BANKRUPTCY AND INSOLVENCY

Whether it be cash-flow or sheet-balance, insolvency issues, along with bankruptcy matters, can prove to be a real challenge for companies, and this is where expert advice steps in, as legal consultation can make all the difference in keeping operations afloat. On this subject, this month *Lawyer Monthly* talks to Angel Ganev, Partner at Djingov, Gouginski, Kyutchukov & Velichko, a prominent Bulgarian law firm.

As a professional working on bankruptcy, insolvency and restructuring cases, in your opinion which sectors experience insolvency more than others in Bulgaria? What are the most common restructuring mechanisms for distressed corporations in Bulgaria?

No clear line can be drawn between the economic sectors which experience insolvency more than others in Bulgaria. In the aftermath of economic crisis, almost all sectors, from agriculture, mining and other natural resource industries to manufacturing and service industries, may and do face insolvency. Even "too big to fail" companies from the private sector, as well as companies from the public sector, traditionally regarded as 'critical infrastructure', strategic objects and activities of major significance to national security (e.g. the National Electricity Company of Bulgaria - the national public provider, transmission company and power generator), are at risk of insolvency exposure. A very noticeable one is also the case of Corporate Commercial Bank (one of the largest Bulgarian banks, 3rd in terms of net profit and 1st in terms of deposit growth until June 2014), where we represent a subsidiary of the State General Reserve of the Sultanate of Oman, holding a major share of the bank's capital. Corporate Commercial Bank was declared bankrupt in November 2014 after scandalous actions of the Bulgarian government and revocation of its banking license by the Bulgarian National Bank.

As the specifics vary from sector to sector, there are different restructuring mechanisms to be employed for distressed corporations in Bulgaria. The most common ones include refinancing, optimization, enforcement of security packages and payment guarantees, different repayment schedules, substitution of debtors and creditors through assignment of receivables and novation, debt-to-equity conversion and others.

You also advise on cross-border cases - what are some of the key complexities that you typically face, in terms of foreign legislative frameworks? How do Bulgarian Insolvency laws and regulations differ when compared to the ones in other EU jurisdictions?

One of the most notable complexities our law practice faced recently is due to the difference between the Bulgarian insolvency legislation (which traditionally does not recognize personal insolvency) and legislation of the UK, which does. As a result, it is very hard, if not impossible for some of the trustee's powers, conferred by UK law, to be exercised in Bulgaria in case of personal insolvency brought in the UK. Some alternative schemes and mechanisms had to be invented and applied by us so that this serious difference is compensated and the client's goals are achieved.

Also, in terms of cross-border cases, which are governed by the Insolvency Regulation, a major problem is the fact that Bulgarian law does not contain provisions implementing or especially designed to facilitate the requirement for publication of notice of the judgment opening insolvency proceedings and, where appropriate, the decision appointing the trustee, for debtors registered outside Bulgaria. Such lack of local provision and the corresponding technical mechanism in Bulgaria has been a serious point in dispute in a number of court cases of our law firm so far.

Until recently, another serious deviation from the rest of the EU jurisdictions was the regulation of avoidance actions. Prior to the respective significant amendments, adopted by the Bulgarian Parliament in February 2013, certain transactions concluded by the debtor after the initial date of insolvency, were considered null and void ex lege and the respective parties were obliged to return any payment or other consideration received under such transactions in the insolvency estate. At the beginning of 2013 significant amendments of the respective law took place in Bulgaria and finally the legal regime of the avoidance actions was put in line with the other EU jurisdictions in terms of hardening periods, voidability, pre-conditions, etc.

What are the most common tactics that you employ in the process of assisting with restructuring operational activities? How does their implication enhance the businesses' profitability?

In fact, choosing the modalities of restructuring depends on a number of factors, such as the concrete situation of the debtor, the degree of indebtedness and debtor's ability to continue its business and to generate cash flow. Accordingly, in our practice we employ an array of legal and financial techniques, including, among others, deleverage in the form of debt for equity swaps, new share issues and the buy-out of debt holders, payment in kind loans, conversion of an intracompany loans into reserves and other methods. However, debt restructuring alone cannot revive a distressed business and the techniques used, being a matter of urgency, in most cases have short term results. In all cases they should be followed by efficient operational improvements and other economic restructuring measures.

How do you assist your clients in the case of debt restructuring and what are the particular complexities involved? Does Bulgarian Law provide any particular legal procedure for expedited debt restructuring?

Historically, Bulgarian law used to recognize the institute of expedited debt restructuring under the term 'protective concordat' promulgated in 1932. Through the use of such instrument the then government tried to provide protection to indebted traders and to reduce the negative consequences of the World Economic Crisis raging at that time.

Currently, in contrast to other EU member states and the "second chance" policy, adopted by the European Commission, Bulgarian law does not yet provide a particular legal procedure for expedited debt restructuring outside insolvency proceedings. Thus, in case of debt restructuring, it is only a matter of private negotiations and private agreements between the parties. In the negotiation process the parties enjoy their right of contractual autonomy.

This is indeed one of the key complexities in the process of expedited debt restructuring of insolvent companies. Potential debt restructuring agreement, concluded with one or some of the creditors, would not be binding for the rest of them as long as they have not entered into it. Accordingly, all terms of a potential debt restructuring agreement and all financial mechanisms, set out therein, need to be carefully considered, worked out and agreed between all existing creditors, which is probably one of the largest challenges faced.

However, upon the Commission's negative report and the respective directions, Bulgarian parliament has recently started working on a new regulation of expedited debt restructuring, which is to reflect the policy of "second chance" for entrepreneurs and the historical traditions of Bulgarian law.

Is insolvency inevitable in the case of financial difficulties in your clients' businesses? How often does insolvency result in liquidation of your clients' businesses and how can liquidation be avoided?

Under Bulgarian law, insolvency is a foreclosure procedure of "universal" nature. Its primary goal, at least theoretically, is to provide an opportunity for recovering of the debtor's entity and continuation of its activity. In most of the cases, however, insolvency results in liquidation of the insolvent company. It is also important to note that insolvency triggers and tests in Bulgaria are clear and well defined by the settled case law - insolvency is initiated when the debtor is either insolvent (it is not able to repay in full an obligation under a commercial transaction or an obligation to the state or the municipalities related to its commercial activities or private claim of the state and such obligation is due and payable) or over-indebted (i.e. its assets are not sufficient to cover its cash liabilities, the so-called "balance-sheet" insolvency). Only the court, within the pre-insolvency proceedings, has the power to determine whether a debtor is insolvent. Normally, the court uses the help of accounting experts to find out if there is a case of insolvency or over-indebtedness. If this is so, insolvency is inevitable.

As regards liquidation, it could be avoided only upon creditors' mutual agreement, which may be implemented either through the reorganization plan or through an out-of-court settlement agreement concluded after initiation of insolvency proceedings. Entering into a private debt restructuring agreement is possible at any stage of the pending insolvency proceedings. If this is the case, however, such agreement would be subject to a number of specific requirements regarding the parties who are allowed to enter into it, its effects, and the consequences in case of non-performance. All these specific requirements draw a line between the out-of-court settlement agreements during pending insolvency proceedings and the typical case of a private agreement concluded before insolvency and having restructuring of a debt as an effect. **LM**

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