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IMPROVING THE POSITION OF SECURED CREDITORS UNDER REGISTERED PLEDGES IN BULGARIA

Almost two decades after being adopted following the model of the World Bank and UNCITRAL for non-possessory registered pledges, the Special Pledges Act (the "***Act***") was substantially amended at the end of 2016. Most of the amendments take immediate effect while those concerning the digitalization of the Central Register of Special Pledges (the "***Register***") will come into force on 1 September 2018.

OVERCOLLATERALIZATION

The effectiveness of the non-possessory pledges was questioned due to certain ambiguities in the Act and their diverse interpretation by the courts. The creditors thus preferred using this security instrument mainly in combination with the traditional mortgage where cohesive and unified case law exists. This practice undermined the otherwise flexible and inexpensive security which should suit well both vanilla financings and more complex structures. It further led to overcollateralization and tied up assets that can be better used in the operations of the debtor.

FILLING THE GAPS

As we highlight below, the amendments to the Act fill in some of the existing gaps, although few of the problematic points remain unresolved:

1. STRENGTHENING THE SUBORDINATION RELATIONS

The creation of any lower ranking pledge can from now on only be made with the explicit consent of the senior ranking pledgee(s). As the previous regime did not expressly address the second ranking security, and as the Register was exercised inconsistently, the refinancing and leverage finance structures were extensively and protractedly negotiated.

However, where a transfer of ownership over the collateral takes place in breach of the consent requirements, any further third party which has acquired the collateral in good faith may question the opposability of the pledge. Thus, the changes in the Act will not ensure the broad protection they are expected to give, but leave room for abusive behavior.

2. IMPROVING THE ENFORCEMENT PROCEEDINGS

2.1. Limitation of enforcement rights of junior creditors

Until now, any secured creditor, regardless of its ranking, was allowed to initiate and carry-out enforcement proceedings. Although the rights of the first ranking, non-selling creditor should not be affected pursuant to the law (as it should have been satisfied with priority out of the selling proceeds), in practice its privilege was undermined. The selling, junior ranking creditor was able to define the sale price and decrease the total amount for distribution between the creditors. Pursuant to the amendments, junior ranking pledgees are restricted from initiating enforcement before obtaining the consent of all senior ranking pledgees.

2.2. Conflicting proceedings

Where a third party has started any enforcement procedures over a collateral, the pledgee shall be considered by virtue of law a "joining creditor" ("присъеднинен взискател") to each and every enforcement procedure, while previously there was uncertainty and the creditors should have closely monitor other creditors' moves. Priority is given to the enforcement proceedings which were started first. After joining, the pledgee should seek satisfaction within the procedure opened by another creditor and it is not able to enforce separately, what was the case before.

2.3. Competing with insolvency creditors

This might be problematic for a pledgee when competing with insolvency creditors as it is loosing its leading position in the assets liquidation which would be controlled by the insolvency claimants. However, in an insolvency threaten scenario a pledgee would now have a window to initiate enforcement under the Act in the interim period after a petition for the opening of insolvency proceedings has been filed and prior to the decision of the insolvency court for the opening of the insolvency proceedings.

3. SPECIAL MANAGER'S ROLE

The debtors often hindered in the past the special manager appointed by a pledgee as the Act was not précised as to whether he depowers the existing managers. The loopholes are now fasten giving priority to the special manager and broader entitlement to the pledgee for access to the pledged assets. The special manager is further able to sell non-core assets of the debtor (i.e. such which are not material for the company to pursue its business) with the consent of the pledgee. The remaining security interests over the collateral will remain in force. It is arguable whether this option protects sufficiently the creditors as it may lead to transfers of high value assets to third parties at a low price.

4. HIGHER PUBLICITY

The entering into force of the pledge is now linked to its recording within the relevant register, administrating the respective assets. Complied with the digitalization of the Register, which is scheduled for 1 September 2018, the creation and subsequent amendments to the pledges will be publicly accessible via web based platform. Similar migration was successfully completed for the companies' files and the real estate batches, administrated by the Registry Agency. Therefore the Register will be moved within the competence of the same agency.
The Register will include additional information such as the pledge agreement, all relevant consents and also the sale notice in case of enforcement which has been regulated in detail and should include extensive information concerning the minimum price, the sale details and the collateral. Moreover, the sale notice shall be published in a special bulletin of the Ministry of Economics at least 14 days prior to the sale date.

5. HIGHER SECURITY VS. ADMINISTRATIVE HURDLES AND HIGHER COSTS

The Act has resolved a number of open questions by introducing new requirements involving the creditors' consent, which shall be granted with notarised signatures. While offering higher security for the creditors, the above requirements would involve additional notarisations and approvals of the officers of the (relevant) register, which would increase the transaction costs and would involve additional administrative steps. This would constitute a considerable change in case of syndicated loans and other more complex transaction involving a number of lenders.

The Act also introduces a clearer regulation of the liability of the enforcement depositary and the special manager (i.e. appointed in case of enforcement of a going concern pledge). Such parties are also required to obtain and maintain liability insurance.

6. PERFECTION FORMALITIES

Each element of the going concern of the pledgor will be considered to be pledged, if the pledge has been registered with the register responsible for the individual assets. There is currently no explicit requirement for including a detailed list of assets to ensure enforceability and opposability of the pledge, what was the case before. However, the practical application of such solution may raise some additional enforcement issues.

In addition, the pledge over real estates (as part of the going-concern of the pledgor), unless otherwise agreed between the parties, will also include the attachments and improvements without needing to derive this conclusion by way of interpretation of the *rights in rem* regime.

IMPLEMENTATION

New procedural rules in relation to the registration process will be adopted by 30th of March. All pledges registered before the current amendments, will remain in force. The

registration procedures initiated before 1 September 2018 will be completed under the existing rules.

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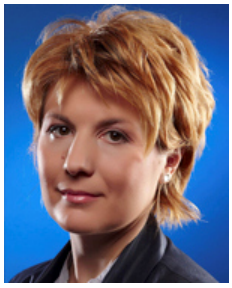

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