the acquisition of the subject of the pledge or mortgage.

The above rules shall not affect the rights acquired by bona fide third parties against consideration prior to the registration of the request for opening of the insolvency proceedings. Unfairness shall be presumed until the contrary is proved, if the third party is a related person of the debtor or the person with whom the debtor negotiated.

<u>Article 647</u> regulates the annulment claims which may be filed by the insolvency receiver, or, should he fail to do so - by any insolvency creditor within one year following the institution of proceedings. The legal nature of these claims originates from *Actio Pauliana* (article 135 OCA). By these claims various actions and transactions committed by the debtor within certain time periods prior to the lodging of the request for opening of the insolvency proceedings (varying from 1 year to 3 years) and infringing the creditors' interest may be declared null and void by the court with respect to the insolvency creditors. These include economically unequal transactions; transactions which prejudice the creditors, and transactions where a party to which is a person related to the debtor, etc.

In addition, it should be noted that acts detrimental to creditors may also be challenged by virtue of the *Actio Pauliana* (<u>article 135 OCA</u>). A creditor may request from the insolvency court to declare as null and void with respect of him the agreements between his debtor and a third party which are detrimental to him. The necessary pre-conditions for the success of such a claim are:

- both parties (i.e. the debtor and its counterparty) to the agreement[5] must have known at the moment of entering into it that the agreement that it causes a prejudice to the

[5] If the agreement is for a consideration (and not gratuitous).

debtor's creditors (if the creditor's claim occurs after the agreement, then both parties must have acted with a fraudulent intent);
- the creditor must have suffered a prejudice (i.e. the creditor's possibility to satisfy its claims from the debtor's assets is reduced/impeded).

(iii) Competent bodies in the insolvency proceedings

The competent bodies in the insolvency proceedings are:

- The insolvency court (the district court at the seat (registered office) of the company[6] at the day of filing the request on opening of the insolvency proceedings);

- The insolvency receiver[7] (which represents the debtor, supervises its activity, finds and ascertains its creditors, finds and ascertains its assets and converts them into cash, etc.);

- The temporary receiver in insolvency (which is appointed by the court's judgement for institution of the insolvency proceedings and (eventually) replaced by the Creditors' Meeting);

- The assistant receiver;

- First Creditors' Meeting (hears the report of the temporary receiver in insolvency, chooses a permanent receiver in insolvency and proposes to the court its appointment, elects Creditors' Committee);

- Creditors' Meeting;

- Creditors' Committee.

(iv) Submission (lodging) of claims

Creditors shall submit their claims in writing before the insolvency court up to one month after the publishing of the judgement on institution of the insolvency proceedings in the Commercial Register[8]. The list of the submitted and accepted (admitted) claims is prepared by the insolvency receiver and approved by the court.

(v) Composition procedure

A composition plan may be proposed not later than one month from the date of publishing of the ruling of the court for approval of the list of accepted claims in the Commercial Register. The plan is approved by the Creditors' Meeting and confirmed by the insolvency court. If the court confirms the plan, it terminates the insolvency proceedings and appoints the Supervisory Body proposed in the plan or elected by the Creditors' Meeting. If the debtor does not perform its obligations under the plan, the court may upon creditors' or Supervisory

[6] Pursuant to Article 3(1) of the EU Insolvency Regulation (which has direct application in Bulgaria as from 1 January 2007) the competent district court is determined by the centre of the debtor's main interest. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary.

[7] The receiver has to be distinguished from the liquidator under Bulgarian law, who is appointed in case of liquidation proceedings, i.e. winding-up of a company which is able to pay its debts but desires to terminate its existence. That is why in this Opinion the term 'receiver' is used for the Bulgarian insolvency officer and not 'liquidator', although the latter is used in the EU Insolvency Regulation.

[8] Bulgarian Commercial Register is on-line based which guarantees high degree of transparency.

Body's request reopen the insolvency proceedings (without new inability to pay debts or over-indebtedness to have to be proven).

(vi) Declaring the insolvency

If no composition plan has been proposed within the legally prescribed term, or if the proposed plan has not been approved or confirmed, or if it is evident that the debtor's activity would prejudice the insolvency estate, or in case of reopening of the insolvency proceedings, the court then will declare the debtor insolvent and will terminate its activity. By the same judgement the court shall order commencement of the conversion of the debtor's assets included in the insolvency estate into cash and the subsequent distribution of this cash.

(vii) Distribution of the debtor's assets converted into cash

The insolvency receiver will prepare an account for the distribution of the available amounts among the creditors with claims according to article 722(1) of the Commerce Act in conformity with the order, the privileges and the securities. The account must be approved by a ruling of the insolvency court. The claims are paid as per the order under the said article 722 and *pari passu* (the creditors of one rank are paid pro rata in accordance with the amount of their claim).

(viii) Termination (closure) of the insolvency proceedings

The insolvency proceedings are terminated by a court's judgement when (a) all the debts have been paid or (b) the insolvency estate has been depleted. By its judgement the court orders deletion of the company from the Commercial Register, unless all the creditors have been satisfied and there are assets left.

(ix) Out-of-court settlement

In every stage of the insolvency proceedings the debtor can conclude with all creditors with accepted claims an agreement in writing for settlement of the payment of the monetary debts. In this case the insolvency receiver shall not represent the debtor as a party. If the agreement complies with the legal requirements and if there are no claims for the ascertaining of the non-existence of accepted claims, the court may then terminate the insolvency proceedings. Civil law shall apply unless provided otherwise in the agreement or the Commerce Act.

If the debtor does not perform his obligations under the agreement the creditors whose claims represent not less than 15 percent of the aggregate claims amount can request reopening of the insolvency proceedings without proving new inability to pay, respectively over-indebtedness. Composition procedure may not be carried out during the reopened insolvency proceedings.

(x) Reorganisation proceedings

At the end of 2016 an entirely new Part V was introduced in the Commerce Act called 'Merchant reorganisation proceedings'. The purpose of these proceedings is to avoid institution of insolvency proceedings by an agreement reached between the merchant and its creditors on the settlement of the merchant's payables, allowing the merchant's business to continue. Reorganisation proceedings may be initiated for any merchant which is not unable to pay its debts but is in imminent danger of such inability.

For the purposes of Part V of the Commerce Act a merchant (trader) is to be understood a trader in the general meaning of the Commerce Act (i.e. any natural person or legal entity whose business is any of the activities listed in Art. 1(1) of the Commerce Act; traders by definition are also the companies and the cooperations). The reorganisation proceedings shall not be applicable for any public enterprises exercising a State monopoly or created by a special law, as well as for a bank or an insurer (for which the special proceedings provided for in the respective laws shall be applicable /as explained below/).

1.1.2. **Specific rules for insolvency proceedings**

Such specific rules are contained in:

1.1.2.1. The Bank Insolvency Act (the **BIA**) and the Credit Institutions Act.

(i) The BIA is applicable in respect of banks having their seat (registered office) in Bulgaria (to the insolvency proceedings of a bank having branches in EU Member States the provisions of Chapter XIII of the Credit Institutions Act shall apply as well, see item (iii) below). A request is submitted to the competent court (the district court at the seat of the bank) by the Central Bank (Bulgarian National Bank) in case of withdrawal of the bank's license under article 36(2)[9] of the Credit Institutions Act. The BIA regulates in detail the whole bank insolvency procedure. Some of the provisions reiterate provisions and principles stated in the Commerce Act, some reflect quite different principles deriving from the specificity of banking activity.

As concerns the ways of complementing the insolvency estate and challenging certain actions and transactions (Art. 22, Art. 58 - 62 BIA), the regulation is similar to the respective regulation under the Commerce Act (see the above item 1.1.1**(ii)**), but the period backward in time in which actions and transactions can be challenged is longer (5 years, following the latest amendments to the BIA) compared to the general rules of the Commerce Act. Of course, there are specific rules as well. For instance, in case of set-off, it shall be deemed that the creditor (who has made the set-off) knew that inability to pay debts by the bank has occurred, provided his receivable or obligation has been acquired after the date of registration of the decision of the Central Bank for withdrawal of the licence for carrying out banking activity (and such knowledge is a condition for declaring the set-off null and void in the insolvency proceedings) (Art. 59(4) BIA). In addition, every set-off, made by a creditor (≠ Art. 645 of the Commerce Act) or by the bank, shall be invalid with respect to insolvency creditors, except for the part which each of them may have acquired from distribution of the converted into cash assets, regardless of the time of occurrence of both counter debts: (a) after the initial date of the bank's inability to pay debts; (b) after the date on which the bank was put under special supervision under the Credit Institutions Act, if this date is prior to the date in item (a) (Art. 59(5) BIA). In these cases the coming into effect of the set-off shall be postponed until the distribution account is credited under article 104 of BIA; when a bank is sold as an enterprise the set-off comes into effect after the transaction is approved by the court (Art. 59(6) BIA).

The distribution of the assets converted into cash among the creditors is to be made according to article 94 of the BIA (and not to article 722 of the Commerce Act).

In 2014 the license of one of the largest Bulgarian banks - Corporate Commercial Bank - was revoked by the Bulgarian National Bank and in April 2015 the bank was declared insolvent by

[9] Grounds for such withdrawal are inability to pay debts, negative equity and not meeting the conditions for restructuring under article 51(1) of the Recovery and Resolution of Credit Institutions and Investment Intermediaries Act.

the Sofia City Court. One of the most discussed issues with regard to the bank are transactions made in 2014 (when it was already clear that the bank is in financial troubles) between debtors (having received loans) and creditors (having deposited funds) of the bank where the creditors sold (transferred) their receivables against the bank to the debtors (with a discount) who then set-off their obligations to repay the loans with the acquired receivables (deposits). It is argued that these transactions infringe the other creditors' rights, and circumvent the rules for payments to the creditors, etc. It is still not clear how these transactions will be finally assessed by the court (the bank's receivers have challenged them as contradicting to Art. 59 BIA; cases are still in the first or second court instance; there are already court decisions confirming that the set-offs made after the initial date of the bank's inability to pay debts are invalid with respect to insolvency creditors). The above cited rules of Art. 59(5) and (6) were modified in November 2014 to better deal with such situations, but the amendments were done *post factum*, i.e. they should not apply in their amended version to the case with Corporate Commercial Bank. That is why, by another package of legislative amendments to the BIA (promulgated in State Gazette on 13 March 2018) the insolvency receivers of Corporate Commercial Bank were given additional powers to challenge certain transactions, to reinstate securities in favour of the bank which had been deleted, etc. The amendments had retroactive effect which lead to public debates.

(ii) Bank *insolvency* should be distinguished from bank *liquidation* which is regulated in the Credit Institutions Act (voluntary[10] and compulsory[11] bank liquidation).

(iii) A special section (articles 133 to 150) is envisaged in the Credit Institutions Act regarding the cross-border reorganisation measures and winding-up procedures of banks (transposing the provisions and requirements of Directive 2001/24/EC on the reorganisation and winding-up of credit institutions). Competent to pass a judgement / decision on the liquidation or opening of insolvency proceedings of a bank licensed in Bulgaria are Bulgarian courts or administrative authorities. The judgement / decision has effect also in respect of the bank's branches in other EU Member States. In such a case, the general rule is that in regard to the liquidation or insolvency proceedings (incl. as regards the conditions under which set-offs may be invoked) of the bank licensed in Bulgaria, Bulgarian laws shall apply (unless something different is envisaged by the Credit Institutions Act).

The judgement / decision of the competent court or administrative authority on opening of winding-up proceedings of a bank licensed in an EU Member State carrying out activity on the territory of Bulgaria shall be directly and without any formalities recognized in Bulgaria and shall have effect in Bulgaria from the time that it enters into force and becomes effective in the EU Member State of the opening of proceedings. In such a case the general rule is that in regard to the winding-up proceedings of the bank, the laws of the EU Member State where the bank has been licensed shall apply.

Pursuant to article 144 of the Credit Institutions Act the adoption of reorganisation measures or the opening of a winding-up procedure of a bank shall not affect the right of creditors to demand the set-off of their claims against the claims of the bank, where such a set-off is permitted by the law applicable to the bank's claim. This provision shall not preclude the actions for voidness, voidability or unenforceability of legal acts detrimental to all the creditors as per the applicable law. Therefore, if the claims arising under the General Agreement are

[10] A resolution on voluntary liquidation may be taken by the General Meetings of the shareholders of the bank after permission of the Central Bank.

[11] Compulsory liquidation of a bank is carried out where the bank's license has been withdrawn on any of the grounds listed under article 36(1) of the Credit Institutions Act (i.e. other than inability to pay debts / negative equity).

governed by a law other than Bulgarian law (and provided that set-off is legal, valid, binding and enforceable under that law), Bulgarian reorganisation measures or winding-up proceedings of a bank should in principle not interfere with the possibility bank's creditors to set-off their claims under the General Agreement.

In case of the adoption of reorganisation measures or the opening of a winding-up procedure of a bank the applicable law in respect of the netting agreements[12] shall be the law applicable under the contract which envisages netting agreements (article 145, it. 2) without prejudice to the provisions of Art. 100 and Art. 103 of the Act on Recovery and Resolution of Credit Institutions and Investment Intermediaries (implementing into Bulgarian law the Bank Recovery and Resolution Directive /Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014/), or the respective provisions of the legislation of an EU Member State. Therefore, if the General Agreement is governed by a law other than Bulgarian law, Bulgarian reorganisation measures or winding-up proceedings of a bank should in principle not interfere with the effectiveness of the General Agreement.

It could be further concluded that article 145, it. 2 of the Credit Institutions Act dealing with netting agreements is *lex specialis* and prevails over article 144 of the same Act dealing with set-off.

1.1.2.2. The Insurance Code (published in State Gazette 102/29.12.2015, last amendments published in State Gazette 27/27.03.2018).

The Insurance Code (Art. 612 - 634) provides for special regulation of the insolvency of insurers (an insurer shall be: (a) a joint-stock company, a European company, a mutual insurance cooperative or a European cooperative society with a seat of business in Bulgaria, which has obtained a licence under the conditions and in accordance with the procedure laid down in the Insurance Code (local insurer); (b) a person who has obtained a license for insurance in another member state and performing activities on the territory of Bulgaria under the conditions of the right of establishment or of the freedom to provide services (insurer from another member state); (c) a branch of an insurer from a third country, registered under the Commerce Act, which has obtained a license under the conditions and according to the procedure laid down in the Insurance Code).

There are special provisions in the Insurance Code regarding the cross-border liquidation and insolvency proceedings of insurers. An explicit provision (Art. 631(3)) states that the opening of liquidation or insolvency proceedings of an insurer shall not affect the right of its creditors to set-off where such a set-off is permitted by the law applicable to the insurer's claim. This provision shall not limit the rights of the liquidator, the receiver or the creditors in accordance with the Commerce Act and the OCA to invoke voidance or to request declaration of voidability or of invalidation with respect to the creditors of actions and transactions. They shall not have this power in case a third party, who has acquired rights under such actions / transactions, proves that the action or the transaction are regulated by the law of another EU Member State, and that according to this law they are effective and valid (Art. 632(2)).

1.1.2.3. The Energy Act.

Pursuant to article 61 of the Energy Act, the relations related to the inability to pay debts and the insolvency of energy companies, which have obtained licenses for electricity or heat or natural gas transmission, for electricity or natural gas distribution, as well as the companies

[12] No definition of 'netting agreements' is provided for by the Credit Institutions Act.

which have obtained a license for activities through objects as per a list of the strategic objects of national importance in the energy sector[13] approved by the Council of Ministers, shall be regulated by a special Act. No such an Act has been adopted yet[14].

It is to be noted that electricity traders do not fall within the scope of this special Act, so, their insolvency proceedings should be governed by the general rules stated in the Commerce Act.

Therefore, from the current participants on the liberalized electricity market in Bulgaria (see item **B.II.**3 of our Opinion) only the electricity generators (those of them which carry out activity through objects included in the said list) should be concerned by the future Act on the insolvency of energy companies. Until the adopting of such an Act, the general rules of Part IV of the Commerce Act (see the above item 1.1.1) regarding the insolvency proceedings shall be applicable in respect of such companies if they become unable to pay their debts and/or over-indebted.

1.1.3. **Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings**

The Bulgarian Commerce Act contains several provisions dealing with applicable law in respect of cross-border insolvency proceedings (a foreign judgement declaring insolvency shall be recognized by Bulgaria under the conditions of reciprocity if it has been passed by the competent authority of the State where the debtor's seat (registered address) is, etc.). As from 1 January 2007 Bulgaria became EU Member State, therefore the EU Regulations are binding for Bulgaria and have direct application. Therefore Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (the **EU Insolvency Regulation**) shall be directly applicable in Bulgaria as well and the provisions of the Commerce Act regulating cross-border insolvency proceedings shall be considered not applicable if EU Member States are concerned.

Any judgement opening insolvency proceedings passed by a court of an EU Member State which has jurisdiction pursuant to article 3 of the EU Insolvency Regulation shall be recognized in Bulgaria from the time that it becomes effective in the EU Member State of the opening of proceedings (based on the principle of mutual trust).

If the debtor (Party A) has its centre of main interests (**COMI**) in Bulgaria (i.e. generally if its seat (registered office) is in Bulgaria), Bulgarian courts will be competent to pass a judgement on opening of the main insolvency proceedings and Bulgarian law shall apply in respect of those proceedings (i.e. Bulgarian law shall be *lex concursus*). If the debtor has only an establishment within the territory of Bulgaria (i.e. any place of operations where the debtor carries out a non-transitory economic activity), Bulgarian courts will have the jurisdiction to open secondary insolvency proceedings and apply Bulgarian law, where the effect of those proceedings will be restricted to the assets of the debtor situated on the territory of Bulgaria.

The law applicable to the insolvency proceedings shall regulate also the conditions for set-off in such proceedings. If Bulgarian law is *lex concursus*, then the above cited article 645 of the

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[13] The text refers only to those companies included in the list which carry out any of the activities public delivery of electricity or natural gas or public supply of electricity or natural gas. A review of the list approved by the Council of Ministers, however, shows that also large electricity generators are included in it; therefore, in our opinion they have also to be covered by the special legal treatment established by the future Act on the insolvency of energy companies.

[14] According to the court practice (Judgement No 791 of 15 December 2005 of the Supreme Cassation Court in case No 471/2005), '*The lack of a special Act regulating the inability to pay debts and the insolvency of the companies licensed under the Energy Act does not exclude the applicability of Part IV of the Commerce Act in such cases.*' This was confirmed also by more recent case law - Judgement No 977 of 17 June 2015 of the Sofia City Court in case No 1992/2014 (not entered into force yet).

Commerce Act shall apply (see the above item 1.1.1**(ii)**). Pursuant to article 6(1) of the EU Insolvency Regulation the opening of insolvency proceedings shall not affect the rights of creditors to demand the set-off of their claims against the claims of the debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claim (i.e. the passive claim). On the other hand, this provision shall not preclude actions for voidness, voidability or unenforceability of legal acts detrimental to all the creditors as per the applicable law (article 6(2) of the EU Insolvency Regulation) (such as under articles 645 to 647 of the Commerce Act - see the above item 1.1.1**(ii)**). If, however, the person who benefited from an act detrimental to all the creditors provides proof that:

- the said act (i.e. the set-off) is subject to the law of a Member State other than that of the State of the opening of proceedings (e.g. if insolvency proceedings are opened in Bulgaria in respect of a Bulgarian Party but the counterparties have agreed that German or English law shall regulate their relations under the General Agreement), and
- that law does not allow any means of challenging that act in the relevant case (i.e. German or English law does not allow the set-off under the General Agreement to be challenged in insolvency proceedings),

the rules under *lex concursus* relating to voidness, voidability or unenforceability of the legal act shall not apply (i.e. the set-off should be not challengeable under Bulgarian law) (article 13 of the EU Insolvency Regulation).

On the contrary, if German or English law allows means of challenging the set-off in the insolvency proceedings, then the set-off is in principle challengeable under article 645 of the Commerce Act and the respective conditions for its validity have to be checked.

It should be noted that the EU Insolvency Regulation does not apply to cross-border insolvency proceedings concerning insurance undertakings, credit institutions, investment undertakings which provide services involving the holding of funds or securities for third parties, or to collective investment undertakings.

The EU Insolvency Regulation does apply in a cross-border insolvency where assets (e.g. claims of the bankrupt Bulgarian Party) are also located in one or more other Member States (other than Denmark) (see also item 1.1.5 below).

1.1.4. **Quasi-governmental entities**

It should be further noted that insolvency proceedings are opened only in respect of traders (i.e. companies (including 100 % State-owned companies), cooperations, single merchants).

Quasi-governmental entities are not subject to insolvency proceedings (neither to the ordinary forced execution proceedings[15]). No insolvency proceedings shall be opened with respect to 'public undertakings' (see item **B.II.**2.(ii) of our Opinion) which exercise State monopoly or are established by virtue of a special law; the relations related to their inability to pay debts shall be regulated by a separate law (no such a law has been adopted yet).

1.1.5. As evident from the above considerations, two main criteria determine the legal rules applicable to insolvency proceedings – what kind of counterparties have entered into the General Agreement and whether there is a cross-border element. With a view to that

[15] This rule is applicable to the municipalities only as regards cash on their accounts received as State subsidies; the forced execution over their other assets (unless public municipal property) shall follow the general order.

following scenarios could be outlined (the list is non-exhaustive) and should be taken into consideration:

(i) Counterparties are two Bulgarian companies (e.g. two electricity traders registered with the Bulgarian Commercial Register and licensed by the (S)CEWR). In this case the general insolvency rules stated in the Commerce Act (Part IV) shall apply (see the above item 1.1.1).

(ii) Counterparties are a Bulgarian company and a Bulgarian bank (i.e. a bank having its seat (registered office) and licensed (authorized) in Bulgaria). Where to the Bulgarian company Part IV of the Commerce Act shall apply, to the bank shall apply the Bank Insolvency Act (see the above item 1.1.2.1).

(iii) Counterparties are a Bulgarian company (having its COMI in Bulgaria) and a company having its COMI in another EU Member State (other than Denmark). If the Bulgarian Party becomes unable to pay its debts (or over-indebted), Part IV of the Commerce Act shall apply, where in respect of the other counterparty the law of the EU Member State where it has its COMI shall apply (see the above item 1.1.3).

(iv) Counterparties are a Bulgarian company (having its COMI in Bulgaria) and a credit institution authorized in another EU Member State. In respect of the Bulgarian Party Part IV of the Commerce Act shall apply (see the above item 1.1.1), in respect of the credit institution shall apply the relevant Act applicable in the State where it is authorised which regulates its winding up.

(v) Counterparties are a company having its COMI in another EU Member State and a credit institution (a bank) authorized in Bulgaria. In respect of the Bulgarian Party the Bank Insolvency Act shall apply (see the above item 1.1.2.1).

1.1.6. **Financial Collateral Arrangements Act (published in State Gazette 68/22.08.2006, last amendments published in State Gazette 102/29.12.2015)**

On 22 August 2006 the Financial Collateral Arrangements Act (the **FCAA**) was published in the State Gazette. As evident from its name, the FCAA was adopted in order to implement into Bulgarian legislation Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements[16]. The FCAA almost literally transposes the provisions of Directive 2002/47/EC, including as regards definitions of financial collateral arrangements (title transfer or security (pledge) financial collateral arrangements), financial obligations, financial instruments, close-out netting provisions, etc. Although the FCAA does not contain any specific insolvency proceedings rules (except for those cited below, but they are not to be considered as procedural rules), we believe that it is relevant in respect of our task and the scope of this Opinion, that is why we summarize below some of the provisions of the FCAA which are of bigger importance for the issues reviewed herein[17]:

(i) Parties to financial collateral arrangements

[16] Prior to its amendment by Directive 2009/44/EC of the European Parliament and of the Council; Directive 2009/44/EC was implemented in the FCAA by the amendments published in State Gazette 101/28.12.2010, in force as from 30.06.2011.
[17] For more details on the FCAA see for example *'Financial collateral'*, Prof. Angel Kalaidjiev, Commercial law, issue 4/2007, pages 5-25; '*Contractual law*', Prof. Angel Kalaidjiev, 7th edition, Sibi 2016, pages 745 – 775; the studies by Ivan Mangachev in Commercial and Competition Law, issues 5 (pages 53-60), 10 (pages 34-37) and 11 (pages 26-30) of 2008, as well as the books by Ivan Mangachev '*Financial collateral arrangements*' (Ciela 2009) and '*The new legal regime of the financial collateral arrangements*' (Ciela 2011).

Parties to a financial collateral arrangement are the collateral provider and the collateral taker. The collateral provider and collateral taker can be only any of the entities listed in the FCAA, such as:

(a) public authorities, local government authorities;
(b) a central bank;
(c) the European Central Bank, the Bank for International Settlements, the European Investment Bank, the International Monetary Fund, the multilateral development banks;
(d) a credit institution (i.e. a bank, see item **B.II.**1(iii) of our Opinion), incl. within the meaning of Directive 2006/48;
(e) a financial institution (see item **B.II.**1(iii) of our Opinion) , incl. within the meaning of Directive 2006/48;
(f) an insurer;
(g) an investment intermediary;
(h) a management company;
(i) a collective investment scheme or a national investment fund;
(j) a regulated stock market;
(k) a Central Depository;
(l) an additional social security company;
(m) a health insurance company;
(n) a company with special investment purpose;
(o) a central counterparty, settlement agent or clearing house, including similar legal entities acting in the futures, options and other derivatives markets;
(p) a trader (excluding the single merchant) acting on behalf of one or more persons holding bonds or other forms of securitised debt or of any entity / institution as listed above in items (a) to (o);
(q) any entity (excluding the single merchant or a company which is not a legal entity) (see item **B.II.**1(i) of our Opinion) provided that the other party to the financial collateral arrangement is an entity / institution as listed above in items (a) to (p).

A party to a financial collateral arrangement can be also any person having the status of any of the above entities / institutions under its national law.

The general idea of Directive 2002/47/EC is that only professional players on financial markets should benefit from the special treatment under it. Bulgaria has applied a partial opt-out and has not excluded totally the arrangements where one of the parties is a person mentioned in article 1(2) (e) of Directive 2002/47/EC, but has included traders (i.e. companies and cooperations) and excluded natural persons, single merchants and civil partnerships.

Therefore, if parties to a transaction which qualifies as a financial collateral arrangement under the FCAA (see the discussion in (iv) below for more details) are a 'special' entity / institution under any of the above items (a) to (p) and a company (for instance, an electricity trading company, registered in Bulgaria or in Germany), the special rules under the FCAA shall apply in respect of this transaction, including concerning close-out netting and beneficial treatment in case of insolvency proceedings. If parties to such a transaction are two 'ordinary' companies (i.e. companies which do not fall under any of the definitions under the above items (a) to (p) – for instance two energy trading companies), then the special treatment under the FCAA will **not** apply in respect of this transaction.

(ii) Close-out netting

Under article 10(2) of the FCAA, a close-out netting provision is a provision of a financial collateral arrangement, or, in absence of such provision, any statutory rule[18], by which, in case of non-performance[19]:

- the obligations of the parties become immediately due and transform into obligations to pay an amount representing their estimated current[20] value, or are terminated and replaced by an obligation to pay such an amount; and/or
- the obligations of the parties are redeemed up to the amount of the smaller obligation[21], where the party owing the larger amount remains debtor to the other party for the net sum equal to the balance of the account.

A close-out netting provision shall apply notwithstanding:

- the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider and/or the collateral taker (the definitions of winding-up proceedings or reorganisation measures also comply with Directive 2002/47/EC; in the definition of winding-up procedures are explicitly included the insolvency proceedings and the liquidations proceedings (voluntary or compulsory); it is further explicitly stated that the rules apply to all winding-up proceedings or reorganisation measures, regardless of the territory of the state where they are being carried out); and/or
- any purported assignment (transfer) of the financial collateral, other disposition of it or attachment in respect of it.

The legal doctrine underlines that the effect of the close-out netting occurs **automatically** (*ipso iure*), without a statement by any of the Parties to be necessary (in contrast to the set-off under the OCA).

Therefore, Art.10(2) of the FCAA provides an exemption from the "cherry-picking right" of the insolvency receiver for qualifying transactions (financial collateral arrangements; see also the discussion in (iv) below for more details) between qualifying parties (broadly speaking, one party needs to be a financial institution).

(iii) Insolvency proceedings and financial collateral arrangements

In case of winding-up proceedings in respect of the collateral provider, the collateral taker shall retain the rights to realise the financial collateral.

A financial collateral arrangement, as well as the provision of financial collateral under such arrangement, may not be declared invalid, void or voidable or be reversed or terminated on the sole basis that the financial collateral arrangement has come into existence, or the financial collateral has been provided:

[18] We are not aware of a statutory rule under Bulgarian law regulating the *ex lege* close-out netting.
[19] 'Non-performance' is the non-performance of a financial obligation or any event as agreed between the parties or stipulated by a law which is made equal to non-performance.
[20] Which value is current is a matter which is decided with a view to each concrete case ('*Contractual law*', Prof. Angel Kalaidjiev, Sibi 2016, page 766).
[21] The wording is taken from the definition of set-off under the OCA.

- on the day of the commencement of winding-up proceedings or reorganization measures, but prior to the order or decree making that commencement (derogation of the 'zero hour principle'[22]); or
- in a legally prescribed period prior to, and defined by reference to, the commencement of such winding-up proceedings or reorganization measures or by reference to the making of any order or decree or the taking of any other action or occurrence of any other event in the course of such winding-up proceedings or reorganization measures (i.e. the financial collateral arrangement and the provision of financial collateral may not be challenged only on the ground that they have been entered into / provided within the 'suspect period').

Where a financial collateral arrangement or a relevant financial obligation has come into existence, or financial collateral has been provided on the day of, but **after** the moment of the commencement of, winding-up proceedings or reorganization measures, it shall be legally enforceable and binding on third parties if the collateral taker can prove (i.e. the burden of proof is for the collateral taker) that he was not aware, nor should have been aware, of the commencement of such winding-up proceedings or reorganization measures.

The right of or the obligation for provision of financial collateral, additional financial collateral or substitute or replacement financial collateral shall not be treated as or declared invalid, void or voidable or reversed or terminated on the sole basis of the provisions of the next paragraph, where a financial collateral arrangement contains:

- an obligation to provide financial collateral;
- an obligation to provide additional financial collateral in order to take account of changes in the value of the financial collateral or in the amount of the relevant financial obligations, or
- a right to withdraw financial collateral on providing financial collateral of substantially the same value.

The following shall not be the basis for a financial collateral arrangement to be treated as or declared invalid, void or voidable or reversed or terminated:

- the provision or substitution being made on the day of the commencement of winding-up proceedings or reorganization measures, but prior to the order or judgement making that commencement;
- the provision or substitution being made in a legally prescribed period prior to, and defined by reference to, the commencement of winding-up proceedings or reorganization measures or by reference to the making of any order or decree or the taking of any other action or occurrence of any other event in the course of such winding-up proceedings or reorganization measures (i.e. within the 'suspect period'), or
- the relevant financial obligations being incurred prior to the date of the provision of the financial collateral, additional financial collateral or substitute or replacement financial collateral.

[22] According to article 634a of the Commerce Act, insolvency proceedings shall be deemed instituted as of the date of the judgement on opening of such proceedings and in case certain actions have been performed on this date, they shall be presumed as effected **after** the institution of the insolvency proceedings.

It deserves mentioning that in the last years the financial collateral arrangements have started to be used in Bulgarian commercial practices due to the advantages they offer to the credit and financial institutions as collateral takers compared to other collateral.

(iv) The FCAA and the Credit Support Annex (**CSA**)

A question is posed whether the CSA would qualify as a financial collateral arrangement under the FCAA.

The first precondition, as discussed above, is to have two qualifying parties to the General Agreement and to the CSA (broadly speaking, one party needs to be a financial institution).

Having two qualifying parties, however, is not sufficient, the Eligible Credit Support under the CSA should qualify as financial collateral within the meaning of the FCAA and Directive 2002/47/EC.

Under the FCAA, financial collateral shall be money claims (Directive 2002/47/EC uses 'cash'), financial instruments and credit claims which, under a financial collateral arrangement, are used to secure the performance of certain financial obligations.

Under the CSA, Eligible Credit Support shall be either (a) Cash or a (b) Letter of Credit. The two collaterals are commented consequently below:

(a) Cash

<u>Definition under the CSA:</u> an amount of money in the Base Currency or any Eligible Currency.

<u>Definition under Directive 2002/47/EC</u>: money credited to an account in any currency, or similar claims for the repayment of money, such as money market deposits.

<u>Definition under the FCAA</u> - instead of 'cash', the law uses the term 'money claims': Money claims shall be any money credited to an account in any currency, or similar claims for the repayment of money, such as money market deposits. Money in cash shall not be money claims within the meaning of this Act.

At the first glance, it seems that the Cash under the CSA does not qualify as financial collateral within the meaning of the FCAA.

However, when excluding money in cash from the scope of the Act, the legislator has meant money in cash <u>not in a bank account</u>. Arguments supporting this conclusion can be derived for example from article 5(2) of the FCAA according to which '*Money claims shall be deemed provided as of the moment when the cash collateral has been credited to, or forms a credit in, the designated account with a bank'*.

Therefore, it is rather to be concluded that the Cash under the CSA qualifies as financial collateral within the meaning of the FCAA and that thus the CSA qualifies as a financial collateral arrangement under the FCAA - <u>with regard to the Eligible Credit Support in the form of Cash</u>.

(b) Letter of Credit

Definition under the CSA: a standby letter of credit, bank guarantee or similar document in a format acceptable to the Transferee denominated in the Base Currency or an Eligible Currency issued irrevocably by a leading commercial bank with a credit rating of at least A- from Standard & Poor's Rating Group or A3 by Moody's Investors Services, Inc. which obliges the bank to pay the amount guaranteed therein upon first demand of the Transferee.

Neither Directive 2002/47/EC nor the FCAA refer to a letter of credit, to a bank guarantee or to a similar document. The letter of credit does not qualify as either financial instrument (any materialized or book entry securities) nor as a credit claim (pecuniary claims arising out of an agreement whereby a credit institution grants credit in the form of a loan).

Therefore, the Letter of Credit does **not** qualify as financial collateral within the meaning of the FCAA and the CSA does not qualify as a financial collateral arrangement under the FCAA with regard to the Eligible Credit Support in the form of Letter of Credit.

If additional certainty is sought that the FCAA would apply in the relations between the two qualifying parties, it would be recommendable (aa) to include a specific reference to the FCAA in the CSA (in case of applicable Bulgarian law) and (bb) to exclude the Letter of Credit from the Eligible Credit Support (i.e. to limit the ECS to Cash only).

Of course, any other Eligible Credit Support agreed in any of the forms of financial collateral under the FCAA is permissible and should qualify the CSA as financial collateral arrangement.

Therefore, in a scenario in which a foreign bank enters into a General Agreement plus a CSA with a Bulgarian electricity/gas company, and both exchange cash as collateral, Art. 10(2) of the FCAA would protect the contractually agreed close-out netting. Of course, it has always to be kept in mind that the Bulgarian market is for the time being only at a stage where physical electricity/gas is traded between classical energy companies (and EFET CSAs are not very wide-spread either). The Bulgarian market is far from developing sophisticated derivatives instruments which banks would require to hedge any physical positions they take.

(v) In August 2015 the FCAA was amended to reflect the implementing into Bulgarian law of the Bank Recovery and Resolution Directive which was done by the Act on Recovery and Resolution of Credit Institutions and Investment Intermediaries. According to Art. 16(2) FCAA, the rules dealing with the close-out netting and the realisation of the financial collateral shall **not** apply to any restriction on the enforcement of financial collateral arrangements or any restriction on the effect of a security financial collateral arrangement, any close-out netting or set-off provision that is imposed by virtue of Chapters XV or XVI of Act on Recovery and Resolution of Credit Institutions and Investment Intermediaries, or to any such restriction that is imposed by virtue of similar powers in the law of an EU Member State to facilitate the orderly resolution of any entity referred to in the above item 1.1.6(i), points (f) and (o) which is subject to safeguards at least equivalent to those set out in Chapter XVII of the Act on Recovery and Resolution of Credit Institutions and Investment Intermediaries (compare with Art.1(6) of Directive 2002/47/EC).

1.1.7. Public Offering of Securities Act (**POSA**) and Market in Financial Instruments Act (**MiFIA**)

The POSA does not provide for special separate insolvency procedural rules in respect of the entities regulated by it – public companies. Therefore, the general insolvency rules stated in the Commerce Act (Part IV) shall be respectively applied (see the above item 1.1.1), or, if any of the public companies is also a bank – the rules under the Bank Insolvency Act (see the above item 1.1.2.1).

The only exception with regard to the public companies are the 'safe harbour provisions' included in the Law on the Payment Services and Payment Systems (**LPSPS**) to which POSA refers - for more details see item **C.I.**1.3.7.

With the adoption of the aforementioned new Act on Recovery and Resolution of Credit Institutions and Investment Intermediaries ('**ARRCIII**', published in State Gazette 62 of 14 August 2015) implementing into Bulgarian law the Bank Recovery and Resolution Directive (Directive 2014/59/EU), some additional safeguard provisions in case of undertaken measures for (i) prevention of insolvency or, (ii) when insolvency occurs, for minimising the negative repercussions by preserving the systemically important functions of credit institutions and investment intermediaries have been provided in Bulgarian legislation. Art. 109 of the ARRCIII implements the safeguard provisions of Art. 77 of Directive 2014/59/EU and stipulates that the respective Bulgarian authority when executing the recovering or resolution measures (i) shall not be authorized to transfer some, but not all, of the rights and liabilities that are protected under a title transfer financial collateral arrangement, a set-off arrangement or a netting arrangement if the parties to the arrangement are entitled to set-off or net those rights and liabilities and (ii) shall not have the right of modification or termination of such rights and liabilities.

With regard to the implementation of the provisions of Directive 2014/59/EU, the Credit Institutions Act was respectively amended and supplemented. Respective provisions were envisaged in the new MiFIA (effective as of 16.02.2018) as well. For example, Art. 145 of MiFIA and Art. 144 of the Credit Institutions Act provide that the execution of recovering measures or opening of winding-up procedure for an investment intermediary, respectively for a bank, shall not affect the rights of its creditors to set-off when the law applicable to the investment intermediary's/bank's claim allows the set-off. As per Art. 146 of MiFIA and Art. 145 of Credit Institutions Act in case of execution of recovering measures or opening of winding-up procedure for an investment intermediary, respectively for a bank, regarding the netting arrangements the applicable law shall be the law applicable to the netting agreement providing such netting arrangements.

1.1.8. **Please clarify whether or not there is a distinction in time with respect to a creditor's rights between:**

(a) the filing of proceedings seeking a judgment of insolvency

(i) As stated in the above item 1.1.1**(i)**, the pre-conditions for opening of insolvency proceedings against a trader are:

(a) inability to pay debts or

(b) over-indebtedness (in case of a private limited company, public limited company or a partnership limited by shares).

The court shall assess on the grounds of the collected evidence whether the necessary pre-conditions for opening of the insolvency proceedings are available. In contrast to ordinary civil proceedings, the insolvency court has the power to collect evidence on its own motion (*ex officio)*.

(ii) The court shall open a case under the filed petition on the day the petition was filed and shall pass a judgement after **four months** at the latest. This term may be longer (depending on the particular case and its complexity), because it is merely instructive and not binding for the court (from our practical experience we would rather say that this term is approx. 8 months).

(iii) If the court decides that there is no sufficient proof that the debtor is unable to pay his debts or if the debtor's difficulties have temporary nature or if the debtor has sufficient assets to cover his debts without the creditors' interests to be endangered, the court rejects the petition by a judgement.

As from 2003 there is a special provision in the Commerce Act (article 631a) stating that if the judgement on rejection of the creditor's petition on opening of insolvency proceedings has entered into force, the debtor has the right to claim compensation, if the creditor has acted intentionally or with gross negligence. The compensation encompasses all direct material (property) and immaterial (non-property) damages[23]. Immaterial damages are determined by the court in accordance with principles of justice.

The idea of this new provision was to reduce the abuses of creditors' right to request from the competent court opening of insolvency proceedings against their debtors.

Creditors' rights: The petition on opening of insolvency proceedings may be filed *inter alia* by a creditor of the debtor. The petition is not published, so in principle the other creditors have no official way to understand about the filed petition. However, if they succeed to obtain information about the petition, they may file petitions as well and be constituted as parties to the proceedings. They have this right until the first court hearing in the proceedings is over.

At this stage (prior to the judgement regarding the filed petition to be taken by the court, see next item (b)) the debtor is neither unable to pay its debts / over-indebted, nor insolvent, i.e. all the restrictions applicable to the debtor, its activity and its creditors after the court judgement on opening of the insolvency proceedings are not applicable yet.

An exception is provided by the law only in case of imposing by the court of preliminary (i.e. prior to the judgement on opening of the insolvency proceedings) security measures under Art. 629a of the Commerce Act. The purpose of these measures is to preserve the debtor's assets (in general, the court may impose all measures which it finds appropriate for the achievement of the said purpose – e.g. appointment of a temporary receiver still at this stage of the proceedings) and they may be imposed upon request of a creditor or *ex officio* by the court.

(b) a bankruptcy court recognizing the filing of proceedings seeking a judgment of insolvency

(i) Our understanding is that here the judgement on opening of the insolvency proceedings is meant.

If the court comes to the conclusion that the debtor is unable to pay its debts or is over-indebted, the court shall pass a judgement by which it *inter alia* declares the debtor's inability to pay its debts, respectively the debtor's over indebtedness, and determines their initial (commencement) date and opens the insolvency proceedings (see also the above item 1.1.1**(i)**).

[23] This was a revolutionary legislative amendment since according to the court practice legal entities shall not have the right to claim compensation for immaterial (moral) damages.

By the same judgement the court imposes security measures with the purpose to preserve the insolvency estate and appoints a temporary receiver.

The declaring of the debtor insolvent comes in principle at a later stage - if no composition plan has been proposed within the legally prescribed term, or if the proposed plan has not been approved or confirmed, or if it is evident that the debtor's activity would prejudice the insolvency estate, or in case of reopening of the insolvency proceedings (see also the above item 1.1.1**(vi)**).

If, however, it is evident that the continuation of the debtor's activity would prejudice the insolvency estate, the court may upon request of the debtor, the liquidator, the insolvency receiver, a creditor or the National Revenue Agency declare the debtor insolvent and terminate its activity by the same judgement on opening of the insolvency proceedings.

(ii) As mentioned above, the debtor continues its activity under the supervision of the insolvency receiver. It may enter into new transactions only with the receiver's preliminary consent.

If the court comes to the conclusion that with its actions the debtor threatens the creditors' interest, the court may deprive the debtor of the right to manage and dispose of its assets and to render this right to the insolvency receiver.

Performance of obligations towards the debtor may only be made against the insolvency receiver.

(iii) The judgement on opening of insolvency proceedings shall be published in the electronic on-line based Commercial Register and may be appealed within 7 days as from having been published.

Creditors' rights: The insolvency proceedings shall be deemed opened on the date of the judgement on opening of the proceedings; if certain actions (e.g. payment of obligations to the debtor) are committed on this date, they are deemed to be done **after** the institution of the insolvency proceedings.

As from the date of the judgement on opening of the insolvency proceedings all the restrictions to the debtor, its activity and its creditors envisaged by the Commerce Act become applicable. Certain actions committed after this date or within certain term before this date are null and void with respect to the insolvency creditors (e.g. performance of an obligation that has occurred prior to the date of the judgement for institution of the insolvency proceedings and is effected after the date of the judgement and not in compliance with the procedure established thereby; for more details see the above item 1.1.1**(ii)** and in particular the comments on Art. 645 of the Commerce Act regulating the permissibility of the insolvency set-off).

The creditors may submit their claims to the insolvency court within certain term as from the date of the publication of the judgement for institution of the insolvency proceedings (for more details see item (d) below). This is the first act in the insolvency proceedings to be published on the webpage of the Commercial Register, i.e. this is the first moment the creditors are officially informed about the insolvency proceedings (except for the cases of imposed preliminary security measures under Art. 629a of the Commerce Act - see the above item 1.1.8**(a)**(iii), final paragraph).

(c) the date on which a bankruptcy court determines a party first becomes insolvent

Our understanding is that here the initial date is meant when the party became unable to pay its debts (*Zahlungsunfähigkeit* in German), or became over-indebted (*Überschuldung* in German) (and not the court's judgement on declaring the insolvency (bankruptcy, *Insolvenz* in German).

Creditors' rights: As stated above (see item 1.1.1**(i)**), the court has the almost unrestricted right on its own motion (based on the evidence collected, of course) to fix this date by its judgement on opening of the insolvency proceedings. There is no legal limit in the Commerce Act how long backward in time this date may be fixed. This lead to problems and uncertainty in practice with a view to the possibility some transactions concluded and payments made within the 'suspect period' (i.e. after the date determined by the court on which the debtor became unable to pay its debts) to be challenged by the insolvency receiver, respectively by the creditors of the debtor. That is why in February 2013 rules were introduced into the Commerce Act that limited the date back in time until which certain transactions can be challenged as null and void (for more details see above item 1.1.1**(ii)**).

(d) any other stage of the proceedings where a creditor's rights may be affected.

A. Most important with a view to creditor's interests and rights is the procedure for lodging of claims and their admittance by the insolvency receiver and approval by the insolvency court (see also the above item 1.1.1**(iv)**).

(i) Creditors must submit their claims in writing to the insolvency court within one month as from publishing in the electronic on-line based Commercial Register of the judgement for institution of the insolvency proceedings. Creditors have to point out their claims, the claim's ground and amount, the privileges and securities and to provide written evidence thereof. If any creditor fails to comply with the one-month term, he still has the possibility to file his claim, not later, however, than two months after its expiry. After expiry of this additional term claims which have occurred by the date of opening of the insolvency proceedings may not be lodged.

(ii) With the submission of a claim the statutory limitation period (*Verjährung* in German) for this claim is suspended and stops running until the insolvency proceedings last.

(iii) Within 7 days as from expiry of the above one-month term the insolvency receiver prepares the list of the accepted claims and a list of the submitted but not accepted claims. These documents are presented by the receiver at the clerk's office with the insolvency court and published in the Commercial Register.

(iv) Within 7 days as from the publication under the preceding item the debtor or any creditor may challenge any accepted or not accepted claim. The challenge shall be made in writing and filed to the insolvency court with a copy to the receiver. The court examines the challenges in an open hearing. If the court deems that the challenges are justifiable, it adapts the list respectively.

(v) The court approves the list of the accepted claims by a ruling which is published on the webpage of the Commercial Register.

(vi) The creditors who have challenged the acceptance or non-acceptance of a claim, but their challenges have been rejected by the court, still have the possibility to file a claim for ascertaining the existence of a not accepted claim or the non-existence of an accepted claim within 14 days as from the publication of the ruling for approval of the list of the accepted claims in the Commercial Register.

B. The next significant moment with a view to a creditor's rights in the insolvency proceedings is the distribution of the debtor's assets converted into cash (see also the above item 1.1.1**(vii)**).

(i) The distribution of the debtor's assets converted into cash is made by the insolvency receiver. The receiver prepares an account for the distribution of the available amounts among the creditors with claims according to article 722(1) of the Commerce Act in conformity with the order, the privileges and the securities of the claims. The account is to be approved by a ruling of the insolvency court which is published on the webpage of the Commercial Register.

(ii) Under article 722(1) of the Commerce Act the order and priority for satisfaction of the claims are the following:

(a) Claims with special privileges:

- claims secured by a pledge or mortgage, or distraint or attachment registered in pursuance of the procedure under the Special Pledges Act - out of the proceeds of the realized security (e.g. of the sale by the receiver of a mortgaged real estate);
- claims with regard to which retention right is exercised - out of the proceeds of the sale by the receiver of the property over which the retention right is exercised;

(b) Claims with general privileges:

- costs related to the insolvency proceedings (state fees, receiver's remuneration, debtor's employees' remunerations if the company has not ceased its activity, costs related to complementing, management, evaluation and distribution of the insolvency estate);
- claims deriving from employment contracts;
- alimony (maintenance) claims;
- public law claims of the State and the municipalities (such as taxes, customs duties, fees, obligatory social security contributions) which have emerged prior to the date of the judgement on opening of insolvency proceedings;
- claims which have emerged after the date of the judgement on opening of insolvency proceedings and have not been paid when due;

(c) Other claims:

- any remaining unsecured claims that have occurred prior to the date of the judgement on opening of insolvency proceedings;
- claims under article 616(2), items 1 to 4 of the Commerce Act.

(iii) If the cash funds are insufficient to fully satisfy the claims of the creditors under the above items (b) and (c), the claims are satisfied as per the above order where creditors of one rank are paid pro rata in accordance with the amount of their claim.

(iv) If the proceeds of the sale of the mortgaged or pledged assets or the assets over which retention right is exercised are insufficient to fully satisfy the claims of the respective creditors and the interest accrued thereon, these creditors will be treated as unsecured creditors for the rest of their claims (item (c), first dash).

1.1.9. **We would also like to know whether there is publicly available information that would confirm any of the procedural steps mentioned above under (a) through (d) or other solvency related facts (e.g., financial statements, corporate actions, etc.).**

(i) As mentioned, as from 1 January 2008 in Bulgaria functions a new Commercial Register system which is on-line based and guarantees a high degree of transparency (until 1 January 2011 all existing companies registered in the old Commercial Register maintained by the district courts at the seat of these companies had to be re-registered in the new electronic Commercial Register). All important acts of the court (judgements, rulings) in insolvency proceedings are subject to publication in the electronic Commercial Register. The first act in the insolvency proceedings to be published on the webpage of the Commercial Register is the judgement on opening of these proceedings (step 1.1.8**(b)** above).

An exception from this rule occurs on the appointment of a temporary receiver (i.e. after the submission of the petition on institution of insolvency proceedings <u>but before</u> the court's judgement regarding this petition). The appointment of a temporary receiver is one of the preliminary security measures under article 629a of the Commerce Act which may be imposed by the court for safeguarding the debtor's assets and is subject to publication on the webpage of the Commercial Register.

We have commented above where an act of the court is subject to publication in the Commercial Register.

Although the creditors (different from the creditor who has filed the petition) have in principle the right to participate in step 1.1.8**(a)** above (i.e. in the proceedings opened under the petition seeking a judgment of insolvency), there is no official way to notify such creditors (the purpose is protection of the debtor's reputation if it turns out that the petition is groundless).

(ii) Apart from that, any circumstances which require a registration in the Commercial Register from corporate law viewpoint can be checked by everybody on the webpage of the Commercial Register (there are published not only the mere registered circumstances, but also scanned copies of all underlying documents – such as corporate resolutions, etc.).

(iii) The annual financial statements of the companies for the preceding year must be published in the Commercial Register until 30 June of the current year (there is a sanction provided by the law if they fail to do so).

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