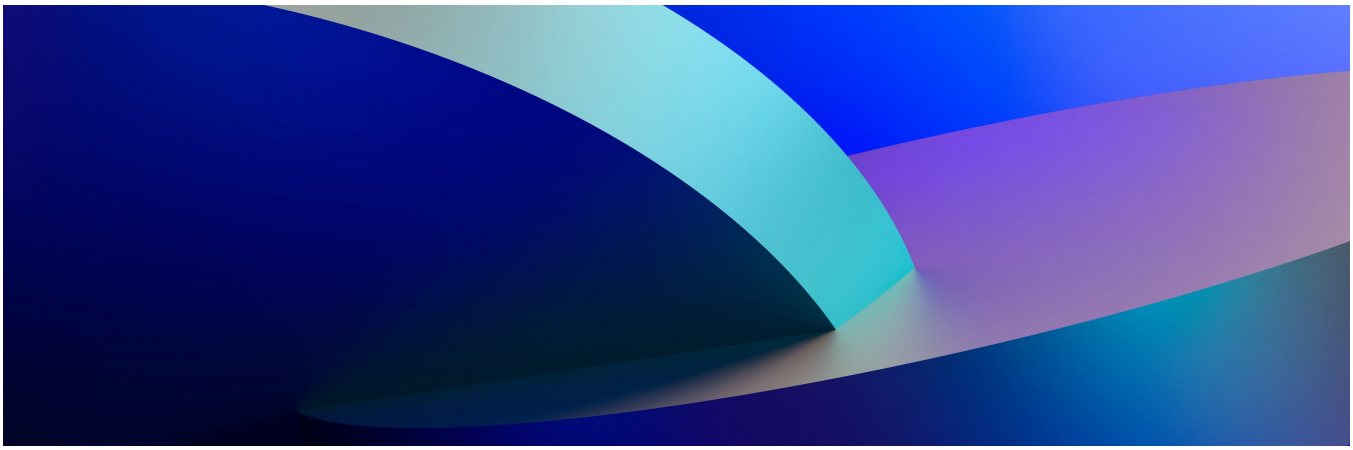

Restructuring and insolvency law in Bulgaria

Restructuring

1. What is the primary legislation governing restructuring proceedings in your jurisdiction?

The main provisions governing restructuring proceedings are set out in Part V (Stabilisation) and partly in Part IV (Insolvency) of the Bulgarian Commercial Act ("Commercial Act") which implements the EU Directive on Restructuring and Insolvency of 20 June 2019 (EUR 2019/1023).

Special provisions with respect to the recovery and resolution of banks and investment firms are set out in the Recovery and Resolution of Credit Institutions and Investment Intermediaries Act (the latter being the local legislation transposing the provisions of the Bank Recovery and Resolution Directive (BRRD)).

We have responded to the questions below from the perspective of the general legislation (i.e. the provisions of the Commercial Act), and regardless of the special regimes applicable to banks and investment firms and certain other exceptions from the general regimes such as insurance companies, monopolies and state enterprises.

2. How are restructuring proceedings initiated?

Stabilisation proceedings under Part V of the Commercial Act are court-driven proceedings that may only be initiated by the debtor.

Restructuring proceedings may also be initiated in the form of a rehabilitation of the company in the course of insolvency proceedings through the adoption of a rehabilitation plan for the debtor (see Insolvency below for further details as to who can initiate insolvency proceedings).

3. Which different types of restructuring proceedings exist and what are their characteristics?

Stabilisation

Stabilisation is an option available when a debtor is not yet insolvent but is in imminent threat of insolvency (subject to certain other conditions set out in the Commercial Act). Proceedings are initiated

by a petition in writing submitted to the competent district court by the debtor who must propose a stabilisation plan. The latter includes all relevant information related to the company's debt, financial activity, expected future revenue and the planned repayment of the company's liabilities. After the court accepts the petition and initiates proceedings, the stabilisation plan shall be voted on and adopted by the creditors in a court hearing and then subsequently approved by the court.

The purpose of stabilisation proceedings is to avoid the initiation of insolvency proceedings by an agreement reached between the company and its creditors on the settlement of the company's debt. The procedure aims to enable viable companies in financial difficulty to restructure their debt at an early stage and continue in business.

Rehabilitation

Another restructuring form stipulated in the Commercial Act is the rehabilitation of a company in the course of insolvency proceedings. Rehabilitation is implemented through the adoption of a rehabilitation plan which may be proposed by:

- the debtor
- the insolvency administrator
- secured or unsecured creditors, having at least one third of the claims in the relevant category
- shareholders with unlimited liability
- shareholders with limited liability, having at least one third of the registered capital
- employees who constitute at least 20% of the total number of the debtor's employees.

The plan may provide for the deferral or rescheduling of payments, partial or total debt relief, reorganisation of the going concern or other actions and transactions. The rehabilitation plan must be adopted by the creditors who vote in separate classes and approved by the court.

The main aim of rehabilitation proceedings is the continuation of the business activity of the debtor (if still viable) while all the creditors receive satisfaction of their claims to a certain extent.

4. Are there different types of creditors and what is the significance of the differences between them?

The Commercial Act identifies five classes of creditors in respect of restructuring proceedings, which can be summarised as:

- secured creditors
- employees (current and former)
- creditors with public law receivables
- unsecured creditors
- related parties or other unsecured creditors entitled to receive satisfaction only if all other claims are satisfied.

Both stabilisation plans (in stabilisation proceedings) and rehabilitation plans (in insolvency proceedings) are voted by the creditors in classes and have to be adopted by the majority of creditors in each class.

5. Is there any obligation to initiate restructuring/insolvency proceedings? For whom does this obligation exist and under what conditions? What are the consequences if this obligation is violated?

Restructuring

There is no legal obligation to initiate restructuring proceedings.

Insolvency

The legal representatives of the debtor have an obligation to file a petition for the initiation of insolvency proceedings within 30 days after the date on which the company became insolvent or over-indebted. The application which shall be filed on behalf of the debtor may also be filed by the liquidator. The procurator has the obligation to notify the debtor about the insolvency/over-indebtedness within 7 days of its occurrence.

In case the debtor fails to file an application for the initiation of insolvency proceedings, the responsible persons shall be jointly liable to the creditors for damages caused by delayed filing.

Also, under the Bulgarian Criminal Code, the directors shall be criminally liable if they do not file for insolvency within 30 days as of cessation of payments. The penalty which may be imposed is imprisonment up to 3 years or a fine of up to BGN 5,000 (EUR 2,556).

6. What are the main duties of the representative bodies in connection with restructuring proceedings?

The representative bodies continue to manage the company during stabilisation proceedings, though they may fall under the supervision of a restructuring administrator in the event that the court decides to appoint the latter. The company is obliged to assist the restructuring administrator by notifying them of any new transactions, new debt or amendments to previous transactions, by providing access to its offices, and by allowing the administrator and the appointed auditor access to its documents. The company shall provide the restructuring administrator, the appointed auditor and the court with any necessary information regarding its finances and commercial activities, as well as all relevant documents, upon request.

In the event that the court establishes the company’s actions may put its creditors’ interests at risk, the former may limit the company’s management and property rights in favour of the administrator.

The representative bodies retain the right to appeal certain court orders and decisions related to the restructuring proceedings.

The representative bodies are very limited in their rights and duties in the event of a rehabilitation, as the insolvency proceedings which shall have been initiated are led by an insolvency administrator. The company’s bodies shall comply with and assist the administrator and, in case of a successfully adopted rehabilitation plan, shall ensure the latter’s fulfilment.

7. What are the main duties of shareholders in connection with restructuring proceedings?

There are no obligations for shareholders with regard to restructuring proceedings.

Insolvency

1. What is the primary legislation governing insolvency proceedings in your jurisdiction?

Pursuant to Annex A to Regulation (EU) No. 2015/848 of the European Parliament and the Council of

20 May 2015 on insolvency proceedings (recast) (the “Regulation”), the corresponding Bulgarian procedure is the insolvency procedure (производство по несъстоятелност). The insolvency legislation is provided for in Part IV (Insolvency) of the Commercial Act. The latter was amended in 2023 to reflect the provisions of the EU Directive on Restructuring and Insolvency of 20 June 2019 (EUR 2019/1023).

2. How are insolvency proceedings initiated?

Insolvency proceedings are governed by the court and are initiated by a petition in writing submitted to the court. The petition must be submitted by the debtor itself or, respectively, by the liquidator (in the event of voluntary liquidation) or by a creditor. It can also be submitted by the national tax authorities or the labour authorities.

3. What are the legal reasons for insolvency in your country?

Under Bulgarian law, there are two triggers for insolvency proceedings: insolvency and over-indebtedness. These triggers are not cumulative; it is sufficient that a company is either insolvent or over-indebted for it to be obliged to enter insolvency proceedings or for its creditors to be entitled to enforce the same.

Insolvency

A company is insolvent when it is unable to meet:

- a due and payable payment obligation caused by or related to a commercial transaction, including its validity, performance, non-performance, termination, invalidity and rescission or the consequences of its termination
- a public obligation to the state and municipalities related to its commercial activity (such as tax)
- an obligation under ‘private state receivables’, such as receivables of the state under contractual agreements, or
- an obligation to pay wages to at least one third of its employees, which has not been discharged for more than 2 months.

There is a legal presumption in favour of insolvency if the company:

- has not applied for publication in the Commercial Register of its annual financial statements for the past 3 years
- has ceased to make due payments, or
- the claim of the creditor who has filed for insolvency has remained outstanding for more than 6 months under enforcement proceedings.

A company may also be insolvent if it is able to pay only some of its debts and such difficulties are not temporary in nature.

Over-indebtedness

A company will be considered over-indebted if its assets are insufficient to cover its monetary (payment) obligations. The definition provided by law is very broad, but in accordance with prevailing case law, the most common test is whether the total value of the company’s cash, cash equivalents and fast liquid assets is lower than the total value of the company’s short-term liabilities, i.e. liabilities which are expected to mature within 1 year.

However, even if the company is deemed insolvent or over-indebted, the court shall not commence insolvency proceedings if it is of the opinion that the company’s distress is of a temporary nature or

the company’s assets are sufficient to cover all of its liabilities without endangering the interests of creditors.

4. Which different types of insolvency proceedings exist and what are their characteristics?

The insolvency proceedings may either proceed as a rehabilitation of the debtor through the adoption of a rehabilitation plan, or as a liquidation of the insolvency estate and dissolution of the debtor.

Rehabilitation

In the first case, the rehabilitation plan may be proposed by the debtor itself or the insolvency administrator, as well as by shareholders, creditors and employees of the debtor above certain thresholds. The main aim of rehabilitation proceedings is the continuation of the business activity of the debtor (if still viable) while all the creditors receive satisfaction of their claims to a certain extent.

Liquidation

In the second scenario, all of the assets of the insolvency estate are being sold for the purposes of satisfaction of creditors’ claims to the extent possible. The insolvency administrator distributes the proceeds between the creditors based on their ranking and the company of the debtor goes into dissolution.

Insolvency proceedings for ‘entrepreneurs’

The 2023 amendments to the Commercial Act established insolvency proceedings for ‘entrepreneurs’ in line with the EU Directive on Restructuring and Insolvency (‘entrepreneurs’ are natural persons conducting business, practicing skilled crafts or working as freelancers, whose enterprises do not require conducting business as a company). Such insolvency proceedings fall under a separate legal regime, taking into account the limited volume of entrepreneurs’ commercial activities.

5. Are there different types of creditors and what is the significance of the differences between them?

The main distinction is made between creditors with secured claims and those with unsecured claims. As a general rule, secured creditors shall be entitled to receive priority satisfaction from the sale of the secured asset. Further, article 722 of the Commercial Act stipulates the ranking of creditors’ claims within the insolvency proceedings on the basis of their claims; the distribution of proceeds from the insolvency estate shall be made by applying the ranking.

Additionally, when adopting a rehabilitation plan, creditors vote for or against the proposed plan by forming different classes which can be identified as:

- secured creditors
- unsecured creditors
- the state
- employees
- other unsecured creditors entitled to receive satisfaction only if all other claims are satisfied.

The interests of creditors of the same class are considered as one and the same when adopting a rehabilitation plan.

6. Is a solvent liquidation of the company an alternative to regular insolvency proceedings?

The distinction between liquidation proceedings and regular insolvency proceedings shall be made on the basis of the financial health of the company.

If the company is solvent and has sufficient assets for the satisfaction of its creditors' claims, the termination of the company shall be pursued by way of liquidation proceedings. Alternatively, provided a company is over-indebted or insolvent, insolvency proceedings shall be followed.

If, during ongoing liquidation proceedings, it is determined that the company is insolvent or over-indebted, the liquidation proceedings shall be suspended and bankruptcy proceedings shall be initiated upon written petition filed with the court by the liquidator. Once insolvency proceedings are opened by the court, the liquidation proceedings shall be terminated.

Financial restructuring from the creditors' perspective

1. If a lender wants to monitor its borrower very closely (i.e. more closely than the usual information covenants in the credit agreement require), what options are there?

If provided for in the facility agreement, a lender may nominate a person to be a member of either the supervisory board or the management board. The shareholders in a general meeting or the supervisory board respectively must approve the appointment. The lender appointee would be subject to the same duties and obligations as any other supervisory or management board member (see Q5 and Q6 under Restructuring above). Alternatively, the lender may ask an observer to be appointed on the board(s), who would have the right only to observe the respective body's meetings but not to vote, or it could request the regular provision of information such as the agenda of board meetings, the minutes of meetings, etc.

2. What issues arise if a creditor extends credit facilities or offers support conditional on additional or extended guarantees to a company in financial difficulties and/or takes asset security?

Any security granted after the commencement of insolvency proceedings is null and void as against the company's creditors. The same may be applied to any security granted after the date on which the court determines that the insolvency or over-indebtedness occurred (the "insolvency date" or the "over-indebtedness date") and within 1 year prior to the petition for initiating the insolvency, subject to certain exemptions (security was granted prior to or simultaneously with a new credit facility extended to the debtor or security replacing earlier security in rem that could not be challenged in the insolvency or security over assets acquired with the proceeds of the secured credit facility).

Furthermore, Bulgarian legislation provides that certain transactions entered into during "suspect periods" can be challenged and can become null and void in law or can be revoked. They can be summarised as follows:

- gratuitous transactions (except for ordinary gifts) entered into 2 years prior to the commencement of bankruptcy proceedings, or 3 years if a party to the transaction is a related party to the company

- undervalue transactions entered into within 2 years prior to the commencement of bankruptcy proceedings but no earlier than the insolvency or over-indebtedness date
- the grant of security for obligations of a third party to secure a previously unsecured claim within 1 year prior to the commencement of bankruptcy proceedings but no earlier than the insolvency or over-indebtedness date
- ·the grant of security for obligations of a third party in favour of the claim of a related party to the company within 2 years prior to the commencement of bankruptcy proceedings, or

a transaction effected within 2 years prior to the commencement of bankruptcy proceedings that prejudices creditors' rights, if a party related to the debtor is party to that transaction. Related parties include spouses or close relatives; employers and employees; persons, one of whom participates in the management of the other's company; shareholders; a company and a person who holds at least 5% of voting shares in the company.

It shall be noted that the limitations above also apply for the period from the date of the petition to the court until the initiation of the insolvency proceedings.

Non Performing Loans

1. How does a lender sell a loan?

Under Bulgarian Law, loans can be transferred either by assignment of rights (and assumption of obligations) or by novation.

Assignment of receivables/rights

This is is the most common method of changing an existing creditor with a new creditor, and it may be combined with an assumption of obligations to ensure the whole transactional relationship gets transferred to a new creditor. An assignment transfers all accessories to the main claim including personal and in rem security. However, the assignment has to be registered with respect to the security to ensure that the new creditor can enforce the security.

If the loan is secured by a mortgage, a notary must certify (authenticate the parties' signatures to the assignment agreement so that the assignment can be registered with respect to the mortgage). Similarly, notary-certified consents are required for an assignment of a claim secured by a registered (non-possessory) pledge to get registered with respect to the security in the Bulgarian Central Pledges Registry. For an assignment of receivables/rights to be enforceable, the borrower must be notified (but need not consent). The assignor/lender is not liable to the assignee (new lender) for the debtor's default unless agreed otherwise.

The borrower's consent is required for a substitution in debt whereby a new lender agrees to replace the existing lender in respect of the outstanding obligations under a loan agreement (otherwise the out-going lender cannot be released from liability).

Novation

This is an alternative to assignment when there is a change of lender and the terms of the loan are being varied. Novation takes effect by discharging the original rights and obligations and replacing them with new ones. A novation requires a multilateral agreement (between the original lender, the new lender and the borrower) because the borrower's consent is needed. Similar to assignments, a novation has to be registered with respect to security (and therefore the novation agreement has to be certified by a notary for the purposes of such registration).

2. If the underlying credit agreement prohibits transfer or assignment (i.e. a change in the lender of record), how else – if at all – can a lender transfer the economic risk and/or benefit in the loan? For instance, are sub-participation agreements allowed under the law of your jurisdiction?

Sub-participation is not prohibited as a matter of Bulgarian law. It is frequently used as a de-risking technique by international finance institutions and larger (typically investment grade) commercial banks as well as for loan trading within the same group of companies because it exposes sub-participants to certain risks. Sub-participation is effected by an agreement between the existing lender and the sub-participant whereby they share both the risks and benefit of their respective portion of the loan agreement. There is no formal transfer of the receivables and no corresponding automatic transfer of any collateral.

Bulgarian law does not differentiate between legal and beneficial title to ownership, nor does it recognise rights held on trust. Therefore, the sub-participant's interest in the loan is not recognised in law. Sub-participants will sometimes negotiate the right to have security transferred and registered in their name by way of an assignment upon the occurrence of certain events (such as an event of default), but this can add cost.

3. Regulatory issues: is any form of licence or prior authorisation from any regulatory authority required for the purchase, sale and/or transfer of loans? Does it fall within the definition of providing banking or financial services in the territory of the assignor or the borrower?

Under Bulgarian law, a banking licence is not generally required to engage in lending activities if the funding for such loans is not sourced through the public solicitation of deposits.

However, granting and/or purchasing loans with a lender's own funds does fall within the scope of providing regulated financial services. If carried on regularly and as a main activity, the loan provider/buyer, although not requiring a banking licence, must register with the Bulgarian National Bank as, and comply with the statutory requirements for, a financial institution.

In addition, details of financial loans (defined as all loans, excluding commercial loans) between Bulgarian and foreign persons must be provided to the Bulgarian National Bank for statistical purposes.

In 2022 a legislative piece regulating the activity of collection agencies with regard to consumer loans and the way such receivables are sold and purchased was adopted in its first reading. However, the bill has not reached a second vote (necessary for final adoption) and there have not been any developments on the topic since.

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