

# INTERNATIONAL SECURED TRANSACTIONS

**BULGARIA**

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## A. INTRODUCTION

Secured transactions law is a broad subject, regulating an array of issues crucial to credit activities which cannot be exhausted within the scope of this chapter. Therefore, the purpose of the chapter is to analyze only the most practical issues pertaining to secured transactions.

In a historical aspect, Bulgarian law, like all Civil Law systems, has always operated with mortgages and pledges of movables and accounts receivable. In recent years, the overall political, economic, and legal transition in Bulgarian society has had effect on Bulgarian security law, as well.

Thus, a slight transition to modern security instruments was brought through the exceptional rules allowing foreign investors to obtain non-possessory pledges, introduced by the repealed Law on the Economic Activity of Foreign Persons and Protection of Foreign Investment (*Zakon za stopanskata deinost na chuzhdestrannite litza i za zakrila na chuzhdestrannite investitzii*).<sup>1</sup>

Since 1997, the modern techniques of non-possessory pledges, implemented in article 9 of the Uniform Commercial Code (UCC) of the United States and the Model Law on Secured Transactions of the European Bank for Reconstruction and Development (the “EBRD Model Law”), have made their way into Bulgarian secured credit law.<sup>2</sup>

The innovative spirit of the Acts has been reflected in the Law on Registered Pledges (*Zakon za osobenite zalozi*).<sup>3</sup> The modern registered pledges system

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1 Law on the Economic Activity of Foreign Persons and Protection of Foreign Investment, *State Gazette*, Number 8, of 28 January 1992, repealed *State Gazette*, Number 97 of 24 November 1997.

2 Law on Registered Pledges, *State Gazette*, Number 100, of 22 November 1996, in effect as of 1 April 1997.

3 *State Gazette*, Number 100, of 22 November 1996, in effect as of 1 April 1997.

adopted by the Law on Registered Pledges is not meant to repeal and be a substitute for the conventional pledges system, rather it seeks the co-existence of traditional and innovative security devices. In view of the obvious benefits of the registered charges, however, the execution of possessory pledges appears not to be a common practice in Bulgaria.

In 2006, a new Law on Financial Collateral Arrangements<sup>4</sup> introduced the harmonized European framework on financial collateral. The main purpose of the new law is to limit the credit risk within the financial system by providing a less formalized system for perfection of security interests and enhanced foreclosure mechanics, seeking fast and effective foreclosure against defaulting debtors.

The approach and scope of this chapter extend to examining the detailed regulation of the most commonly used forms of security interests, i.e., the mortgage and registered pledge, while outlining other security interests only in basic parameters.

Furthermore, the present chapter is aimed at delineating, where applicable, the cohesiveness of mortgages and non-possessory pledges with the recommendations embodied in the EBRD Model Law, the Draft Legislative Guide on Secured Transactions of the United Nations Commission on International Trade Law (the “UNCITRAL Guide”), and Directive on Financial Collateral Arrangements 2002/47/EC by way of indicating only any divergence therefrom.

In view of the fact that the EBRD Model Law has been intended for countries having no established and workable “mortgage” practice, which is not the case with the Bulgarian legal system, the advanced Law on Registered Pledges practically deviates from the model but, on the whole, respects its main principles.

## **B. OBJECTIVES OF THE SECURED TRANSACTIONS REGIME**

### **i. In General**

Bulgarian secured credit law, in particular the Law on Registered Pledges, generally follows the basic principles and key objectives of an efficient and effective secured transactions system implemented in the UNCITRAL Guide.

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<sup>4</sup> Law on Financial Collateral Arrangements, *State Gazette*, Number 68, of 22 August 2006, implementing Directive 2002/47/EC of the European Union and of the Council on Financial Collateral Arrangements.

**ii. Utilize Full Value of Assets to Obtain Credit**

This objective is best achieved by the registered pledges system, established by the Law on Registered Pledges, which through its comprehensiveness in terms of:

1. Expanding the possible objects of secured transactions; and
2. Expanding the possible types of obligations to be secured overcome the disadvantages of the traditional possessory pledge.

**iii. Obtain Security in Simple and Efficient Manner**

Similar to the previous objective, this one is best realized by the registered pledges system. Through eliminating unnecessary formalities and providing for a simple method for creation of security rights, the Law on Registered Pledges enables the reducing of transaction costs. On the other hand, mortgage fails to achieve this goal due to the relatively high costs of its creation.

In addition, the Law on Financial Collateral Arrangements avails to financial institutions the option to obtain security rights over financial collateral without being required to register the collateral agreement in a public registry.

**iv. Validate Non-Possessory Security Rights**

Through introducing and validating non-possessory security rights, the Law on Registered Pledges overcomes the practicable inconveniences related to the possessory pledge.

Enabling the grantor to continue to operate his business is considered to be of great economic importance in the field of credit markets and, hence, is one of the key benefits of the registered pledges.

**v. Establish Clear and Predictable Priority Rules**

Bulgarian secured credit law establishes clear and precise priority rules meant to create certainty as to competing creditors' rights.

Therefore, creditors are allowed to assess risk more prudently and minimize it and, thus, expand access to credit.

**vi. Facilitate Enforcement of Creditors' Rights in Predictable and Timely Fashion**

The Law on Registered Pledges and the Law on Financial Collateral Arrangements successfully achieve this objective through introducing out-of-court foreclosure on registered pledges and financial collateral, which allows efficient, predictable, and commercially reasonable enforcement to be effected.

The Law on Financial Collateral Arrangements further enhances the out-of-court foreclosure by recognizing close-out netting of all counter obligation of the parties to the arrangement and further allowing the creditor to take title to the collateral.

On the other hand, the time-consuming procedure under court foreclosure, which is the sole method of foreclosure with respect to mortgage and possessory pledge, fails to conform to this objective.

**vii. Provide Equal Treatment of Domestic and Non-Domestic Creditors**

Bulgarian secured transactions law treats local and foreign persons equally in regard to acquisition of a security interest whether mortgage, possessory, or registered pledge or financial collateral arrangement.

**C. BASIC APPROACHES TO SECURITY**

**i. In General**

As mentioned, Bulgaria's legal framework of secured transactions is based on a dynamic approach and, therefore, is dispersed among several legislative acts, these being:

1. The Law on Obligations and Contracts (*Zakon za zadulzheniata i dogovorite*);<sup>5</sup>
2. The Law on Commerce (*Turgovski zakon*);<sup>6</sup>
3. The Law on Registered Pledges (*Zakon za osobenite zalozi*);
4. The Law on Special-Investment Purpose Companies (*Zakon za druzhestvata sas specialna investicionna cel*);<sup>7</sup> and
5. The Law on Financial Collateral Arrangements (*Zakon za dogovorite za finansovo obezpechenie*).<sup>8</sup>

Thus, traditional and more innovative security devices exist in a non-conflicting manner.

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5 Law on Obligations and Contracts, *State Gazette*, Number 275, of 22 November 1950.

6 Law on Commerce, *State Gazette*, Number 48, of 18 June 1991.

7 Law on Special-Investment Purpose Companies, *State Gazette*, Number 46, of 20 May 2003.

8 Law on Financial Collateral Arrangements, *State Gazette*, Number 68, of 22 August 2006.



## ii. Instruments Traditionally Designed for Security

### a. Security Rights in Immovable Property

Under Bulgarian law, the mortgage is the sole method for securing creditors' rights in immovable assets. The specifics of the mortgage will be discussed in detail in the text, below.

### b. Security Rights in Tangible Movable Property

**Possessory Pledge of Movables** The most common form of possessory security in tangibles is the pledge, which is a security interest in movables created by a pledge agreement and delivery of possession of the movables, securing the performance of a duty or payment of a debt.

The pledge agreement is of a “real” nature (the so-called “real contracts”), i.e., for the purpose of its validity, the debtor or a third-party grantor must effectively give up possession of the collateral to either the secured creditor or a third person agreed on by the parties. The pledged assets are delivered on mere deposit, and no trustee-beneficiary relationship is created. Nevertheless, at all times, the secured creditor must retain possession over the pledged assets to be able to enforce his rights under the pledge agreement.

Generally, there is no requirement as to the form of the pledge agreement. However, in order for it to be enforceable *vis-à-vis* third parties, the agreement must be executed in writing with a certified date, and it should specify the pledged assets and the secured debt.

A possessory pledge may be created in respect of any movables which are not *extra commercio*. Pledge of a future asset also is valid, although it becomes effective as of the moment of acquisition of the asset. Furthermore, a pledge may be created for securing either an existing or a future debt. In the latter case, however, the security interest becomes effective as of the arising of the secured debt. The greatest disadvantage of the possessory pledge is the required dispossession, which prevents the debtor from using the encumbered assets.

**Commercial Possessory Pledge of Movables** A commercial possessory pledge is a security interest which may be created in respect of movable goods by a pledge agreement and delivery of the pledged assets to the secured creditor for the purpose of securing performance of an obligation arising out of a commercial transaction.<sup>9</sup>

Under Bulgarian law, a “commercial transaction” is considered as any transaction executed by a merchant in the course of his business, as well as certain

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<sup>9</sup> Law on Commerce, article 310.

transactions enumerated in the Law on Commerce, regardless of whether the parties thereto are merchants or not, including, among others, banking transactions.<sup>10</sup> Pursuant to the new Law on Credit Institutions,<sup>11</sup> the following activities are regarded as banking transactions:

1. Receiving deposits or other repayable funds from the public;
2. Granting credits or other financing for its own account and at its own risk;
3. Providing payment services;
4. Issuing and administration of other means of payment, such as electronic payment instruments and travelers' checks, different from the payment services under the previous item;
5. Accepting valuables on deposit;
6. Engaging in activity as a depository or trustee institution;
7. Engaging in financial lease transactions;
8. Issuing bank guarantees;
9. Trading for own account or for account of customers in (a) money market instruments different from the financial instruments in the next item, (b) foreign exchange and precious metals, and (c) financial futures, options, exchange and interest-rate instruments, and other derivative instruments different from the financial institutions in the next item;
10. Trading for own account or for account of customers in transferable securities, participation in securities issues, and other services and activities related to financial instruments;
11. Engaging in money brokering;
12. Offering advice to companies regarding their capital structure, branch strategy and related issues, as well as advice and services in connection with transformation of companies and transactions for acquisition of enterprises;
13. Acquiring accounts receivable arising from the supply of goods or the provision of services (factoring);
14. Acquiring and managing participating interests;
15. Providing safe custody services;
16. Collecting and providing information and references on customer creditworthiness; and

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<sup>10</sup> Law on Commerce, article 286, in relation to article 1, paragraph 1.

<sup>11</sup> Law on Credit Institutions, *State Gazette*, Number 59, of 21 July 2006.

17. Engaging in any other activities as may be specified by an Ordinance of the Bulgarian National Bank.

The commercial possessory pledge does not require a special form for its validity. However, in order for the pledge to be valid, effective delivery of the pledged asset to the creditor or a third party, appointed by the latter, should take place. In addition, in order for the pledge to be enforceable *vis-à-vis* third parties, it must be executed in writing with a certified date.

The commercial pledge may be contractual or statutory, depending on the grounds for its occurrence. The statutory pledge arises *ex lege*, irrespective of the parties' will in the cases provided by the Law on Commerce.<sup>12</sup>

**Right of Retention** It is widely accepted that the right of retention is similar to the possessory pledge and, therefore, regarded as a mere quasi-security. Pursuant to the general legal framework contained in the Law on Obligations and Contracts, the right of retention is allowed under the cumulative presence of two preconditions, namely:

1. The exercise of possession in fact over a movable object by a holder in "good faith"; and
2. A due and payable receivable owing to the holder in relation to preserving, maintaining, repairing, or improving the object, or in relation to injuries caused by the object.

The obligation for delivery of the object and the reverse receivable of the retaining creditor need not be part of the same relationship.

The right of retention is not allowed where the debtor has provided security for his debt. Retention rights may be exercised until full satisfaction of the creditor's claim. It is significant that the party in retention is entitled to satisfaction with priority out of the proceeds of the retained asset within the individual enforcement procedure.

Specific regulation to the right of retention applicable to commercial transactions is provided for in the Law on Commerce. The commercial right of retention has the following distinct features:

1. It secures receivables arising out of a commercial agreement between two merchants;
2. The creditor may exercise retention rights only with respect to movable property and/or securities;

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12 The statutory commercial possessory pledge arises in favor of the commission merchant, the carrier, and the depositary of a public warehouse over the assets delivered in their possession.

3. The retention rights may be exercised only with respect to a due and payable receivable with few exceptions;
4. Between the claim of the creditor and the goods or securities, which the latter holds, there need not be any connection; and
5. The creditor must hold the goods or securities on a legal ground.<sup>13</sup>

c. *Security Rights in Intangible Movable Property*

**In General** Intangibles comprise a broad variety of rights, such as the right to the payment of money or the performance of other contractual obligations, different types of securities, and intellectual property rights.

**Pledge of Accounts Receivable** A pledge also may be created in respect of transferable accounts receivable by way of a pledge agreement executed between the secured creditor and the security provider. The pledgor must hand over to the secured creditor the documents evidencing the pledged accounts, where such delivery is not a precondition for the validity of the pledge agreement.

As a general rule, under Bulgarian law, all accounts receivable may be transferred and, hence, they may be pledged, save for those which may not be transferred by virtue of law or a contractual stipulation to this effect, or by virtue of their nature.

In order for such a pledge to be enforceable *vis-à-vis* the pledgor's debtor, the latter must be notified thereof and, similar to the pledge in respect of movables, in order for the pledge to be enforceable *vis-à-vis* third parties, the pledge agreement must be executed in writing with a certified date and should specify the pledged accounts receivable and the secured debt.<sup>14</sup>

**Commercial Possessory Pledge of Securities** A commercial possessory pledge under article 310 of the Law on Commerce also may be created in respect of securities (bearer or endorseeable securities) by a pledge agreement and delivery of the pledged assets to the secured creditor for the purpose of securing performance of an obligation arising out of a commercial transaction.

With respect to endorseeable securities on order, in addition to delivery of the security to the secured creditor, it is necessary that an endorsement in pledge be effected in favor of the secured creditor.<sup>15</sup>

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13 The creditor, however, would not be in a position to exercise retention rights in case the debtor has given to him the goods or securities for a specific purpose under a mandate agreement.

14 Law on Obligations and Contracts, article 162.

15 Law on Commerce, article 310, paragraph 1, item 2.

**Possessory Pledge in Securities** A creditor may take security interest in both materialized and dematerialized (book-entry form) securities (whether shares or debentures). However, it is essential that a pledge over materialized securities is created as a possessory pledge, while a pledge over book-entry form securities is deemed non-possessory.

The mechanics for creation and perfection of a share pledge with regard to registered materialized shares are similar to those applicable to the possessory pledge in accounts receivable, already discussed above, but display a few specifics, as well. Creation takes place through a pledge agreement, which must be in writing with a certified date in order for the pledge to be enforceable *vis-à-vis* third parties, as outlined above.

Creation of the pledge also requires endorsement in pledge and delivery of the pledged shares in possession of the pledgee. Registration of the pledge into the Book of Registered Shareholders of the issuer company is required for purposes of perfection *vis-à-vis* the same company.

As a general rule, under Bulgarian law, a creditor having in security a pledge of shares is not entitled to receive dividends and other profit distributions relating to the shares; nor can it avail of the voting rights thereunder. However, a few exceptions in this relation exist.

Pursuant to the Law on Commerce, dividends from pledged shares must be paid to the pledgor, provided that the pledgee has not raised objections within one month on written notification by the company (issuer). If the pledgee objects to the payment, the due amount must be deposited in a bank for the purpose of serving as security for the secured creditor.

The second exception applies in particular to registered shares and provides that the voting right thereunder must be exercised by the shareholder, unless otherwise stipulated by the parties to the share pledge agreement.

However, in the case of listed companies, the secured creditor will not be allowed to exercise the voting rights solely on the grounds of the share pledge agreement but will need an express and notary-certified power of attorney for each separate meeting of shareholders. The implemented liberalized regime entitles the secured creditor to effectively control the payment of dividends, as well as to preserve the right to vote the pledged shares.

**Financial Collateral in Cash Receivables and Securities** A creditor, eligible under the Law on Financial Collateral Arrangements, may take security interest in “cash receivables” or “financial instruments”.

The financial collateral arrangement must be evidenced in a written instrument. The general principle of the Law is that the security interest over financial collateral is considered perfected with the designation of its creation

which, depending on the type of the collateral provided, could be in the form of delivery, transfer, endorsement, or simple designation in the records of the collateral taker. If there are special legal requirements for creation of certain types of collateral, such as materialized shares, such requirements must be abided by.

**iii. Use of Title for Security Purposes**

*a. Transfer of Title to Creditor*

Bulgarian law does not specifically govern fiduciary transfers of title. Under the existing legal practice, however, a security transfer of title is deemed null and void except in the case of financial collateral arrangements. Under the Law on Financial Collateral Arrangements, title-transfer collateral arrangements are valid security agreements under which the security provider can transfer the full ownership over the collateral to the secured creditor to secure the performance of financial obligations.

In the case of a fiduciary transfer of title, the parties are free to agree that the secured creditor can return on termination of the arrangement equivalent collateral which, in relation to cash receivables, means a payment in the same amount and in the same currency and, in relation to financial instruments, instruments from the same issuer, of the same issue or class, and of the same nominal amount, currency, and description.

In addition, in the case of a financial collateral arrangement, different from a fiduciary transfer of title, the secured creditor still may be entitled to the collateral on foreclosure, provided that this option is agreed in advance by the parties.

In any other case, such transfers of title should be regarded as circumvention of the rules governing secured transactions on the grounds that they result in weakening the position of the debtor and the debtor's other creditors through impairing of their legitimate expectations for satisfaction of their claims.

*b. Retention of Title by Creditor*

Under Bulgarian law, commonly used forms of retention of title by the creditor are the sale agreement with retention of title and the lease agreement. However, Bulgarian law does not treat such forms of retention of title as security interests, but as true ownership. The basic rule is that the sale contract with retention of title and the lease contract shall not be enforceable *vis-à-vis* the secured creditor that has subsequently acquired and registered a pledge under the Law on Registered Pledges over the sold or leased assets.

However, the seller/lease grantor is entitled to file his title over the sold/leased assets in the Central Pledges Registry so that third parties seeking to take security

interest in the sold/leased property are put on notice of the seller's/lease grantor's title over the sold/leased property.<sup>16</sup> As described in greater detail below, a "purchase money security interest" is granted priority in respect to ordinary security interests.

#### **iv. Uniform Comprehensive Security**

The concept of a single, uniform, and comprehensive security right in tangibles and intangibles, which was first developed by article 9 of the UCC and recommended by the EBRD Model Law, is not recognized by Bulgarian secured credit law.

The dynamic approach to security interests adopted by Bulgarian law accommodates both traditional and more innovative security devices. It is widely known, however, that conventional possessory pledges are unfit and inadequate for the modern credit market. Conversely, the mortgage and registered pledge are the most widely spread forms of security interests.

#### **v. Special Securitization Regime**

Another new option under Bulgarian law for securitization of real estate assets and receivables (provided by the Law on Special-Purpose Investment Companies) is available by way of "packaging" of such assets in a special-purpose company which, in turn, is listed on a regulated market in financial instruments. Such companies are also entitled to raise funds by way of issuing debentures. A special-purpose company may only enter into transactions related to:

1. Raising funds by issuing securities;
2. Acquiring real estate for the purpose of assigning the management, lease, or sale thereof; and
3. Engaging in transactions directly related to items 1 and 2, above.<sup>17</sup>

The special-purpose company is prohibited by law to directly manage the activities related to exploitation and maintenance of (including collection of receivables from) the real estate in which investments have been made. The

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<sup>16</sup> Law on Registered Pledges, article 12, paragraph 2.

<sup>17</sup> The special-purpose company also is permitted to enter into certain auxiliary transactions, such as (a) issuing debt instruments registered for trade on a regulated market, (b) taking credits from banks to acquire and operate assets that are subject to securitization, (c) taking short-term (up to 12 months) bank credits up to 20 per cent of the balance value of its assets where the loans will be used for payment of interest, (d) investing up to 10 per cent of its capital in the servicing company, (e) investing free funds in securities issued or guaranteed by the state, and (f) depositing free funds in banks.

special-purpose company should commission one or more other companies, which possess the necessary organization and experience (servicing company), with the managing and maintenance activities related to the assets, as well as servicing the receivables, keeping accounting records, and performing other services.

As a guarantee for the investors in the special-purpose company, the law prohibits any setting-off by the servicing company of revenues of the special-purpose company against management fees due to it.

Investor contributions paid in for shares in a special-purpose company and proceeds from the activities of a special-purpose company are deposited in a special bank account maintained at a depository bank, which manages all payments to and from the special-purpose company. The special-purpose company is obliged to distribute not less than 90 per cent of its profit for the respective financial year. Dividends should be distributed within 12 months as of the end of the respective financial year.

The special-purpose company is subject to licensing by the Financial Supervision Commission. The special-purpose company should be a Bulgarian joint-stock company, incorporated by a maximum of 50 shareholders, and 30 per cent of the capital should be subscribed by institutional investors. The registered capital of a special-purpose company should be at least BGN 500,000, distributed in book-entry form registered shares, all of which should be fully paid in on incorporation.

On obtaining of a license from the Financial Supervision Commission, the special-purpose company is obliged to increase its registered capital by 30 per cent by way of initial public offering of shares. Shareholders holding, directly or through affiliates, more than five per cent of the shares in the special-purpose company are obliged to declare before the Financial Supervision Commission by way of an affidavit the origin of their funds and the taxes paid during the last five years.

The directors of a special-purpose company can be individuals or legal entities. It is required that individuals who are nominated for directors or who represent a director have university-level education and satisfy additional criteria evidencing their competence and reliability.<sup>18</sup>

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18 Such criteria require that the director may not have been sentenced for an intentional crime, not have been declared insolvent nor be in a bankruptcy procedure, not have participated as board member of a company which has been declared bankrupt during the last two years preceding the opening of the bankruptcy procedure, not have been deprived of a right to hold a position related to responsibility over property, and not be a spouse or a relative (up to third degree inclusive, in direct or lateral descent) to another board member of the special-purpose company or the servicing company.



## D. CREATION OF MORTGAGES AND NON-POSSESSORY PLEDGES

### i. In General

Under Bulgarian law, a security interest represents a legal relationship of an “accessory” nature, i.e., its existence and validity are premised on the due existence and validity of the secured debt which, in such case, represents the “primary” legal relationship. As a general rule, a security interest may be granted by either the debtor himself or a third party, as security for performance of a duty or payment of a debt by the latter.

Principally, a security right is created by way of an agreement between the parties to the secured transaction. There are, however, exceptions to this rule applicable to security rights which arise *ex lege* (e.g., statutory mortgages), subject to the performance of certain additional acts by the secured creditor. Depending on the type of security interest, the creation thereof is subject to diverse requirements.

### ii. Elements of Security Right

#### a. *Obligations to Be Secured*

**In General** The debt to be secured by a mortgage or registered pledge has the following common features:

1. It may be owed by any person who need not be the grantor of the charge;
2. Any specifically defined debt may be secured;
3. It may be existing, conditional, or future; and
4. It may be secured in full or in part.

In addition to these common specifics, the mortgage and the registered pledge also have certain peculiarities with regard to the secured debt.

**Mortgage** The mortgage may be created for securing either a monetary or non-monetary obligation. Where the mortgage secures a non-monetary obligation, the mortgage contract should specify the monetary amount which the mortgage is intended to secure. This amount represents a monetary assessment of the damages arising from non-performance of the non-monetary obligation.

The main debt may be interest bearing. In order that a valid security interest in respect of the interest is created as well, the mortgage contract should specify the exact rate of such interest. The mortgage secures only interest accrued during the lapsed part of the year as of commencement of foreclosure, the two

years preceding that year, and that part of the current year which would have elapsed by the time the sale of the mortgaged assets is effected.<sup>19</sup> Furthermore, the mortgage secures the creditor's expenses related to mortgage creation, renewal, and foreclosure.

**Registered Pledge** The Law on Registered Pledges does not provide for specific limitations as to the main debt to be secured. In addition to the common features of the secured debt typical for both mortgages and registered pledges, it should be emphasized that the obligations to be secured by a registered pledge also may be identified in gender.<sup>20</sup>

By virtue of an express provision of the Law, the registered pledge securitization covers not only the secured debt itself, but also any interest accrued, as well as liquidated damages, where applicable.<sup>21</sup>

This rule extends the scope of the obligation to be secured by a registered pledge, as compared to the general rule under the Law on Obligations and Contracts.<sup>22</sup> However, in contrast to the mortgage, expenses are not covered by the registered pledge and, therefore, must be covered by an express stipulation in the pledge agreement.

**Financial Collateral** Financial collateral arrangements can secure only financial obligations, defined as obligations (including current, future, or conditional, as well as third-party obligations, or obligations defined by their gender or class) that may be settled with cash receivables or delivery of financial instruments and at least one party to which is a financial institution.

Financial collateral arrangements cover by default the principal obligations as well as the related interest, penalties, indemnification for damages, and expenses.<sup>23</sup>

*b. Assets to Be Encumbered*

**Mortgage** A mortgage may be created in respect of any kind of immovable assets which are not *extra commercio*, e.g., land, buildings, superficies right, and undivided interest in real property. The law requires, however, that the mortgaged asset be particularly indicated through its type, location, and borders. Incapable of mortgaging are non-transferable immovable assets, such as

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19 Law on Obligations and Contracts, article 174.

20 Law on Registered Pledges, article 5, paragraph 1.

21 Law on Registered Pledges, article 5, paragraph 2.

22 The general rule under article 136, paragraph 4, of the Law on Obligations and Contracts is that the right to preferential satisfaction covers the adjudged interest, the interest accrued following the commencement of foreclosure, as well as interest for the year preceding such foreclosure.

23 Law on Financial Collateral Arrangements, article 7, paragraph 2.

rights *in rem* of “personal” nature (the usufruct) and public state-owned or municipal-owned property.

A mortgage will be null and void if the mortgagor does not have title to the real property mortgaged as of the time of execution of the mortgage agreement. It is important to note that the mortgage covers the accessions, as well as the improvements, of the real estate.

**Registered Pledge** As an innovative legislative act, the Law on Registered Pledges permits a broad range of movable assets, tangible and intangible, to serve as encumbered assets. The assets in respect of which a registered pledge may be created are exhaustively specified by law, as follows:

1. Accounts receivable, dematerialized securities,<sup>24</sup> and movables, exclusive of ships and aircraft;<sup>25</sup>
2. Equity participation in companies and partnerships;
3. Floating pools of assets;
4. Industrial property rights, including patent rights for inventions and utility models, registered marks, industrial designs, topologies of integrated circuits, and certificates for plant varieties and animal breeds; and
5. Going concerns.

In addition, it is possible that the pledged property be defined in gender or even be future. The law allows that a future crop may be pledged, which is generated either from the current or subsequent economic year. If the pledged asset is reprocessed or incorporated, the pledge follows the new chattel.

*Floating Pools of Assets* Under Bulgarian law, a floating lien is allowed only in relation to:

1. Accounts receivable;
2. Machines and equipment;
3. Inventory, goods, or materials; and
4. Dematerialized securities.<sup>26</sup>

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24 Dematerialized securities encompass shares issued by joint stock companies (corporations), debentures, or any other classes of securities (e.g., equity, fixed income, or the money market). Dematerialized securities do not encompass, however, equity participation in general partnerships, limited partnerships, partnerships limited by shares, and limited-liability companies.

25 Ships and aircraft also may be subject to a security right under terms and conditions contained in other legislative acts, i.e., the Merchant Shipping Code (mortgage on ships) and the Law on Civil Aviation (pledge on aircraft).

26 Law on Registered Pledges, article 4, paragraph 1, item 3.

Apart from that, a floating lien also may be created in respect of a “going concern” (recognized as a separate type of a registered pledge). A floating pool of assets is an independent object of law only for purposes of charging it with a security interest and cannot be an object of a sales contract. The essence of a pledge over a floating pool of assets is that any items which cease to be part of the floating pool drop out of the pledge and, conversely, any items that subsequently become part of the floating pool will become pledged. The floating pool “freezes” automatically as of the time the secured creditor commences foreclosure, and only items forming the floating pool at that moment are subject to foreclosure.

*Equity Participation in a Company* The Law on Registered Pledges authorizes creation of security interest in equity participation in the following types of legal entities:

1. General partnership;
2. Limited partnership;
3. Partnership limited by shares; and
4. Limited-liability company.

*Going Concern* The rules applicable to a floating lien also apply to the pledge of a going concern. The on-going business of an enterprise, commonly referred to as a “going concern” and defined as “a pool of rights, obligations, and factual relationships”, also may be subject to a registered pledge. Once the pledge is created, the company continues to perform its ordinary business, and newly acquired items, such as rights, assets, or funds, become part of the going concern and, hence, are covered by the registered pledge.

Conversely, items which the company has disposed of drop out of the going concern and, therefore, would not serve for security of the secured creditor on foreclosure. Moreover, provided that particular assets have been identified in the pledge agreement, a specific (fixed) lien will be considered to have attached thereto, and such assets will continue to serve as security in favor of the pledgee regardless of and following their disposal by the company.

Thus, specific reference to a real estate asset in the pledge agreement will achieve the effect of a mortgage, while avoiding some of the complications associated with creation of a standard mortgage. However, for the purposes of perfection, such a pledge agreement must be registered with the relevant Real Estate Registry, for which additional costs need to be incurred.

**Financial Collateral** Financial collateral can be provided either in the form of a fiduciary title transfer arrangement or security financial collateral arrangement. Only “cash receivables” or “financial instruments” can serve as financial collateral. Cash receivables are defined as money credited to an

account in any currency, including money deposits and excluding cash. Financial instruments include:

1. Equity securities that can be traded on the capital market (both materialized and book-entry) issued by commercial companies, including shares in collective investment schemes;
2. Debt securities that can be traded on the capital markets; and
3. Any other instruments usually negotiated on the capital market (except for payment instruments), which give right to acquire equity or debt securities, including by way of physical settlement, including money market instruments, or receivables and rights associated with such instruments.

c. *Scope of Security Right*

**Mortgage** The Common Law notion of a mortgage, whereby a mortgage operates as a transfer of the legal title to the mortgagee, subject to default of payment of debt or performance of duty by the mortgagor, is not applicable in Bulgaria. In contrast, under Bulgarian law, a mortgage is considered a mere lien, and does not create a title or estate in favor of the mortgagee.

A mortgage is an interest in land or other immovable assets providing security for performance of duty or payment of debt, and giving the secured creditor the right to be satisfied with priority out of the proceeds of the sale of the collateral. The right to preferential satisfaction from the sale proceeds of the mortgaged assets is the essence of the mortgage security right.

**Registered Pledge** A registered pledge is a security interest in movable goods, tangibles or intangibles, specified by law, created for the purpose of securing performance of duty or payment of debt, and giving the secured creditor the right to be satisfied with priority out of the proceeds of the sale of the collateral.

The right to preferential satisfaction from the sale proceeds of the pledged assets is the essence of the pledge security right, whether created by a registered or possessory pledge.

**Financial Collateral** Financial collateral arrangements create security interest in cash receivables and financial instruments, whereas such secured interest could be enforced through sale of collateral or taking title of collateral in lieu of satisfaction.

The acquisition of financial instruments is allowed only where the parties have in advance explicitly agreed thereto and have further agreed on the manner of evaluation of the financial collateral.

**iii. Security Agreement**

*a. Definition*

A security agreement is the agreement between the creditor and the debtor or a third-party security grantor intended to establish a security right in certain assets in favor of the creditor.

*b. Parties*

Parties to the mortgage or possessory pledge contract may be any natural or legal person, whether Bulgarian or foreign.<sup>27</sup> As regards the mortgage and registered pledge agreement, any person may act as the pledgee/mortgagee thereunder, provided that he is a creditor under the secured debt.

The grantor under a registered pledge agreement, however, may only be a merchant or a person falling within one of the categories under article 2 of the Law on Commerce (i.e., persons working in the agricultural sector, craftsmen and freelancers, and persons exercising hotel services).<sup>28</sup> Such restriction does not apply in respect of pledges over dematerialized securities, equity participation in companies, and industrial property rights and, therefore, a registered pledge over such items may be granted by any person regardless of his capacity.

Furthermore, a municipality can validly execute a registered pledge agreement,<sup>29</sup> granting security for a municipal loan extended in compliance with the requirements set in the Law on Municipal Debt and pursuant to a valid public procurement procedure.

Parties to the financial collateral arrangements may only be governmental bodies, central banks, the European Central Bank, the Bank for International Settlement, the European Investment Bank, the International Monetary Fund, and the multinational banks for development, credit, or financial institutions, insurance companies, investment intermediaries, asset management

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27 Pursuant to an amendment of the relevant provisions of the Bulgarian Constitution of 2 February 2005, foreign nationals and corporate bodies may acquire right of ownership over land under the conditions ensuing from the accession of Bulgaria to the European Union, or by virtue of an international agreement, ratified, promulgated, and entered into force for Bulgaria, as well as by inheriting under law. These provisions, however, entered into force as of 1 January 2007 (the date of accession to the European Union). As a result, European Union nationals will be allowed to acquire ownership over regulated real estate with the expiration of a five-year transitional period (1 January 2012) and over agricultural land with the expiration of a seven-year transitional period (1 January 2014). Nationals of other third countries are currently not allowed to own real estate in Bulgaria.

28 Law on Registered Pledges, article 3, paragraph 1.

29 In order for the agreement to be valid, the collateral should not be public municipal property or receivables on account of subsidies from the state budget.

and investment companies, collective investment schemes, regulated markets, special-purpose vehicles, settlement agents and depository institutions, pension funds, social insurance funds, and merchants,<sup>30</sup> when they represent one of the above or third-party bondholders or other holders of other debt securities, as well as other merchants when the other party to the financial collateral agreement is one of the above.<sup>31</sup> No other legal entities, sole proprietors, or individuals may be parties to such arrangements.

*c. Formalities*

**Mortgage** A mortgage is established either by means of a contract or by operation of law, the so-called statutory mortgage. The creation of the contractual mortgage involves two components, namely:

1. A written agreement in the form of a notary deed executed between the grantor and the creditor; and
2. The entry of the mortgage in the Real Estate Registry at the court region where the immovable assets are situated.

Thus, recording is not merely meant to perfect the mortgage *vis-à-vis* third parties, but also to enable the creation of the mortgage.

The statutory mortgage is a security interest in favor of a creditor who needs increased protection. For the creation of the statutory mortgage, all common requirements applicable to the contractual mortgage need to be at hand. A statutory mortgage may be created in favor of:

1. The transferor of immovable property on a deferred payment basis; and
2. The co-partitioner to whom a supplementing of the share is due.<sup>32</sup>

Crucial from a practical standpoint is the statutory mortgage provided in favor of banks over real estates and rights *in rem* over the latter, acquired wholly or partially through the use of a bank loan.<sup>33</sup>

**Registered Pledge** A registered pledge agreement must be executed in writing, as a requirement for the contract's validity. On observance of the written form, the issue in whose possession the asset remains is of no relevance.

As an exception to the rule, a pledge agreement with respect to a going concern and equity participation in legal entities (general partnership, limited

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30 Merchants are considered commercial entities within the meaning of the Law on Commerce (i.e., general partnership, limited partnership, partnership limited by shares, limited-liability companies, and joint-stock companies), cooperatives (except for residential buildings) and sole proprietors.

31 Law on Financial Collateral Arrangements, article 3.

32 Law on Obligations and Contracts, article 168.

33 Law on Credit Institutions, *State Gazette*, Number 59, of 21 July 2006, article 60, paragraph 4.

partnership, partnership limited by shares, and limited-liability company) must be executed in writing, and the parties' signatures must be notarized.

**Financial Collateral** The Law on the Financial Collateral Arrangements does not create any specific formalities with regard to the creation, perfection, and validity of a financial collateral contract, save for the requirement of having a written instrument to evidence the arrangement.

In the case of receivables or book-entry securities the written form is deemed achieved by simple recording of the security interest over the respective account, where such receivables or securities are credited. The security interest is considered perfected as of the moment it is designated as established in favor of the collateral taker or a person acting on its behalf.

*d. Minimum Contents*

**Mortgage** A mortgage contract must contain specific statutory-defined data and, in order for the mortgage to be valid and enforceable, the notary deed should identify the creditor, the mortgagor, and the debtor, as well as the mortgaged assets and the secured debt, and specify the exact monetary amount which the mortgage is intended to secure.<sup>34</sup>

If any of the mandatory elements is missing or not adequately specified, the mortgage is considered null and void.

**Registered Pledge** Bulgarian secured credit law does not set out the minimum contents of a security contract creating a possessory or a registered pledge. However, such contract should at least contain:

1. The identification of the parties;
2. A description of the secured debt;
3. A description of the charged property; and
4. The signatures of the parties thereto.

**Financial Collateral** The law requires that, at the minimum, financial collateral arrangements specify the secured financial obligations and the provided financial collateral.

Such content need not be incorporated in a separate instrument and could be part of the instruments establishing the principal financial obligations being secured.

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<sup>34</sup> The amount may be equal to the whole of the secured debt or part of it.



e. *Effect*

The effect of the security agreement is to create a valid security right between the parties to the agreement. For this reason, it is not usually required that a security agreement has been registered or otherwise perfected for it to constitute a binding agreement between the parties thereto.

Any subsequent filing, date certification, or other similar technique makes the agreement effective *vis-à-vis* third parties. The only exception to this rule is provided for financial collateral arrangements where such subsequent publication may not be required even for the purposes of making the arrangement effective *vis-à-vis* third parties.

**iv. Additional Requirements**

There are exceptions to the general principle outlined under the previous paragraph. The first exception is in respect of the mortgage, where filing with the Real Estate Registry of the contract or application (in the case of a statutory mortgage), respectively, is necessary for both the validity of the mortgage and its enforceability *vis-à-vis* third parties.

Filing is necessary for the registered pledge to be enforceable *vis-à-vis* third parties, and it is a prerequisite for the secured creditor to enjoy the alleviated procedure of private foreclosure under the Law on Registered Pledges.

As discussed above, effective delivery of possession over the pledged asset is required for the validity of the possessory pledge, while the agreement itself should be in writing with a certified date in order for the pledge to be enforceable *vis-à-vis* third parties.

**E. PUBLICITY**

**i. In General**

Publicity implies perfection of the security interest. It usually requires that the secured party give public notice of the interest by filing in a public office or any other way.

Publicity should be regarded primarily as a matter of enforceability of the security right *vis-à-vis* third parties, rather than only as a matter of priority.

**ii. Public Registration for Non-Possessory Security**

a. *Mortgage*

A mortgage must be filed with the Real Estate Registry Office at the region of the court where the mortgaged assets are situated. At present, real estate transactions

are registered in 113 decentralized paper-based registries with the Registry Agency located at the seats of the existing Regional Courts.<sup>35</sup>

Filing is made based on the mortgage contract, which is in the form of a notary deed. In cases of a statutory mortgage, filing is made based on an application by the creditor, accompanied by the deed for transfer or partition, respectively.

A mortgage is considered to have priority with respect to competing mortgage claims to the same assets which have been registered subsequently. A mortgage follows the mortgaged property; hence, buyers will acquire rights in the encumbered assets subject to the mortgage.

*b. Registered Pledge*

**Title Transactions and Security Transactions** Title transactions pose a risk for third parties dealing with the holder of the assets in question, as well as for the third-party owner of such assets. For this reason, title transactions also create problems of publicity.

As discussed above, a sale contract with retention of title or a lease contract, respectively, will not be enforceable against the secured creditor that has subsequently acquired from the purchaser/lessee and registered a pledge over the sold or leased property unless filed in the Central Pledges Registry.

**Consensual and Non-Consensual Security Rights** The link between a possessory pledge and a registered pledge over the same tangible asset is based on competition. This means that the priority between both security rights shall be determined from the earlier between:

1. The date of the filing of the registered pledge; and
2. The date of certification of the possessory pledge agreement.

Should accounts receivable be encumbered with a pledge under the Law on Obligations and Contracts, followed by a registered pledge under the Law on Registered Pledges, the registered pledge will take precedence over the former one.<sup>36</sup> However, if both pledges over the same account receivable are created as registered within the meaning of the Law on Registered Pledges, the priority between them will be established according to the date of their filing.

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35 The Law on Cadastre and Property Register, *State Gazette*, Number 34, of 25 April 2000, envisages the creation of a new centralized system for registration of property rights. The unified cadastre system is already operating and online searches are available in all 113 Real Estate Registries for entries made within the last 20 years. Older entries can be found only in the paper-based registries.

36 Law on Registered Pledges, article 12, paragraph 2.

Apart from filing with the Central Pledges Registry, a registered pledge of accounts receivable should be notified to the debtor under the pledged receivable in order that the pledge is enforceable against the latter. Notice may be given by either the pledgor or the pledgee.

**Single Registry and Multiple Registry** The Central Pledges Registry is the first centralized and exclusively computer-based registry applicable for registered pledges. Any pledge of assets is registrable in the Central Pledges Registry, unless an exception has been created by law.

Such exceptions exist when ownership of certain assets is registrable in a specialized registry and, thus, pledges of such assets are registrable in such respective specialized registry.

**Dematerialized Securities** A registered pledge created in respect of dematerialized securities must be filed with the Central Securities Depository.

Should the pledge be created over government securities, filing must be made in the State Securities Registries.<sup>37</sup>

**Equity Participation in Legal Entities** A registered pledge in respect of equity participation in a legal entity (general partnership, limited partnership, partnership limited by shares, and limited-liability company) must be filed with the Commercial Registry at the Registry Agency.<sup>38</sup>

**Industrial Property Rights** To be enforceable *vis-à-vis* third parties, a pledge over industrial property rights must be registered in the Patent Office Registry.<sup>39</sup>

**Going Concern** To be enforceable *vis-à-vis* third parties, the going-concern pledge must be filed with the Commercial Registry. In addition, in order for the pledge to be enforceable *vis-à-vis* third parties that subsequently acquire rights with respect to particular assets of the company, a secondary filing of the pledge must be performed with the respective registry (see text, below).

**Notice and Document Filing** In respect of registered pledges, Bulgarian secured credit law assumes a system of filing of notices which is fast, efficient, and flexible as compared to the document filing relevant for mortgages. The transaction document also could perform the function of a notice in this case.

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37 Law on Registered Pledges, article 18.

38 A unified register creating integrated online searchable access to all Bulgarian company files, irrespective of the place of incorporation, which have been previously dispersed among many district courts, was created under the Law on the Commercial Register, *State Gazette*, Number 34, of 25 April 2006. The unified register was operational as of 1 January 2008 and is managed by the Registry Agency at the Ministry of Justice.

39 Law on Registered Pledges, article 19a.

**Timing of Registration** Similar to a mortgage, a registered pledge is considered to have priority with respect to competing registered pledge claims to the same assets as of the date of its filing with the respective registry.

**Required Content of Registered Notice** Applications for filing a registered pledge must be in writing and in special forms pre-approved by the Minister of Justice. The information required is in respect of identifying:

1. The secured creditor and the pledgor;
2. To the extent different from the latter, the obligor under the secured debt;
3. The secured debt; and
4. The collateral pledged as security.

Applications for filing a statutory mortgage must contain all the requisites relevant for the mortgage contract.

**Need for Protection of Remote Transferees of Encumbered Assets** As a basic rule, a security right follows the encumbered assets and, hence, a third party will acquire rights in the pledged property subject to the pledge. Exceptions to the rule are discussed below.

**Linkage to Registries for Immovables** Such a relationship arises in cases of a pledge over a going concern, where a real estate asset either initially forms part of the going concern or is subsequently included therein.

Consequently, in order for the pledge to be enforceable *vis-à-vis* third parties that subsequently acquire mortgage rights with respect to the real estate, which is then part of the going concern, a secondary filing of the pledge must be performed with the respective Real Estate Registry where the real estate is situated.

**Linkages between General Registry and Asset-Specific Registry** Such a relationship arises in cases of a pledge over a going concern, where various assets form part of the dynamic pool of rights, obligations, and factual relations comprising the going concern.

Consequently, in order for the pledge to be enforceable *vis-à-vis* third parties that subsequently acquire security rights with respect to particular assets of the company, a secondary filing of the pledge must be performed with the respective registry, e.g., the Central Pledges Registry in respect of movable goods, the Ships' Registry in respect of ships, and the State Registry of Aircraft in respect of aircraft.

**Private Registration or Publication** Since perfection of a registered pledge is effected through a public registry (i.e., the Central Pledges Registry or other relevant registry), filing should be deemed as a publication rather than a private registration.

**Registration and Enforcement** The correlation between registration and enforcement is that, absent valid filing of the registered pledge with the respective registry, no enforcement under the alleviated procedure provided for by the Law on Registered Pledges could be performed.

c. *Financial Collateral*

Creation, perfection, and enforcement of financial collateral does not require registration in a public registry. However, depending on the type of collateral, the parties may opt to register such collateral with a public registry, such as the Central Securities Depository in respect of book-entry securities issued by Bulgarian companies.

iii. **Debtor Dispossession and Equivalent Control Mechanisms**

a. *Debtor Dispossession as Substitute for Registration*

No filing in any registries is required with respect to possessory pledges. The Bulgarian legislator has adopted the notion that dispossession of the grantor is a form of publicity. However, a written document with a date certification is further required for the pledge to be enforceable *vis-à-vis* third parties.

b. *Symbolic Possession*

Possession by the secured creditor does not always require physical removal of the encumbered assets from the grantor's premises. To the contrary, delivery also may be effected by way of transfer to the pledgee of the keys of the premises where the respective asset is located.

c. *Third-Party Notice or Control*

The issue of a third-party notice would be relevant in the case of a pledge of accounts receivable. As discussed above, such a pledge will be enforceable *vis-à-vis* the pledgor's debtor if the latter is notified thereof.

d. *Third-Party Effects of Unpublicized Security Rights*

As a rule, the circumstances subject to filing are considered familiar to *bona fide* third parties as of the date of filing.<sup>40</sup> Consequently, the lack of publicity should make the security right ineffective *vis-à-vis* third parties for mortgages, possessory pledges, and registered pledges.

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40 Law on Registered Pledges, article 30, paragraph 1.

**iv. Third-Party Effect of Publicized Security Rights**

Publicity, whether effected by way of filing in a public registry, date certification, or other similar technique, should be regarded as a precondition to the effectiveness of the security rights as against third parties.

**F. FILING SYSTEM**

**i. In General**

The filing system is a public office where an announcement by way of document or notice filing is made alerting third parties to the existence of a security right. Under Bulgarian secured transactions law, there is no single filing system.

The establishment of a uniform registry applicable for all types of security devices is not feasible due to the operation of separate title registries relevant for title to separate types of assets.

**ii. Key Design Issues**

*a. Notice Filing*

As mentioned above, the registered pledges system requires filing of an application containing only the minimum data necessary to inform searchers of the existence of another claim.

*b. Authority to File and Signature*

Although filing is effected by the interested party, the filing application must be accompanied by the written consent of the pledgor with a notary-certified signature.<sup>41</sup>

Similar to filing, deletion is performed by the interested party. The application for deletion must be accompanied by the written consent of the secured creditor with a notary-certified signature.<sup>42</sup>

*c. Grantor-Based or Asset-Based Index*

The Central Pledges Registry is organized in a way that allows computer searches of the pledgor details. Hence, the grantor's identification is the basis for the index.

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41 Law on Registered Pledges, article 27, paragraphs 1 and 2.

42 Law on Registered Pledges, article 27, paragraph 4.

*d. Filing Process*

The application for filing is promptly considered since ultimate expedition of the procedure is sought. Denials for filing may be made only if the application does not contain the required data or the applicable fee has not been paid. The applicant may remedy the deficiencies in the application and file a new one, where the new filing shall acquire a new order of priority.

Denials for registration issued by the Central Pledges Registry's Director are subject to appeal before the Minister of Justice. In turn, the Minister's denials to register are subject to appeal before the Supreme Administrative Court.

An appeal against denial to register has as its immediate effect the prompt registration of the relevant security interest, subject to public notice in the Central Pledges Registry that the registration might be annulled in case of unsuccessful appeal by the applicant. In other words, appeals against denials for registration do not have timing impact on accomplishing the desired registration regardless of the appeals process's duration.

*e. Duration of Effectiveness of Filed Notice*

**Mortgage** The filing is effective for a term of 10 years as of its execution and may be extended on request of the mortgagee for other 10-year periods.

It is important that the request for renewal be made prior to expiration of the 10-year period in order for the secured creditor to retain his priority as of the date of its original filing. Otherwise, a new filing may still be effected and the mortgage will have priority as of the date thereof.<sup>43</sup>

**Registered Pledge** Filing is effective for a term of five years as of the date of its execution, and it may be renewed for other five-year terms provided that a request for renewal is made prior to expiry of the original five-year term.<sup>44</sup>

**iii. Other Basic Elements**

*a. Public Access to Database*

**Mortgage** Traditional real estate registries are public; however, the access to the database is impeded due to the following major inconveniences:

1. The original registries are paper-based, and this can affect the time it takes to access information; and
2. The decentralization of the registry system additionally aggravates the problems of registries' inaccessibility.

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43 Law on Obligations and Contracts, article 172.

44 Law on Registered Pledges, article 30.

These inconveniences have been remedied to some extent with the implementation of the unified cadastre system, which provides the option for online check for encumbrances both by property location and by the name of the owner. Online searches, however, are available only for entries made within the last 20 years.

**Registered Pledge** Public access to the Central Pledges Registry is by far its most significant feature. Any person may obtain a reference statement or a certificate for existence or absence of recorded facts.

In addition, the registry is entirely based on digitally stored information; hence, computerized processing of data is possible and makes searches extremely fast.

Amendments of the Law on Registered Pledges<sup>45</sup> envisage the creation of online searchable database and a system of electronic filing in the Central Pledges Registry. However, those services are not yet available.

*b. Extent of Detail in Statutory Text*

The regulation of the registered pledges' filing system is contained in the Law on Registered Pledges and the Rules on the Organization and Activities of the Central Pledges Registry with the Ministry of Justice (the "Rules").<sup>46</sup>

While the key principles of the filing process are provided for in the law, the detailed regulation in this regard is contained in the Rules in a fairly low level of detail. Such exhaustive approach does not allow for any vagueness to be raised, nor does it allow for various interpretations to be made.

*c. Fees*

**Mortgage** The creation of a mortgage involves payment of:

1. A registration fee of 0.1 per cent of the secured amount payable for entering the deed into the Real Estate Registry but not less than BGN 10;<sup>47</sup> and
2. A notary fee computed as a declining percentage of the secured amount pursuant to the Tariff on Notary Fees,<sup>48</sup> which may not exceed BGN 6,000.

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45 Law on Registered Pledges, *State Gazette*, Number 100, of 21 November 2008.

46 Rules on the Organization and Activities of the Central Pledges Registry with the Ministry of Justice, *State Gazette*, Number 27, of 1 April 1997.

47 Tariff on State Fees, Collected by the Registry Agency, *State Gazette*, Number 94, of 25 November 2005, article 2.

48 *State Gazette*, Number 71, of 1 September 1992.



**Registered Pledge** State fees are collected for:

1. Filing applications;
2. Providing reference statements; and
3. Issuing certificates.<sup>49</sup>

A vital requirement for the collected fees is that they be fixed at a flat rate, without being dependent on the value of the secured interest, and be as low as possible. Consequently, filing is charged a state fee on a “per-page basis”, equal to BGN 40 for the first sheet of the filing application and BGN 10 for each page thereafter.<sup>50</sup>

*d. Public or Private Operator*

The Central Pledges Registry with the Ministry of Justice has the status of an independent public agency under the Minister of Justice, managed by a Director and having its own independent budget within the budget of the Ministry of Justice. The Minister of Justice is authorized to open local branches of the Central Pledges Registry on a needs-basis with the existing District Courts.

Under law, the Central Pledges Registry’s operation may be sub-contracted to a private operator. The Central Pledges Registry has not yet tested this provision of the law.

*e. Effect of Registry Error and Allocation of Risk of Loss*

**Mortgage** The main system is still paper-based. A digital, unified cadastral database also has been implemented, although it is still not finalized.

In the paper-based system, there is less probability of filing errors, as this is a registration system where a copy of the mortgage agreement (the notarial deed) is enclosed with the respective real estate file. Indeed, the paper form of the registry is less efficient for searches, but the possibility of clerical mistakes in the electronic version cannot be entirely dismissed due to the significant volume of paper files that had to be processed.

**Registered Pledge** If the system is exclusively electronic, there is little opportunity for filing office errors. Due to the lack of a paper archive in the Central Pledges Registry, back-up of registry information is easy, economical, and secure, while the risk of tampering and wear and tear is negligible. On the other hand, the system is built up and functions as trustworthy in respect of preventing disputes as to the exact time a registration has been made.

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49 Law on Registered Pledges, article 25, paragraph 1.

50 Tariff on the State Taxes Charged by the Central Pledges Registry, *State Gazette*, Number 28, of 4 April 1997, article 1.

If discrepancies between the information filed and the actual contents of the registry exist, the objective standing of the respective registry will be authentic. In case of damages caused by office errors committed as a result of illegal acts or omissions of registry officials, interested parties, including in particular the parties to the secured transaction, would be entitled to claim damages from the state, pursuant to the Law on the Liability of the State and Municipalities for Damages (*Zakon za otgovornostta na durzhavata i obshinite za vredi*).<sup>51</sup>

*f. Proof of Content of Database*

Registration in the Central Pledges Registry is effected pursuant to a methodology which allows proving the content of the database. First, a unique registration number for each accepted filing form is generated.

A bar-code sticker is pasted onto a special box on the form, whereby the form itself is scanned and an image file of the form is created in the system and is automatically associated with the generated filing number. Thus, the actual information contained in the Central Pledges Registry is an exact copy of what was submitted by the applicant.

*g. Compliance with International Model Laws*

Using as models the EBRD Model Law and article 9 of the UCC, the Law on Registered Pledges establishes a modern and reliable filing system for registered charges, based on the key design features of the Central Pledges Registry, such as electronic carrier, precision of timing, public access, notice filing, and low fees.

## **G. PRIORITY**

### **i. Concept of Priority and Importance**

To be efficient, a secured transactions law must provide for clear and transparent priority rules that predict the extent to which secured creditors, whether lenders, sellers, or lease grantors, may obtain the economic benefit of their security rights in preference to other creditors claiming an interest in the same property.

A creditor's certainty to this effect facilitates extending of low-cost secured credit. As already discussed above, without valid perfection no priority may be attained.

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<sup>51</sup> Law on the Liability of the State and Municipalities for Damages, *State Gazette*, Number 60, of 5 August 1988.

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**ii. Priority Rules****a. First-to-File Priority Rule**

Generally, a reliable filing system allows that priority is based on the order of filing, where preference is given to the earliest filing. Consequently, under Bulgarian law, the principle of “first recorded, first ranked” applies with respect to those security instruments subject to filing (mortgage and registered pledge).

In other words, the priority of those security interests with respect to the same encumbered property shall be determined as of the moment of their filing in the respective registry. However, the first-to-file priority rule does not apply in some cases, which will be discussed further below.

**b. Priority Based on Possession or Control**

With respect to possessory pledges, priority is alternatively established based on the date of certification of the pledge agreement.

**iii. Types of Competing Claimants****a. Statutory Priority Rules**

Under Bulgarian law, charges have different priority depending on whether foreclosure is effectuated independently by the secured creditor or it forms part of the bankruptcy procedure. In a non-bankruptcy setting, both in the event of court and out-of-court foreclosure, the claim of the secured creditor (whether the pledgee or mortgagee) with regard to the proceeds of the sale of the collateral, or its acquisition in cases of title-transfer collateral arrangements, comes forth following:

1. Claims under fiduciary title-transfer financial collateral arrangements;
2. Claims for attachment expenses and foreclosure expenses, if a third party has requested the initiation of enforcement proceedings in respect of the collateral;
3. Claims of the state for past due taxes on real estate or a vehicle when the same real estate or vehicle serves as collateral to creditors; and
4. Claims arising from preserving or improving of the pledged or mortgaged assets, to the extent a retention right is exercised over such assets by the claimant.<sup>52</sup>

It is important to note that a claim secured by a possessory pledge or financial collateral enjoys identical priorities to a claim secured by a mortgage, except

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<sup>52</sup> Law on Obligations and Contracts, article 136, items 1–4; Law on Financial Collateral Arrangements, article 11, paragraph 7.

that tax claims of the state related to real estate will be irrelevant in the case of foreclosure on a possessory pledge and, therefore, will have no priority. A claim secured by a registered pledge enjoys identical priorities to a claim secured by a mortgage or a possessory pledge.

Furthermore, pursuant to the order of preferential satisfaction under article 136 of the Law on Obligations and Contracts, state receivables do not enjoy priority over claims of secured creditors.

*b. Unsecured Creditors*

In harmony with the recommendations of the UNCITRAL Guide for an effective secured credit regime, secured creditors under Bulgarian law are entitled to be satisfied out of the proceeds of the sale of the collateral with priority over unsecured competing creditors. Unsecured creditors would be satisfied:

1. Only if there are proceeds left after the satisfaction of the creditors ranking ahead of them; and
2. *Pari passu* with other unsecured creditors.

*c. Sellers of Encumbered Assets*

A significant exception to the first-to-file priority rule is afforded to certain credit providers. If the purchase is made on credit provided by the seller or financed by a lender, where the seller or lender obtains a security right in the goods or rights acquired for securing his price receivable or extended loan, respectively, such seller or lender will have priority *vis-à-vis* other creditors with an earlier-in-time filed security right in the floating pool, part of which the goods have become.<sup>53</sup> This heightened priority is vital to promoting “purchase money financing” as an effective mechanism for providing funds necessary to acquire specific goods.

The rights of the seller having retained title until payment in full of the purchase price, as well as the rights of the lease grantor, are enforceable *vis-à-vis* the creditor with an earlier-in-time filed security right in a floating pool.<sup>54</sup> The preferential satisfaction and enforceability of rights, discussed above, will have effect only if the pledge, sale, or lease, respectively, has been filed in the Central Pledges Registry within 14 days from execution.

*d. Buyers of Encumbered Assets*

Under the Law on Registered Pledges, sales of encumbered assets or any other transactions therewith handled within the ordinary course of the grantor’s

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<sup>53</sup> Law on Registered Pledges, article 15, paragraph 1.

<sup>54</sup> Law on Registered Pledges, article 15, paragraph 2.

business shall terminate the security right that the pledgee has in the assets. In other words, the buyer will obtain the encumbered assets free of any existing charges. To protect the secured creditor, the law provides that the pledgee will have the right to security interests in the proceeds of the sale or disposal. This is actually one of the major advantages of the registered pledge as compared to other pledges.

It should be further noted that, on a sale of items forming part of a pledged floating pool, the buyer will obtain such items free of the pledge. Likewise, in cases of a multiple sale of a pledged asset, the transferee will acquire the respective asset free of any existing charges insofar as no security interest over the sold asset has been filed in the name of the seller.

By contrast, sales of encumbered assets outside the ordinary course of business of the grantor do not affect the security right that the pledgee has in the assets. In such cases, buyers will acquire rights in the pledged property subject to the pledge, and will assume the same position as the pledgor.<sup>55</sup> Consequently, on default by the grantor, the secured creditor may enforce his security right against the assets in the hands of the buyer.

*e. Judgment or Execution Creditors*

Similar to the seller with retention of title and the lease grantor, the creditor in whose favor an attachment over specific property is ordered by the public or private bailiff<sup>56</sup> will not be able to enforce its rights *vis-à-vis* the secured creditor that has subsequently acquired a registered pledge under the Law on Registered Pledges over attached assets, unless the attachment is registered in the Central Pledges Registry.

In this regard, filing of an attachment over particular assets would be most advisable in view of the reasonable protection of the creditor in whose favor attachment has been admitted against subsequent creation of a registered pledge over attached property. It is essential that claims of judgment or execution creditors do not enjoy any priority over other creditors' claims, i.e., such creditors are not considered preferential creditors.

*f. Preferential Creditors*

The Civil Procedure Code (*Grazhdanski protzesualen kodeks*)<sup>57</sup> treats the state as a preferential creditor in the meaning that it will be always deemed as

<sup>55</sup> Law on Registered Pledges, article 13.

<sup>56</sup> Pursuant to the new Law on Private Bailiffs, *State Gazette*, Number 43, of 20 May 2005, in force as of 1 September 2005, the system of public (state) executive judges has been supplemented by private bailiffs who have rights and competence equal to public bailiffs in enforcement proceedings.

<sup>57</sup> Civil Procedure Code, *State Gazette*, Number 59, of 20 July 2007, effective as of 1 March 2008.

a joined execution creditor under a commenced enforcement procedure for past due taxes and other obligations of the debtor.

In this respect, for purposes of establishing past due taxes at the time of execution of a mortgage agreement or filing a registered pledge agreement, the person granting security interest must submit before a notary public or the Central Pledges Registry, respectively, or other registry as the case may be, a certificate from the revenue authorities evidencing the lack or existence of past due public liabilities (taxes and social security payments).

The amounts of past due taxes, if any, will then be entered into the respective registry and paid with priority on foreclosure on the real estate mortgaged or assets pledged.<sup>58</sup>

*g. Insolvency Administrators*

Under the specific priority rules set out by article 722 of the Law on Commerce applicable to foreclosure as part of a bankruptcy procedure, bankruptcy costs, including the remuneration of the receiver, follow:

1. Claims under fiduciary transfer of title;
2. Claims secured by a pledge or mortgage or financial collateral; and
3. Claims with regard to which the right to retention is exercised.

**iv. Priority in Future Advances and After-Acquired Property**

*a. Future Advances*

As discussed above, a security interest under Bulgarian law may be created for securing a future debt. Consequently, future advances of a credit are afforded the priority afforded to advances made at the time the security right is first created.

*b. After-Acquired Property*

A security right also may be created in respect of future property (exclusive of the mortgage). Consequently, the priority of the creditor's claim regarding future assets will date as of the time of the initial creation of the security interest.

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<sup>58</sup> Article 218 of the Tax and Social Security Procedure Code (*Danachno-osiguriteln protzesualen kodeks*) (*State Gazette*, Number 105, of 29 December 2005), reads as follows: "The creditor secured [by a pledge or mortgage], or the creditor who has exercised the right of retention, as the case may be, may effectively oppose against satisfaction of the claim of the public claimant on grounds of written evidence bearing a valid date." The reverse of this rule leads to the effect that any secured transactions, even if registered, which have a valid date subsequent to the maturity date of the public liability claim are invalid and unenforceable *vis-à-vis* the public claimant.

c. *Priority in Proceeds*

In cases of a mortgage and possessory pledge, the secured creditor has the right to security interest in the insurance compensation or the compensation due for expropriation of mortgaged/pledged assets where the security interest in the compensation enjoys the same priority as the security interest in the actual collateral.<sup>59</sup>

Similarly, the pledgee of a registered pledge has the right to security interest in the compensation obtained in lieu of pledged assets. Moreover, as discussed above, he has the right to security interest in the proceeds from the sale or disposal of pledged assets. The security interest in the compensation or proceeds, respectively, enjoys the same priority as the security interest in the actual collateral.

Should the compensation or proceeds, respectively, be not traceable, the pledgee becomes entitled to the equivalent of received compensation or proceeds. In the latter event, however, the creditor acquires a first general priority claim over the general assets of the debtor.

Therefore, to the extent that there is compensation or proceeds of the sale, the pledgee continues to have substitution security and priority claims over such compensation or proceeds.

d. *Voluntary Alteration of Priority: Subordination Agreements*

Subordination agreements as a way of altering the priority rank are generally enforceable under Bulgarian security law inasmuch as they affect only the parties thereunder. Nevertheless, in the case of foreclosure, on drawing up the distribution plan for satisfying entitled creditors, the public or private bailiff or the receiver will not be bound to consider such subordination agreements; neither will the court if approached with objections regarding the so-implemented satisfaction.

However, since the subordination agreement constitutes a valid contractual arrangement between the parties thereto, the agreement will be enforceable against the party that has violated the respective stipulations in seeking due liability thereunder.

## **H. PRE-DEFAULT RIGHTS AND OBLIGATIONS**

### **i. Party Autonomy**

#### *a. Principle*

Bulgarian contract law and private international law is based on the principles of parties' autonomy and freedom of contract. Likewise, freedom of

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<sup>59</sup> Law on Obligations and Contracts, article 154.

contract is a basic principle governing the relationships of the parties to the security contract.

This means that to the extent contractual flexibility is allowed, the parties to a security contract may adjust the terms and conditions thereof according to their needs and wishes. Hence, they may determine their rights and obligations in a way to ultimately guarantee and protect their interests.

*b. Limitations*

There are restrictions imposed by law on party autonomy, which extend to the imperative legal provisions (mandatory rules, rising to the level of public policy) and good morals. The failure to comply with the afore-referenced statutory confines may entail the invalidity of the agreement, or a part thereof.

Nevertheless, invalidity of separate parts of the security agreement may not automatically render the entire agreement null and void. The agreement may continue to exist and have a binding effect in respect to its operative provisions or, in the alternative, the inoperative provisions may be replaced by the imperative rules of the applicable law, provided that the intention of the parties allows such “remodeling”.

**ii. Default Rules**

*a. Meaning*

The law does not set forth an exhaustive list of the rights and obligations to the parties during the lifetime of the secured transaction; rather, it provides for the most common and significant rights and obligations.

However, where such rights and obligations are mandatorily prescribed by law, these must be strictly complied with.

*b. Policy Objectives*

Similar to the policy objectives recommended by the UNCITRAL Guide in providing the scope of pre-default rights and obligations to the parties, Bulgarian secured credit law seeks to pursue reasonable allocation of responsibility for taking care of encumbered assets, preserving their pre-default value and maximizing their post-default value.

*c. Types of Default Rules*

**In General** The nature of rights and obligations of the parties during the course of a secured transaction depends on which party is in possession of encumbered assets. In this regard, while delineating the scope of pre-default rights and obligations specified by law, a distinction should be drawn between separate types of charges.



**Mortgage** By operation of law, the secured creditor is entitled to demand abstaining from actions over the mortgaged property leading to lowering the cost of the real estate. In other words, the mortgagee is entitled to require from any third party that he not deteriorate the condition of the mortgaged assets.<sup>60</sup> The right of the creditor is aimed at securing his main right to preferential satisfaction out of the mortgaged property's value.

Given the afore-referenced pre-default right of the secured creditor, it could be inferred that the most significant obligation of the mortgagor prior to commencement of foreclosure is to take care of and preserve the mortgaged property in a reasonable manner.

**Possessory Pledge** A secured creditor is entitled to hold the pledged goods where possession may be performed by either the pledgee personally or by a third party. The right to possession may be opposed to the pledgor and any third party. Should a secured creditor be dispossessed, he is entitled to claim return of the pledged asset by the person that has deprived him of possession. However, a pledgee may not enforce said right against a *bona fide* third party.

A secured creditor is not entitled to exploit the pledged asset, unless consent for such operations has been explicitly granted. A secured creditor is obligated to exercise due care with respect to the pledged goods. If the pledged property is in danger of spoiling, the creditor may request permission from the court for the goods to be sold and the proceeds thereof to be deposited in a bank as security for the creditor.

Finally, a secured creditor is entitled to reimbursement for any costs incurred with respect to pledged assets, regardless of whether they are regular or extraordinary.

However, if the pledgee is a merchant and the pledged item is perishable, the creditor may sell it, provided the item has a market or commodity exchange price, and deposit the amount with a bank as his security. The creditor must promptly notify the pledgor of the sale.

**Pledge of Accounts Receivable** In cases of a pledged account receivable under the Law on Obligations and Contracts, a secured creditor is under the obligation to perform any and all measures required to preserve it.

Furthermore, a secured creditor is obligated to collect interest payments on becoming due and payable, as well as the principal. The amount collected is to be deposited in a bank for the pledgee's security.

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<sup>60</sup> This right is not expressly provided for by law, rather could be derived from the claim for damages' compensation which the mortgagee has against the owner of the real estate who is not personally obliged. Law on Obligations and Contracts, article 177, paragraph 2. *Per argumentum, a fortiori*, this right of the secured creditor also is enforceable *vis-à-vis* the debtor.

**Registered Pledge** The Law on Registered Pledges provides for the following pre-default rights and obligations inherent to the parties under the security contract. The pledgor has the right to retain possession of the pledged property, in which case he is entitled to:

1. Use it in the course of his business according to its designation; and
2. Carry out transactions of disposal therewith, provided the pledgee's consent is obtained, where disposal is beyond the pledgor's ordinary course of business.

The pledgor having retained possession of the pledged property must preserve the pledged assets with the care of a good merchant, by way of:

1. Maintaining insurance of the pledged assets at his own expense;
2. Notifying the creditor of any damage, physical attack, or legal proceeding affecting the pledged property;
3. Notifying in writing the pledgee in case of occurrence of any third party's rights in the pledged property and furnishing the pledgee with the documents establishing such rights;
4. Informing any third parties acquiring rights in the pledged property of the rights of the pledgee; and
5. Selling the pledged property in case of potential spoiling, after giving notice to the pledgee and depositing the proceeds therefrom in a bank as security for the creditor.

A pledgor is obligated to provide the secured creditor with opportunities to examine the condition of the pledged property.

Finally, based on a certificate from the registry of a recorded security interest, a secured creditor is entitled to request, from state authorities and third parties who hold and keep records of the pledged assets, information regarding such assets that is accessible to the pledgor.

**Financial Collateral** Under a security financial collateral arrangement, a creditor is entitled to use the financial collateral, provided that it undertakes to either provide equivalent collateral on the maturity of the secured obligations or set-off the collateral with the secured obligations on their maturity date.

The right to use the financial collateral is granted as of the moment of its delivery until the satisfaction of the secured obligations or the foreclosure on the financial collateral. Under a financial collateral arrangement, the security provider has further the option to provide replacing collateral or additional collateral, in each case preserving the priority of the original security.

## **I. DEFAULT AND ENFORCEMENT**

### **i. In General**

Under Bulgarian law, there are two methods of foreclosure in a non-bankruptcy setting, as follows:

1. Court foreclosure, which is the sole method for foreclosure when the security interest is created by means of mortgage or possessory pledge; and
2. Private (out-of-court) foreclosure, which may be put in place where the security interest has been created by a registered pledge or by a commercial possessory pledge or by financial collateral.

### **ii. Key Objectives**

Bulgarian secured credit law generally follows the specific objectives for a default and enforcement procedure proposed by the UNCITRAL Guide, which are:

1. Provide clear, simple, and transparent legal rules for the enforcement of security rights following a debtor's default, and for the post-default rights, obligations, and priorities of interested parties;
2. Maximize the realization value of the encumbered assets in a manner consistent with protection of the rights of interested parties and the public;
3. Provide transactional finality on compliance with the enforcement procedure; and
4. Coordinate the enforcement rights and procedures of the security right regime with the rights and procedures for security rights in insolvency proceedings.

### **iii. Default**

#### *a. Meaning*

The term "default" is not legally defined under Bulgarian law. However, in a broad sense, default should encompass any possible form of non-performance of the due result. Default is usually provided with a definition in the security contract, which also may enlist events of default, deemed as preconditions for the secured creditor to enforce his security right. The rule is that, on failure to perform the secured debt, the creditor may proceed to enforcement against encumbered assets.

A secured creditor may seek performance ahead of the due date if the debtor has become insolvent, has reduced the security provided to the creditor, or

has failed to provide the promised security.<sup>61</sup> A specific hypothesis of debt acceleration is set out in the Law on Registered Pledges allowing the pledgee to demand performance ahead of due date in case of failure by the debtor to perform his obligations under the security contract.<sup>62</sup>

*b. Cure of Default*

It may be considered that the debtor is allowed the opportunity to “cure default” within a two-week grace period as of receiving the notice for voluntary payment by the executive judge on default in cases of court foreclosure and within two weeks as of the registration for commencement of foreclosure by the secured creditor in case of a registered pledge.

Under the Law on Financial Collateral Arrangements, there is no requirement for the provision of a cure of default period, unless the parties agree to the contrary.

*c. Notice of Default*

**Mortgage** When proceeding to foreclosure, an executive judge must send to the debtor a notice for voluntary payment within a two-week term. The notice should contain:

1. The name and address of the execution creditor;
2. A notice to the effect that, if the debtor fails to fulfill his obligation within such period, effective foreclosure actions will be launched;
3. Information about the attachments levied on the property; and
4. A copy of the execution document on grounds of which execution is sought.

**Registered Pledge** Prior to commencement of foreclosure, a secured creditor must file with the Central Pledges Registry a written statement for commencement of foreclosure.<sup>63</sup> Such statement is made based on a standard form, and it must specify:

1. The initial filing number of the pledge;
2. The part of the secured debt that is being sought;
3. A description of the pledged asset which is the target of foreclosure; and
4. The personal details of the depository.

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<sup>61</sup> Law on Obligations and Contracts, article 71.

<sup>62</sup> Law on Registered Pledges, article 11.

<sup>63</sup> In cases where the registered pledge is filed with another specific registry, as discussed above, a statement for commencement of foreclosure must be filed with the registry where the initial filing of the pledge has been made.

The pledgee also must notify the pledgor of the commenced foreclosure. The notice must be in writing and include:

1. A statement of commencement of foreclosure referring to the details of filing of the same statement with the Central Pledges Registry;
2. A description of the secured debt and the part of it which is being sought; and
3. A description of the pledged property.<sup>64</sup>

In cases of a registered pledge of accounts receivable, a secured creditor must notify the third party owing under the pledged account for commencement of foreclosure.

**Judicial or Administrative Review** A debtor may challenge the writ of execution within two weeks of it being serviced with the writ. The law does not require that the objection be grounded.<sup>65</sup>

Foreclosure is not suspended except where the order of execution is issued on grounds of a promissory note, bill of exchange, or bonds. If the debtor succeeds to substantiate his allegations by making a conclusive showing on the base of extrinsic written evidence, the court may suspend the enforcement proceedings.

Thereafter, in order for enforcement proceedings to be reinitiated, the enforcement creditor would have to take a proactive stand, being required to file a claim and obtain a final court decision confirming the existence of the secured debt (and/or security interest).

A debtor also may challenge the creditor's receivable under the writ of execution with a claim by initiating a general dispute procedure if new material facts or written evidence are found out.<sup>66</sup>

#### iv. Options after Default

##### a. *Judicial Action to Enforce the Security Right*

**Court Foreclosure** Effective foreclosure is preceded by the issuance of a writ of execution, the latter being initiated by filing of a petition or application depending on the enforceable act by the secured creditor to the competent court.<sup>67</sup> The event which may trigger the filing of such a petition is a creditor-claimed default of the debtor on performance of the secured debt.

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<sup>64</sup> Law on Registered Pledges, article 33.

<sup>65</sup> Civil Procedure Code, article 414.

<sup>66</sup> Civil Procedure Code, article 424.

<sup>67</sup> Civil Procedure Code, article 405, in relation to article 404, and article 411, in relation to article 417.

A state fee of two per cent of the amount for which enforcement is sought is collected on each application for a writ of execution. Once a writ of execution has been issued, the secured creditor is entitled to request the public or private bailiff to launch effective foreclosure activities. The new Civil Procedure Code introduced some changes in the practical steps of foreclosure carried out by the bailiff which involve the following:

1. Attachment of the debtor's relevant assets;
2. Invitation by the bailiff to the debtor for voluntary payment within a two-week grace period (in the case of a writ of immediate execution the grace period starts from the moment when the order is given to the debtor);
3. Production of a detailed description of the assets over which a security interest has been created;
4. Defining of the price for the sale of the asset by the bailiff;
5. Arrangement and conduct of a public sale of the attached real estate or movable assets at 75 per cent of the price;<sup>68</sup>
6. Reception of bids (written and oral) in case of public bid auction; if there are no purchasers, the bids are invalid, the purchaser has not paid the price, or the real estate is not assigned to the purchaser, a new auction is initiated by request of the enforcement creditor;
7. Receipt of sales proceeds by the bailiff; and
8. Drawing up of a distribution plan and payment to the entitled creditors (if the enforcement creditor is announced as a purchaser, he may make a set-off and pay the proportionate parts of the receivables of the other enforcement creditors or the remaining part of the price to the debtor within one week of the distribution).

There are no statutory term indications regarding the completion of the public auction. However, practice under the old Civil Procedure Code demonstrated that the procedure was highly inefficient and could take between several months and a few years. The major weak points of the court foreclosure were related to:

1. The length of the procedure;

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<sup>68</sup> Under the provisions of the new Civil Procedure Code, the sale of movables is to be carried out not only through a shop or commodity exchange, but also through a public bid auction or on the terms of public sale of real estates pursuant to the Civil Procedure Code. The shop is chosen by the debtor and the exchange is chosen by either the enforcement creditor or the debtor but, in each case, the written consent of the relevant shop (or commodity exchange) should be presented. The items for which the public sale should be executed under the rules of the sale of real estates are motor vehicles, ships, airborne vehicles, and items with a value of more than BGN 5,000.

2. The mandatory court valuation of the assets; and
3. The relatively high expenses.

Apart from that, almost all procedural steps had to be undertaken in the presence of the debtor who could impede the enforcement actions by avoiding service of process. In addition, the debtor also was allowed to appeal and request suspension of foreclosure in certain circumstances.

Therefore, to eliminate some of the procedural weaknesses and inefficiencies of the court enforcement, the new Civil Procedure Code introduced some changes. The possibility of the debtor to dispute the actions of the bailiff are limited and, therefore, his opportunities to suspend foreclosure. A new efficient and improved procedure of announcing and conducting the public sale also were introduced by the new law.

In the new Civil Procedure Code, the debtor (if not a merchant) still has the opportunity to reschedule his obligation by paying 30 per cent of his debt by the day preceding the day of the sale or by the moment of the delivery of the asset in the shop or exchange and committing to pay 10 per cent of the debt every month.<sup>69</sup> Should the debtor avail of such legal opportunity, the secured creditor must comply with the so-effected rescheduling irrespective of his valid, due, and payable claim.

**Out-of-Court Foreclosure** In addition to the requirements that must be met in order for the pledge to be considered as a commercial possessory pledge outlined above, a possessory pledge may be subject to out-of-court foreclosure, provided that certain requirements are met, namely:

1. The pledge contract is executed in writing with a certified date;
2. The parties have agreed on the opportunity for sale of the pledged assets without court intervention on the debtor's default; and
3. The collateral has a market or stock exchange price.

If the aforesaid prerequisites are at hand, the creditor may sell the pledged collateral and, after satisfaction from the sale proceeds, he should return to the pledgor any remaining balance thereof.

In the event of enforcement of a registered pledge, court involvement is excluded, hence, no judicial fees are payable and the whole procedure is expedited in the absence of a formal judicial procedure.

**Enforcement against Public Debtors** The Civil Procedure Code sets forth additional rules for enforcement of monetary claims against government entities, municipalities, and entities subsidized by the state budget. Pursuant to

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<sup>69</sup> Civil Procedure Code, article 454.

these rules, receivables against government entities and municipalities may not be collected by way of the general enforcement procedures but must be satisfied with funds allocated and designated in the budget of the respective entity for the purpose of satisfaction of such claims.

The amount of the debt should be paid from the credit allocated in their respective budgets. If there is no credit allocated, the higher institution should undertake all necessary actions to provide funds in the budget for repayment of the debt as soon as possible but, in any case, not later than in the next annual budget.

Pursuant to article 519 of the Civil Procedure Code, the higher institution is obliged to ensure funds for repayment of the debts. However, such a higher institution does not substitute for the public debtor in its obligation to the creditor, and the creditor does not acquire a claim against the higher institution if such institution fails to provide funds as required by article 519 of the Civil Procedure Code.

The practical result of the special enforcement regime is that past-due obligations of government entities and municipalities may not be subject to enforcement but can only be repaid voluntarily. If there is no voluntary repayment, the higher institution has an obligation to provide funds in the budget of the debtor to meet the liability.

However, there is no sanction and no right of action for the creditor against such higher institution if the latter fails to provide financial resources. Thus, a creditor secured with a pledge granted by a government entity may not foreclose on the collateral or otherwise enforce its security rights against the pledgor. This fact substantially limits the security effect of any pledge granted by public debtors.

The limitation with regard to entities subsidized by the state budget is that foreclosure with respect to such debtors may not be directed at subsidies transferred from the state budget. To the contrary, the general enforcement procedures apply in respect of mortgages, pledges, or financial collateral over assets, which qualify as private property of public entities subsidized by the budget.<sup>70</sup>

*b. Freedom of Parties to Agree to Enforcement Procedure*

The Law on Obligations and Contracts expressly provides that any agreement whereby the parties agree in advance on transfer of title over the collateral to the secured creditor, or any method for foreclosure different from the one provided for by the law, is considered null and void.<sup>71</sup>

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<sup>70</sup> Civil Procedure Code, article 520.

<sup>71</sup> Law on Obligations and Contracts, article 152.



In this regard, the collateral may only be sold (either by a public or private bailiff under court foreclosure or independently by the secured creditor under out-of-court foreclosure in cases of a registered pledge) to a third party, but title thereto may not be acquired in satisfaction of the secured debt, except in the cases of financial collateral.

However, transfer of title to the collateral in lieu of payment of the secured debt may be validly effectuated by way of a subsequent express agreement between the parties to the secured transaction. Under subsequent contractual arrangements to this effect, however, creditors will not enjoy priority rights.

*c. Acceptance of Encumbered Assets in Satisfaction of Secured Obligation*

Acceptance of encumbered assets in satisfaction of the secured obligation in favor of the mortgagee or the pledgee under court foreclosure is not possible any more after the introduction of the new Civil Procedure Code. However, the mortgagee or the pledgee may be participants in the public sale of the collateral.

*d. Redemption of Encumbered Assets*

Bulgarian secured transaction law provides for an opportunity that the grantor of a charge who is not personally obliged under the main debt or a third-party transferee of the collateral may redeem the encumbered assets by paying the outstanding secured obligation and subrogate in the creditor's rights against the debtor.<sup>72</sup> Such redemption brings the secured transaction to an end.

*e. Removing Encumbered Assets from Grantor's Control*

After filing of a statement for commencement of foreclosure with the Central Pledges Registry and notifying the debtor thereof, as discussed above, the secured creditor under the Law on Registered Pledges becomes entitled to take hold of the collateral and take such measures as he deems necessary for its preservation.

In cases of a mortgage, however, removing of the encumbered assets from the grantor's control is not allowed until the purchaser of the real estate is put in possession of the estate on the grounds of a decree for assignment issued by the bailiff.

*f. Sale or Other Disposition of Encumbered Asset*

After filing a statement for commencement of foreclosure, notifying the debtor thereof, and taking possession of the collateral, the secured creditor under the Law on Registered Pledges is finally entitled to sell the collateral by himself.

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<sup>72</sup> Law on Obligations and Contracts, article 155.

The sale of pledged assets can be effected following a two-week period as of the filing of commencement of foreclosure and must be completed within six months starting from the same date. Should the six-month term not be complied with, any other creditor who has filed a statement for commencement of foreclosure becomes entitled to sell the pledged property.

The sale is handled by the pledgee on his own behalf and for the account of the pledgor. The creditor may sell the pledged assets by way of a tender, negotiations, or any other way at his discretion. The sale must be performed subject to the following conditions:

1. The pledgee should act with the “diligence of the good merchant”;
2. The purchase price should be paid in full directly to the appointed depository; and
3. The pledgee may only sell the pledged assets to a third party rather than acquire title thereto in satisfaction of the secured debt (see text, above).

*g. Variations on General Framework*

**Specific Rules with Respect to Registered Pledges** Depending on the object of the registered pledge, certain specific requirements as to its foreclosure may be outlined.

In case of default by a pledgor, the secured creditor is entitled to sell the accounts receivable or, in case of a monetary accounts receivable, collect the latter. The monetary claim is deemed assigned for collection to the pledgee as of the moment of filing of a statement for commencement of foreclosure.

Under Bulgarian law, a pledge of materialized securities may only take the form of a possessory pledge or a financial collateral if such securities are negotiable on the capital market; enforcement of a pledge of such types of securities is carried out pursuant to the Law on Registered Pledges or the Law on Financial Collateral Arrangements, i.e., by way of an out-of-court procedure.

In case of default by a pledgor, the pledgee is entitled to transfer the security in the manner appropriate for that particular type of security. When the security is transferable by endorsement, the chain of endorsements will be deemed uninterrupted. If the security has a stock exchange price, it will be sold according to the price quoted by the stock exchange a day prior to the transfer.

As to a going concern, a pledgee must choose a manner of foreclosure, which could be either a sale of the entire going concern as a dynamic pool of rights, obligations, and factual relations, or a piece-by-piece sale.

In the case of a sale of the going concern as a dynamic pool, a pledgee is entitled to appoint a manager, thus disabling the enterprise owner from managing or disposing of enterprise assets. The manager of the going concern, entrusted with performing all actions related to its day-to-day activity, may not:

1. Transfer or encumber the going concern or any real estate assets forming part thereof, to incur obligations under bills of exchange and promissory notes; or
2. Apply for loans and initiate court action.

A pledgor may perform the actions excluded from the powers of the manager of the going concern with the consent of the pledgee. The manager of the going concern is obliged to exercise his duties in the best interest of the pledgor.

If a sale of individual assets of the going concern has been opted, the pledgee must first sell those assets, the sale of which would impede the pledgor's business to the least degree.

**Specific Rules with Respect to Financial Collateral** The Law on Financial Collateral Arrangements provides for two separate methods of satisfaction of the secured creditor, namely:

1. Execution of close-out netting; and
2. Sale or acquisition of the collateral.<sup>73</sup>

The secured creditor could execute close-out netting by means of which the obligations of the parties are set off against each other and become immediately enforceable for an amount equal to the current value after the set-off. The obligations may be terminated or substituted with an obligation for a payment of such amount of money, or they may be set off. In case of default under title-transfer collateral arrangements, the obligation of a secured creditor to transfer back the financial collateral is terminated.

The specific requirement to use the method of acquisition of the collateral is that it is possible only if the parties have agreed on in advance on the acquisition and on the evaluation of the collateral. To commence enforcement the creditor is not required (unless otherwise agreed in advance) to:

1. Make a notification for realization of security;
2. Approve of terms for enforcement by court or other third party;
3. Enforce by public auction; or
4. Foreclose within a fixed term, except where the parties have agreed to the contrary.

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<sup>73</sup> The two methods could be used jointly.

After completing of enforcement of the financial collateral, a secured creditor is required to inform the debtor and the collateral provider, at the latest on the day following the completing of enforcement, about the terminated financial obligations and their amount. A secured creditor is presumed by law to have performed the obligation to enforce his rights against the collateral with the care of the good merchant.

**Competition between Public and Private Foreclosure** Practice demonstrates that a secured creditor may want to initiate enforcement in respect of assets on which he has a mortgage or a pledge claim after the state has already initiated attachments or notice of default on the same assets for state taxes, or other public receivables due by the debtor.

Should this be the case, the secured creditor may not apply the court or out-of-court foreclosure procedure but must seek remedy within the state-initiated enforcement proceedings under the terms and conditions of the Tax and Social Security Procedure Code instead.<sup>74</sup> Such scenario might be disadvantageous to the creditor, as enforcement of his rights will depend on the efficiency and time frame of state officials' actions within the state-initiated foreclosure procedure.

The Law on Registered Pledges makes an exception, whereby the secured creditor who has initiated out-of-court foreclosure is entitled to request the possession of the pledged asset from the bailiff in a state-initiated proceedings or in court foreclosure before the public sale.

Under the Law on Registered Pledges, the secured creditor has the freedom of choice as regards the method of foreclosure, i.e., he could either apply the court or out-of-court foreclosure procedure. However, in view of the obvious benefits of the private out-of-court foreclosure provided for by the Law on Registered Pledges, it would be advisable that the secured creditor avail of the said alleviated procedure.

*h. Allocation of Proceeds of Disposition*

Under the Law on Registered Pledges, proceeds of the sale of collateral must be paid to the appointed "depository". The depository, appointed by foreclosing the pledgee, should be a natural person who has a degree in accounting. The depository has the function to collect proceeds, drawing up a list of creditors entitled to distribution proceeds, drawing up a distribution plan, and paying proceeds to entitled creditors and the balance, if any, to the pledgor.

Only creditors whose claims are secured by a registered pledge in the same collateral are entitled to participate in the distribution of the sale proceeds and

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<sup>74</sup> Tax and Social Security Procedure Code, article 191.

receive remedy therefrom. In cases of court foreclosure, the above-referenced functions of the depository are performed by a public or private bailiff.

*i. Finality*

Following disposition of the encumbered assets, the creditor's security interest in the collateral terminates. Likewise, the grantor's rights in the encumbered assets terminate. It is essential that, under court foreclosure carried out pursuant to the Civil Procedure Code, on sale of encumbered assets a transfer of title thereof is effected in favor of the purchaser. Such transfer of title is made based on a decree for assignment of sold assets issued by the bailiff.

However, should the sold assets serving as collateral have not belonged to the security grantor, the following rules with respect to *bona fide* third parties will apply. The buyer of a movable asset will become the owner thereof regardless of whether it belonged to the pledgor. In turn, the previous owner is entitled to receive the price of the asset if it has not yet been paid and, if paid, to demand from the creditors and the debtor the amount that has been accordingly allocated to them under the distribution plan.

On the other hand, if, by the *res judicata* court decision, it has been confirmed that the debtor did not have title to the sold real estate serving as collateral, the buyer of such real estate asset will not acquire title and has the right to demand the price paid by him if it has not yet been paid to the creditors and, if paid, to demand from each of them and from the debtor the amount received by each of them.

**v. Judicial Proceedings Brought by Other Creditors**

Bulgarian secured transactions law is coordinated with the civil procedural law in respect of providing other secured creditors with protective opportunities as to their security rights.

Thus, both in a court and out-of-court foreclosure, any creditor may challenge other competing creditors' rights in the collateral or, in the proceeds thereof, by initiating court actions, or otherwise protect their interests pursuant to the means provided by the Civil Procedure Code.

In addition, *bona fide* third parties, whether transferees or previous owners of sold assets, are provided with protective mechanisms with respect to their rights, as discussed above.

**vi. Compliance with International Model Laws**

In contrast to the recommendations of the international model laws on secured transactions, enforcement rules under Bulgarian secured credit law are not unified for all security devices.

Instead, both traditional and more innovative methods of foreclosure are applicable depending on the type of security right being enforced. The advantages of the private enforcement proceedings under a registered pledge are obvious, these being:

1. Straightforward procedure;
2. Elimination of court involvement, except where requested by foreclosing creditors;
3. Availability of the court to ensure recognition of legitimate claims of the debtor and other interested parties with rights in the encumbered assets;
4. Evaluation of sold property is avoided; and
5. Reduced costs of the procedure.

## **J.       INSOLVENCY**

### **i.        In General**

Bulgarian law has distinct rules governing secured transactions and bankruptcy. However, both legal frameworks should be coordinated in regulating enforcement of security rights and seek the same primary objectives.

The regulatory framework with regard to bankruptcy proceedings is set out in the Law on Commerce. Bankruptcy is a universal foreclosure procedure aimed at satisfaction of all of a debtor's creditors, whether creditors under commercial transactions, public liabilities, or employment relationships. The grounds for initiating bankruptcy proceedings are:

1. Insolvency, representing inability of the debtor to pay his debts as they become due; and
2. Over-indebtedness, in the sense that the debtor's assets are insufficient to cover his liabilities.

The procedure could develop as one aimed directly at liquidation of the commercial business of the debtor and the subsequent cashing-in of his assets, or could involve a reorganization plan designed to maximize the value of assets by saving the debtor's business.

### **ii.       Key Objectives**

In line with UNCITRAL recommendations, Bulgarian bankruptcy law is aimed at facilitating enforcement, minimizing the risk for secured creditors with respect to their enforcement rights, establishing clear priority rules, and recognizing the validity of security rights in the bankruptcy proceedings.

### iii. Security Rights in Insolvency Proceedings

#### a. *Inclusion of Encumbered Assets in Insolvency Estate*

Under Bulgarian law, the bankruptcy estate comprises:

1. Property rights of the debtor as of the date of the court decision for institution of bankruptcy proceedings; and
2. Property rights of the debtor acquired after such date.<sup>75</sup>

In this regard, a debtor's encumbered assets are normally included in the bankruptcy estate with certain limitations with respect to those which are encumbered with a registered pledge under the Law on Registered Pledges.

#### b. *Limitations on Enforcement of Security Rights*

A debtor's bankruptcy causes the suspension of all pending enforcement procedures against assets included in the bankruptcy estate. Only mortgagees and pledgees may request from the court a permission to continue foreclosure actions, provided that sale of mortgaged/pledged property has commenced and there is a danger of impairing the foreclosing creditor's interest.

Should the conditions not be met, a mortgagee/the pledgee would be bound by the pace of bankruptcy proceedings and would have to wait for the general liquidation of the estate, which would normally take place a long time after the commencement of bankruptcy.

This rule, however, does not apply to the enforcement of a registered pledge initiated under the Law on Registered Pledges prior to the bankruptcy procedure. Once the pledge has been created in compliance with the Law on Registered Pledges, the respective collateral may not be disposed of by the receiver.<sup>76</sup>

Even if foreclosure of a registered pledge under the Law on Registered Pledges has not yet been initiated, the receiver is under the obligation to search the bankrupt's files in the Central Pledges Registry and identify possible creditors with registered security interests.

The receiver is then required to transfer possession of the collateral to the entitled secured creditors for the purpose of carrying out the foreclosure procedure pursuant to the Law on Registered Pledges separately and independently from the parallel bankruptcy procedure.<sup>77</sup> Any balance remaining after satisfaction of such claims is paid by the depository into the bankruptcy estate.

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<sup>75</sup> Law on Commerce, article 614.

<sup>76</sup> Law on Registered Pledges, article 43.

<sup>77</sup> Law on Registered Pledges, article 43, paragraph 2.

c. *Participation of Secured Creditors in Insolvency Proceedings*

In bankruptcy proceedings, secured creditors have all rights they are entitled to outside bankruptcy and have all rights available to creditors in general. Moreover, the Law on Commerce provides for the compulsory involvement of representatives of the secured creditors in the creditors' committee for the purpose of effective protection of their interests.

The creditors' committee is entrusted with assistance and supervision of the receiver's activity regarding administration of the debtor's assets. Furthermore, secured creditors are entitled to claim their receivables for the purpose of their inclusion in the receiver's list of creditors with recognized claims, as well as among the parties eligible to propose a reorganization plan.

d. *Validity of Security Rights and Avoidance Actions*

**Avoidance Actions under Bankruptcy Regime** It is a basic rule under Bulgarian bankruptcy law that secured creditors retain within the bankruptcy proceedings their security interests created outside bankruptcy.

Under the Law on Commerce, creation of a pledge or mortgage in respect of a right or an object of the estate will be null and void in respect of the creditors of the estate if effectuated after the date of the decision for commencement of bankruptcy proceedings ("first court decision") in violation of the established procedural order.<sup>78</sup>

Similarly, creation of a pledge, mortgage, or other security interest in a property right of the estate will be null and void with regard to the creditors if entered into by the debtor after the initial date of "insolvency" or "over-indebtedness".<sup>79</sup>

In addition, the receiver (or, due to his inactivity, each of the creditors of the estate) is entitled, within a year from the bankruptcy institution, to file a claim for declaring invalid, with respect to the creditors of the estate:

1. Creation of a mortgage, pledge, or another security interest in favor of a receivable not secured until that time, effected within a year prior to the institution of bankruptcy proceedings; and
2. Creation of a mortgage, pledge, or another security interest in favor of a partner's or shareholder's receivable not secured until that time, effected within two years prior to the institution of bankruptcy proceedings.<sup>80</sup>

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78 Law on Commerce, article 646, paragraph 1.

79 Law on Commerce, article 646, paragraph 2.

80 Law on Commerce, article 647, in relation to article 649, paragraph 1.



It is essential that a security right which is validly established under the secured transactions regime may be invalidated in such circumstances on entirely objective grounds. There is no protection for *bona fide* third parties.

### **Invalidity of Certain Actions under the Law on Obligations and Contracts**

Under Bulgarian law, any of the debtor's creditors may seek a court decision to set aside any of the debtor's contracts (including a security transaction) if such creditor may prove that:

1. The challenged contract adversely affects the creditor's rights by way of reducing the total amount or value of the assets of the debtor;
2. The debtor knew, or ought to have known, about the adverse effect of the particular security agreement on the interests of the creditor; and
3. In respect to transactions concluded for a consideration that the co-contractor of the debtor also has known, or ought to have known, about the adverse effect of the transaction on the legitimate interest of the creditor.

The above-referenced claim may be exercised by the creditor within five years after the execution of the respective agreement. The effect of the court judgment consists in that the challenged contract is declared null and void *vis-à-vis* the creditor.

In other words, the assets that have dropped out of the debtor's property as a result of the agreement's execution will be reinstated therein but only with respect to the challenging creditor. As a whole, the right of a creditor to challenge an agreement entered into by his debtor is extremely burdensome for the creditor, having in mind the above-mentioned points he must prove.

**Invalidity of Certain Transactions under the Tax and Social Security Procedure Code** Pursuant to article 216 of the Tax and Social Security Procedure Code, certain gratuitous transactions, including creation of security over an asset of the debtor,<sup>81</sup> may be declared invalid in respect to a public claimant (the state or a municipality) if concluded after the initial date of the public liability claim, or after an order for audit assignment has been served, if the audit has resulted in establishment of public liability. For the purpose, the respective public authority competent to pursue enforcement of the respective

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81 Such transactions include (a) gratuitous transactions, (b) transactions where the value of the debtor's obligation considerably exceeds the consideration promised in return, (c) in-kind contributions, (d) transactions or actions aiming at harming the interests of the public claimant, (e) *dation in solutum* in respect of monetary claims if repossession of title would increase the funds which would be used for distribution among and satisfaction of the claims of the creditors, and (f) transactions concluded with the intention to harm the public claimant, a party related to the debtor.

public claim should initiate an action before a court of law and obtain a final court decision honoring his claim.

Notwithstanding the above, the relevant public authority also may avail itself of the rights accorded under Bulgarian civil law and pursue a negatory claim under the Law on Obligations and Contracts.

However, in such proceedings, the public authority has a privileged position (unlike ordinary private creditors), as a rebuttable presumption will be in effect in respect to the awareness of the debtor's co-contractor of the adverse effect of the transaction on the legitimate interest of the creditor when the debtor and the co-contractor are related parties.

**Validity of Certain Actions under the Law on Financial Collateral Arrangements** Pursuant to the Law on Financial Collateral Arrangements, a financial collateral is not considered null and void, voidable, and may not be terminated or unwound solely because the financial collateral is executed:

1. Within the suspicious or hardening periods before commencement of the insolvency proceedings;
2. In the same day of commencement of the insolvency proceedings, but before the issuance of an order for their commencement; or
3. In the same day of commencement of the insolvency proceedings, but after the issuance of an order for their initiation if the collateral taker proves that it has acted in good faith.

In addition, the following events will not be deemed as grounds for invalidity, voidability, revocation, or termination of a financial collateral agreement:

1. Granting or replacement, effected on the day of initiation of insolvency proceedings, but before the issuance of an order for initiation thereof;
2. Granting or replacement, effected in a statutorily prescribed term before initiation of the insolvency proceedings; or
3. Undertaking of financial obligations before the date of granting of financial collateral, of additional collateral, or the replacement of the financial collateral.

*e. Relative Priority of Security Rights*

In foreclosure as part of a bankruptcy procedure, claims secured by a mortgage or any kind of pledge enjoy absolute first priority before:

1. Claims for which the right to retention is exercised; and
2. Bankruptcy expenses.

Such claims are satisfied out of the proceeds from sale of the respective collateral. Nevertheless, the rights of a secured creditor are not limited to the proceeds of

the sale of the respective collateral and, for the uncovered balance of its claims, a creditor may participate in the distribution of other assets forming part of the bankruptcy estate along with unsecured creditors.

The only exception to this rule is that, in foreclosure as part of insolvency procedure claims secured by a title-transfer, collateral arrangements have absolute first priority even before claims secured by a mortgage or any kind of pledge.

*f. Security Rights in Reorganization Proceedings*

A formal corporate rescue process is available within the bankruptcy procedure, which is carried out under the supervision of and with the assistance of the court. The rescue process includes the preparation and execution of a reorganization plan, which may provide for the restructuring of the debtor's enterprise or the transfer of all or part of the debtor's assets.

The most significant effect of the confirmed reorganization plan is the termination of the bankruptcy procedure. The procedure, however, could be resumed if the debtor fails to perform his obligations thereunder. The plan is mandatory for the debtor and the creditors whose claims have arisen prior to the first court decision.

However, the plan does not have effect on third parties that have granted a mortgage or pledge for securing obligations of the debtor. Secured creditors will retain security rights under a reorganization plan unless such rights have been accordingly restructured thereunder.

## **K. CONFLICT OF LAWS AND TERRITORIAL APPLICATION**

### **i. In General**

Bulgarian secured transactions law does not contain specific conflict-of-laws rules regarding the creation, validity, and enforceability of security interests under international secured transactions.

However, the Private International Law Code<sup>82</sup> introduces the general conflict-of-laws framework which also is applicable to international security contracts.

### **ii. Choice of Foreign Law**

The choice of foreign law is valid and enforceable under Bulgarian law. Moreover, having separate parts of a contract be subjected to different national legal

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82 Private International Law Code, *State Gazette*, Number 42, of 17 May 2005.

systems (i.e., *dépeçage*) is permitted. However, under Bulgarian law, the application of the contractual choice of law is subject to several restrictions.

The choice of law will not apply to relations which are governed by mandatory norms of Bulgarian law.<sup>83</sup> Regardless of the contractual choice of law, Bulgarian courts may apply mandatory provisions of the law of another state with which the contract has a close connection. In particular, party autonomy may not derogate the mandatory rules of the law of the state with which all elements of the contract were connected as of the moment of choosing the applicable law.

To decide whether foreign mandatory rules should be applied, the court of proper jurisdiction should consider the nature and subject matter thereof, as well as the consequences of their implementation or failure to implement.

### **iii. Conflict-of-Laws Rules for Creation, Publicity, and Enforcement**

Pursuant to Bulgarian conflict-of-laws rules, the proper law of contract (with or failing parties' choice thereof) will govern:

1. Interpretation of the contractual provisions;
2. Performance;
3. Consequences of material or partial breach of obligations;
4. Extent of damages;
5. Grounds for termination;
6. Validity and enforceability;
7. Statute of limitations; and
8. Preclusion periods.

When a foreign law has been chosen by the parties to a security contract, it is recommended that the respective security interest granted by a Bulgarian grantor be perfected pursuant to Bulgarian law so that it is enforceable *vis-à-vis* third parties.

Thus, in the cases of registered pledge, in order for the parties to be able to enjoy the alleviated enforcement procedure under the Law on Registered Pledges, it is necessary that the “perfection” and “enforcement” provisions of the respective pledge agreement be governed by Bulgarian law.

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83 A particular example of mandatory rules of Bulgarian law can be found in provisions restricting limitation of liability, prescribing minimal standards of consumer protection, and regulating bankruptcy proceedings, foreclosure order, and perfection of security interests.