Bulgarian legislator introduces new preventative restructuring mechanism

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The Bulgarian Parliament has recently adopted important amendments to the Law on Commerce, establishing, among others, a completely new tool for early restructuring for traders and commercial enterprises in financial distress – the so-called 'business stabilisation procedure'. The amendments concerning the stabilisation procedure will become effective as of 1 July 2017.

The new procedure has been adopted as a result of the recommendations of the European Commission and the Council of the European Union for adoption of expedited debt restructuring and second chance frameworks, as well as in response to critics that state that Bulgaria is the only EU Member State whose legislation does not provide a nearly restructuring tool.

The purpose of the stabilisation procedure is to create a viable option where traders and commercial enterprises are not yet insolvent, but the danger of insolvency is imminent – to achieve restructuring and, where possible, partially discharge debts and prevent insolvency.

Key features of the new procedure

Applicability

The new stabilisation procedure applies only in cases where the trader is solvent, but there is an imminent threat that it will become insolvent. An 'imminent threat' is deemed where the trader, with a view of maturity of its debts for the next six months as from the date of the application for opening stabilisation proceedings, will not be able to repay due payments or is likely to stop payments.

The amendments provide for an exhaustive list of cases where the stabilisation procedure is not permitted, including, inter alia: (1) the cases when the trader has failed to submit its annual financial reports to the Commercial Register for the three years prior to the application for stabilisation proceedings;[1] (2) where the stabilisation procedure has been opened for the same trader within the three years prior to the application; (3) if an application for opening insolvency proceedings has already been filed against the same trader; and (4) when over one-fifth of existing debts are to related parties or persons who have acquired receivables from parties related to the trader. The stabilisation is also not applicable to public undertakings holding a state monopoly or those established under a special law.

Initiation and administration of the procedure

Only the incumbent trader has the right to ask for the opening of stabilisation procedures. There are a number of specific requirements and attachments to the application for opening a stabilisation procedure, so it can be admitted for a review by the court. The applicant has to specify, inter alia, the type, amount and maturity of all its debts, together with detailed information on any existing security and enforcement measures, to provide data about all its assets and details of any judicial, arbitration or foreclosure proceedings opened against it, including any action for out-of-court settlement with creditors.

The key feature of the application is the detailed reorganisation plan, containing the deadlines, conditions and means of repayment of debts, as well as the figured level of satisfaction of creditors and the securities offered to them.

The stabilisation under the new amendments is a court-administered procedure – the body competent to decide on the application and to open and supervise the stabilisation procedure is the district court at the registered seat of the trader.

Parties to the stabilisation procedure are all creditors, including those to which the trader has given security on debts to third parties. In the case of non-cash debt, all non-cash debts of the trader are converted to cash ones at their market value as of the date of the application for stabilisation. The creditors retain their rights to the existing security, while those that are related to the trader are considered chirographic (unsecured) vis-a-vis all other creditors, thus being satisfied last.

The new amendments introduce new legal bodies, playing an important role in the stabilisation procedure – a trusted party (fiduciary) and a verifier (optional). The trusted party (fiduciary) is an auxiliary body to the court and is required to have a degree in law, as well as to meet the requirements for a trustee in bankruptcy. The powers of the trusted party are very similar to those of the appointed trustee in bankruptcy and include, inter alia, the power to propose the list of creditors to the court and to control the business activities of the trader under the supervision of the court. The verifier could be a chartered auditor and their appointment is optional. However, if the reorganisation plan provides for reorganisation of the business or conversion of debt into equity, the appointment of a verifier is mandatory.

Where the required grounds exist, the court will open the proceedings, appointing a trusted party and, if necessary, a verifier. The court determines their remuneration and it also has the discretionary powers to decide whether it is necessary to secure the debt. If the court admits the application, it is required to schedule a public session within three months to examine and eventually to approve the proposed stabilisation plan.

Consequences of the opening of stabilisation procedures

The effect of the opening is that the trader is restricted in its operations either partially (ie, they could be carried under the supervision of the trusted party) or fully, when the trader is divested of its rights to manage and dispose of its assets. The latter restriction could be imposed if the court decides that the trader seriously hampers the creditors' rights and interests. The opening of the proceedings also imposes a ban over the trader to repay debts that occurred prior to the date of the application and have not been paid on the maturity date, except for public payments (eg, value added tax, excise duties, local taxes or mandatory social security contributions). Another consequence is the suspension of forcible execution proceedings against the trader and any proceedings under the Registered Pledges Act. If the proposed plan is not approved by the court within four months, the suspension is lifted and the execution proceedings are resumed. The court may also allow termination of contracts where the trader is a party to, as far as the contract has not been fulfilled at the time of termination and its future fulfilment will render difficult the implementation of the reorganisation plan and the termination will not cause losses to the other party greater than the normal ones in similar cases.

Similar to insolvency proceedings, the court also has the right to impose interim relief (conservatory) measures on the trader through imposition of attachments, freezing orders and any other appropriate interim measures.

Opening of stabilisation proceedings alone has no effect on the debts of the trader. In contrast to insolvency proceedings, the obligations do not become due and payable, nor are they converted into Bulgarian currency as in the case of opened insolvency proceedings.

Development of the procedure

The court rejects the application if it does not contain the necessary prerequisites and attachments or the grounds for opening are not present. Specifically, the court would reject the application if it finds that the trader is already insolvent, if the proposed stabilisation plan does not correspond to the requirements of the law or if it apparently contravenes to the factual property and financial status of the trader. Another group of grounds for rejection concerns the situation when the trader does not act in good faith in the process of requesting opening of stabilisation procedures (eg, if the information provided in the application is false, or the court finds that the imminent danger of insolvency is solely due to the trader's bad faith or lack of due diligence in conducting its commercial activity). The court will also reject the application if the rules for granting state aid have been infringed.

The core stage of the stabilisation procedure is the review and approval of the proposed stabilisation plan. It is reviewed in an open court hearing where the presence of the trader is mandatory. The right to vote and approve the plan has only those creditors that have been included in the final list of creditors, prepared by the trusted party on the basis of the information, provided by the trader with the application for opening the stabilisation procedure and finally approved by the court. Similar to the insolvency proceedings, each creditor has the opportunity to raise objections to the inclusion or non-inclusion of a creditor in the final list of creditors. The trader, in turn, has the right to express its position regarding the objection.

The plan is voted by classes of creditors. It is adopted by each class of creditors by a majority of more than half of the debts in the relevant class, provided that at least three-quarters of the creditors of the relevant class have voted. The court holds a session to rule on the approval or rejection of the plan voted in that way. The court ruling is subject to appeal by the trader and by any creditor affected by the plan before the Supreme Court, whose decision is final. After it is approved, the plan becomes mandatory for the trader and for the creditors, the debts to which occurred prior to the date of the ruling on the approval. In contrast to the rehabilitation plan in the insolvency proceedings (where it has effect towards all creditors of the insolvent debtor), the approved stabilisation plan has effect only with regard to creditors who took part in the stabilisation procedure, irrespective of whether they cast their vote for the plan.

If the trader does not fulfil the approved plan, the respective creditor has the right to obtain a writ of execution and launch foreclosure proceedings against the debtor, based on the plan. In such case the debtor loses the advantages of the plan (eg, reduction of obligations) and shall pay the full original amount of the debt. In order for the creditors to effectively realise this possibility, the new amendments provide for a special rule for the terms of limitation with regard to the trader's debts. All terms of limitation are deemed suspended during the stabilisation procedure. If the stabilisation procedure is successful, new terms of limitation start for the obligations transformed by the plan. In case the procedure is terminated, the suspended terms are resumed.

The stabilisation procedure is terminated if the stabilisation plan has not been approved by the court within four months as of the date of application for opening, regardless of any suspension. Each creditor affected by the plan may request its invalidation because of threat or fraud, within the time limit for realisation of the plan.

Critical notes

The main goal of the newly adopted procedure is to create a preventative restructuring mechanism and a framework for traders and commercial enterprises in an attempt by the local legislator to overcome the current negative situation in Bulgaria, where the length and recovery for insolvency proceedings are well above the average level for the EU.

However, in terms of technical realisation, the legal practitioners are rather sceptical about the effectiveness and viability of the stabilisation procedure in its current mode.

The first impression is that the amendments have been adopted in a very formal manner, repeating the onerous regulation of the restructuring within the framework of insolvency proceedings to a great extent. The amendments again set up the leading role of the state, as the stabilisation plan needs to be explicitly approved in advance by the Minister of Finance, which itself creates conditions for the unequal treatment of the rest of the private creditors vis-à-vis the state. Another serious procedural shortcoming is that the amendments do not provide for detailed regulation of the interconnection and possible collision between the stabilisation procedure and potential insolvency proceedings opened afterwards, as well as with the Registered Pledges Act and the independent procedure for creditor's satisfaction, set out there.

There are also certain issues in terms of the expedition and costs of the new procedure. Some of the most important characteristics of such measures, in order for them to be economically viable, are the low costs and promptness, allowing for control over the debtor's minimum costs. However, the amendments do not provide for any preferable cost regime for the stabilisation procedure in comparison to the existing rates of the common state fees for standard court proceedings. This also includes the costs for the newly presented bodies of trusted party and verifier, who are appointed solely by the court and whose remuneration is mandatory. At the same time, failure of the trader to pay the remuneration of the trusted party or the verifier is an ultimate ground for termination of the stabilisation procedure, irrespective of the reasons for the lack of payment (eg, refusal of the trader to pay due to excessive remuneration, set by the court). Such legal approach ruins the effectiveness of the new procedure and renders it difficult to implement, especially for small and medium enterprises seeking low-cost restructuring procedure. The excessive number of prerequisites and attachments to the application for the opening of stabilisation procedures additionally increases the costs of the procedure as the trader is requested to provide, inter alia, market evaluation of its assets and evaluation of the securities provided, which is normally connected with the appointment of independent experts and high legal costs.

Another procedural failure is the omission of the legislator to set up legal grounds for the trader to appeal the interim measures and the restrictions of its powers, if necessary. Such measures and restrictions – imposed by the court in the process of implementation of the stabilisation procedure, in the absence of the trader's ability to challenge them – might appear excessive and inappropriate, thus leading to the economic collapse of the trader rather than to its stabilisation.

Conclusion

The critical analysis of the new amendments for adoption of stabilisation procedures leads to the general conclusion that it is unlikely the new amendments will achieve its goals, mainly due to non-conformity with the principles of equal treatment and economic effectiveness, which are of ultimate significance for early restructuring and second-chance mechanisms. The new amendments conform with most of the common principles on the use of preventative restructuring frameworks – set out in the new proposal of the European Commission for a Directive on preventative restructuring frameworks, the second chance measures to increase the efficiency of restructuring, insolvency and discharge procedures. Despite this, the newly adopted stabilisation procedure could not overcome the number of procedural and substantive law oversights and shortcomings, merely leading to problems rather than solutions.

Note

1 The new amendments also introduce the trader's failure to submit its annual financial reports to the Commercial Register for the last three yearsas a new ground for opening of insolvency proceedings.

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A golden age of Ukrainian restructuring

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Brief headnote

This article deals with the long-awaited and prominent Ukrainian 'Law on Financial Restructuring' (the 'Law'), and describes the Law's general provisions and optimistic prognosis on its influence over Ukrainian distressed business. As a joint initiative of leading lenders, including the European Bank for Reconstruction and Development and World Bank, the Law ensures prospective debtors with a brand new opportunity for out-of-court financial recovery.

General preconditions for adoption

For Ukraine, 2016 was a year of both hope and fear. Despite giving birth to a number of controversial legislation initiatives, a 'golden age' for Ukrainian restructuring began in 2016. On 14 June 2016, the Ukrainian Parliament (Verkhovna Rada) adopted the 'Law on Financial Restructuring' (the 'Law'), an unprecedented act, which has a high probability of radically changing the situation in both the domestic and European distressed debt markets.

As in many young democracies, Ukrainian business does significantly rely on bank loans. Not surprisingly dozens of companies appeared on or even crossed the verge of insolvency as a result of the current banking crisis. For such companies, having defaulted debts should have not led to insolvency since a vast amount of them owned assets and conceived business plans sufficient for reorganisation and even optimisation of their activities. These companies desperately needed an effective remedy to get a stay of pending court and/or enforcement proceedings, to be in a position to keep the business continuity without fearing arrests and seizures and, more importantly, to pave the way for effective restructuring liaison and possible distressed debts relief.

However, as of 14 June 2016 the domestic legislation had few options for solvency restoration. The Ukrainian Law on Insolvency did mention 'restructuring' as a term, but only as an equal to that of 'reorganisation' and therefore it did not provide separate options for either write-off or repayment of the distressed debt. Pre-trial financial relief (*dosudova sanatsiya*) was a theoretical rather than a practical remedy, as the whole