

Recent Amendments to the Insolvency Regulation Provisions to the Bulgarian Commercial Law

The Bulgarian Parliament has recently adopted certain amendments to the Commercial Law which were introduced with State Gazette, issue 20/2013, effective as of 28 February 2013.

The most important changes are in the domain of Insolvency Law and more specifically the regulation of the avoidance actions related to the collection of insolvency estate. The key changes are as follows:

(i) New regulation of the types of debtor's acts that could be subject to annulment

The first group of amendments redefines the criteria applicable to the legal acts of the debtor, which have a preferential effect in prejudice to the creditors and which could be therefore annulled. The legislator also adopted a new approach in setting the deadlines for claiming annulment. According to the previous regulation any transactions carried out the debtor *after the initial date of insolvency/ overindebtedness*, as determined by the insolvency court with the decision for opening of bankruptcy proceedings, irrespective of their purpose and characteristics, could be the subject of a claim for annulment to the detriment of the third parties acting in good faith.

First of all, the recent amendments narrow down the type of transactions that can be annulled to the following ones:

(a) payment of undue monetary obligations, irrespective of the type of payment, made in the one year period prior to the filing of a petition for *initiation* of insolvency proceedings;

(b) mortgage or pledge, established by

the debtor after the occurrence of the secured obligation and made in the one year period prior to the filing of a petition for *initiation* of insolvency proceedings; and

(c) payment of due and payable monetary obligations, irrespective of the type of payment, made in the six month period prior

(d) to the filing of a petition for *initiation* of insolvency proceedings;

If the third party has knowledge that the debtor is insolvent or indebted, the deadlines under items (a) and (b) are extended to two years and the deadline under item (c) is extended to one year. Knowledge shall be presumed if (i) the debtor and the third party are connected parties or (ii) the creditor knew or should have known that the debtor is insolvent or overindebted.

One of the most significant changes adopted concerns an exception to the common rules for annulment as described in items (a) and (c). More specifically, the annulment of payments made by the debtor in the one year period prior to the filing of a petition for *initiation* of insolvency proceedings could not be claimed if the payment has been effected by the debtor within the ordinary course of business and:

(i) The payment has been effected simultaneously against equivalent consideration in favor of the debtor or within 30 days as of the due date of the monetary obligation; or

(ii) The creditor has provided to the debtor equivalent consideration after the payment.

In regards to the establishment of security in the

form of a mortgage or a pledge, pursuant to the new amendments, such security could not be annulled if:

- (i) The mortgage or the pledge has been established simultaneously with the secured transaction;
- (ii) The mortgage or the pledge has been established to substitute other security, which could not be declared invalid under the relevant rules of the Insolvency chapter;
- (iii) The mortgage or the pledge has been established to secure a loan, granted for acquiring of the assets, subject to the security.

Further to the abovementioned transactions, the legislator has redefined and specified other debtor's acts and deals, which could also be subject to annulment upon request by the trustee or any of the creditors if the trustee fails to do so:

- (a) Gratuitous deals/acts, excluding ordinary donations, where the counterparty is connected to the debtor, made within three years before filing the bankruptcy petition;
- (b) Gratuitous deals/acts, made within two years before filing the bankruptcy petition
- (c) Deals/acts against consideration where the consideration/performance provided by the debtor significantly outstrips the consideration provided by the other party, made within the two years before filing the bankruptcy petition but not earlier than the initial date of insolvency/indebtedness as declared by the court;
- (d) Establishment of security for securing third party's obligations, if made within one year before filing of the bankruptcy petition but not earlier than the initial date of insolvency/indebtedness as declared by the court;
- (e) Creation of security for securing third party's obligations, where the other party is connected to the debtor, if made within two years before filing the bankruptcy petition;
- (f) Any deal made in prejudice to the creditors, where the other party is connected to the debtor, made within two years before filing the bankruptcy petition;

Moreover, avoidance actions could be brought by the trustee or any creditor if the trustee fails to act, within one year as of opening of the bankruptcy proceedings. In such case the trustee may also file a claim for repayment of the sums paid under the annulled transaction within the same proceedings (in contrast to the previous regulation, according to which the secondary claim for repayment of the sum should have been filed independently subject to positive results of the avoidance action).

Pursuant to Para. 14 of the Transitional and Final Provisions of the Bulgarian Law on Commerce the abovementioned amendments shall be applied retroactively to all bankruptcy proceedings and avoidance actions pending at the moment.

In conclusion, the amendment of the rules concerning insolvency would have a positive impact on third parties to contractual relationships, acting in good faith. In contrast to the former regime, the new rules require that the respective legal actions shall have a clear preferential effect in prejudice to the creditors in order to be annulled by the court. The new regime entitles creditors to act independently and to file claims in case the trustee remains idle and fails to undertake the necessary actions aiming at recovering the bankruptcy estate. In addition reducing the deadlines under which the trustee and the creditors may act, is likely to contribute to legal confidence and predictability which finally would result in improved faith in commerce. Finally the new rules are of such nature that may bring about more certainty in terms of protection of parties' rights.

A negative aspect is that the amended criteria and grounds for commencing avoidance actions shall be applied retroactively to only some of the avoidance actions pending at the moment, depending on the type of the applicable criteria.

Accordingly, the provisions setting such partial retroactive effect of the new amendments (namely Para 14, item 1 in the part concerning avoidance actions pending at the moment, para 14, item 2 and para 15 of the Transitional and Final Provisions) have been challenged by the Supreme Court of Cassation Commercial Division before the Constitutional Court on the grounds of inconsistency with the Constitution of the Republic of Bulgaria.

In particular, the requesting authority claims that those provisions are inconsistent with the principles of equality before the law and equal protection of the law, explicitly proclaimed by the Constitution.

Such inconsistency stems from the fact that Para 14 and 15 extend the retroactive effect of the amended criteria only to some types of debtor's actions, while others remain under the previous legal regime, i.e. the retroactive effect shall not be applied to them. This means that the creditors, the debtor and the third parties to the respective challenged transactions would be unreasonably placed under two different legal regimes – some pending avoidance actions would be decided by the court applying the new substantive provisions setting new criteria for commencing avoidance actions and others – depending on the specific grounds for challenging the transaction – would be decided under the previous regulation, the latter presumably being more unfavorable to the debtor and the third concerned parties.

According to the requesting authority, such unequal treatment of the parties to the bankruptcy proceedings is unreasonable and directly contradicts to art. 4, art. 6, art. 19, para 2 and art. 121, para 1 of the Constitution, proclaiming the abovementioned principles of equality before the law and equal protection of the law. Instead, the supreme judges insist on standardizing and extending the retroactive effect to all pending insolvency proceedings and all types of avoidance actions pending at the moment with no exception so that all parties to the bankruptcy proceedings are placed on an equal footing.

If the Constitutional Court favors the request and finds that such differential approach in applying the retroactive effect of the new amendments is inconsistent with the Constitution, it will repeal those provisions to the extent of the inconsistency.

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