

**Deloitte &
Touche**



A

***Bulgaria: The Legal Framework
for Privatization***

Delivery Order No. 20
Bulgaria Electronics Privatization

Project No. 180-0014
Contract No. EUR-0014-I-00-1056-00
Eastern European Enterprise Restructuring
and Privatization Project

U.S. Agency for International Development
EUR/RME

April 1993

Deloitte & Touche



B

Suite 350N
1001 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-2594

Telephone: (202) 879-5600
Facsimile: (202) 879-5309

May 3, 1993

Gary Maher
EUR/RME/ER
Agency for International Development
320 21st St., N.W.
Washington, D.C. 20523

Re: Contract No. EUR-0014-I-00-1056-00, Delivery Order No. 20, Bulgaria
Electronics Privatization - Phase I Deliverables

Dear Mr. Maher:

In accordance with Article IV of the referenced delivery order, enclosed please find the deliverables for Phase I of this project. They represent deliverables A, B, and C for Phase I as stipulated in Section V of Attachment 1 to the delivery order.

These deliverables were prepared by the Deloitte & Touche team working in Sofia, Bulgaria. If you have any questions concerning these deliverables, please call Anne Nisenson at (202) 879-5661. Thank you.

Sincerely,

Kathleen J. Machen

Kathleen J. Machen
Operations Manager

Enclosures

TABLE OF CONTENTS

Page

INTRODUCTION	1
1. PRIVATIZATION LAW IN BULGARIA	1
1.1. Enabling Law	1
1.2. Privatization Organs	2
1.4. Privatization Program	3
1.5. Privatization Methods	4
1.6. Possible Privatization Methods for Bulgaria's Electronics Industry	7
1.6.1. Sale of a Company	7
1.6.2. Sale of Assets of a State or Municipal Enterprises	7
1.6.3. New Private Investment (Joint Venture)	8
1.6.4. Public Offering of Shares	8
1.7. Valuation of Companies	9
1.8. Preferences	10
1.9. Restitution and Compensation of Former Owners	11
2. REGULATIONS GOVERNING FOREIGN OWNERSHIP	13
2.1. General Provisions	13
2.2. Licensing and Registration	14
2.3. Ownership Rights	15

D

Page

2.4.	Labor and Social Security Relations	17
2.5.	Protection of Foreign Investment	17
3.	LAWS RELEVANT TO PRIVATIZATION OF BULGARIA'S ELECTRONICS INDUSTRY	19
3.1.	Law on Commerce	19
3.2.	Contract Law	21
3.3.	Bankruptcy Law	21
3.4.	Taxation	22
3.5.	Banking Law	25
3.6.	Competition Law	27
3.7.	Securities Law	28
3.8.	Law on Accounting	29
3.9.	Export Controls	29
3.10.	Immigration Law Affecting Business	31
3.11.	Environmental Law	32
	CONCLUSION	32
	ANNEX I	33

LEGAL FRAMEWORK OF PRIVATIZATION IN BULGARIA

INTRODUCTION

1. PRIVATIZATION LAW IN BULGARIA

The passage of the Law on Conversion and Privatization of State and Municipal Enterprises ("LCP") adopted on April 23, 1992 became the centerpiece of the economic reform in Bulgaria. Together with the new Constitution, the laws on foreign investment, restitution, and a number of important legislative acts already passed in relevant legal areas, it defines the core of the legal framework of privatization in Bulgaria.¹

1.1. Enabling Law

Bulgaria's privatization law regulates two different processes that are crucial to introducing market mechanisms to the Bulgarian economy: (i) converting state enterprises to normal corporate forms; and (ii) selling the resulting state or municipally owned corporations to private investors (article 1). Although conversion is mentioned first, the real emphasis of the LCP is on privatization. The LCP is not the only legislative act to regulate privatization, however, and is limited mainly to industrial, commercial construction and transportation companies.

¹ For a complete listing of the most important laws and regulation pertaining to privatization see Appendix I.

1.2. Privatization Organs

Articles 3 and 4 of the LCP define the authorities competent to make privatization decisions. Depending on the book value of fixed assets of an enterprise, the decision for privatization must be adopted by either the relevant Ministry (for enterprises within their domain if the book value of fixed assets does not exceed 10 million leva), by the privatization Agency (if the book value of fixed assets exceeds 10 million leva) or by the Privatization Agency with the approval of the Council of Ministers Council (for enterprises with book value of fixed assets not less than 200 million leva).

With regard to municipal companies, regardless of size, the only authority competent to make privatization decisions is the local municipal council.

Proposals for privatization may be issued either by the management of an enterprise, a majority of the workers or employees of an enterprise, or by the Privatization Agency.

The Privatization Agency is a state authority within the Council of Ministers, financed from the budget. It is in charge of overseeing the whole privatization process and conducting the sales of individual companies. The managing bodies are the Supervisory board, which is in charge of establishing policy, and the Executive Director, managing the day-to-day activities (Chapter Two, articles 10-15).

The Agency has two sectoral divisions. The first, Division of Programs and Methods of Privatization, consists of departments dealing with the licensing of property appraisers; methods of privatization; analysis, prognosis and programs of privatization;

and information services. The second is the Division of the Organization of the Privatization Process, which consists of departments dealing with financing and privatization transactions. It is envisaged that regional offices will be set up in major cities in the country.

In summary, the executive branch of government is in charge of privatization, although Parliamentary control is guaranteed through the appointment of six of the eleven members of the Supervisory Board of the Privatization Agency by the National Assembly, while the five other members are appointed by the Council of Ministers.

1.4. Privatization Program

Privatization in Bulgaria is to be carried on according to an annual program developed by the Privatization Agency. Following approval from the Council of Ministers the program is submitted by the government to the National Assembly, which must discuss and adopt it together with the Law on State Budget (article 2).

The privatization program should include: the minimum privatization goals for the year, the expected amount of revenue from privatization, the expenses resulting from privatization, a list of sectors of industry and/or enterprises which cannot be wholly or partially privatized under the terms of the current program, and general guidelines for the privatization policy of municipalities (article 2(2)).

The 1992 privatization program of the Privatization Agency encompassed 56 enterprises. Five enterprises were proposed by the Agency, while the rest were proposed by the sectoral Ministries. However, the privatization of none of these

enterprises has yet been achieved, although appraisers have already been assigned to some of these enterprises.

The first full annual privatization program, for 1993, has been adopted by the Council of Ministers. The Program targets the following sectors: electronics, machine-building, food, textile and clothing, cosmetics, retail trade, services, tourism, construction and public transport. The 1993 Program aims to privatize at least 300 companies. Net receipts are forecast at three billion leva (US\$ 120 million). A number of industries are specifically excluded from the program, these include: military equipment, oil refining, electricity generation, mining, nuclear power and railways.

1.5. Privatization Methods

The LCP provides for two different methods of privatization, applicable respectively to the sale of interest or shares of state enterprises converted into commercial companies (Chapter Five, articles 19-29), or to the sale of state or municipal enterprises, or autonomous parts thereof, prior to their conversion into commercial companies (Chapter Six, articles 30-34).

Article 25 allows almost all generally accepted privatization methods, with the exception of the voucher method used in some other Eastern European countries. The law adopts a market oriented approach, calling for maximum transparency and equal opportunity for all participants.

The following methods may be used:

- a) public offering of shares;
- b) public auctions of blocks of shares;
- c) public tenders; and
- d) negotiated sales.

The sale of shares or interest in companies should be completed within five years after the registration of the commercial company (article 19(1)). The sale can be carried on according to only one or a mix of the above methods, and it can be completed in one or several stages (article 26(1)).

Moreover, the sale of shares may be accompanied by an increase in capital through issuance of new shares (article 26(2)). This allows the dilution of the government's equity position through the input of capital from the private sector, resulting in a joint private-government ownership.

In addition, article 29(3) provides that the Privatization Agency shall have the authority to allow debt for equity swaps. Although this provision is welcome, such complex transactions obviously can not be regulated by a single paragraph and implementing regulations will be needed. Besides, this method might be applied only after the conclusion of the negotiations between the Bulgarian government and the London Club creditors.

Chapter Six of the LCP applies to the sale of enterprises that have not been converted into commercial companies with a book value of fixed assets not exceeding 10 million leva (i.e. it applies to the so called "small privatization").

According to article 34 the ownership of such enterprises can be transferred by:

- a) leasing for a term not exceeding 25 years with a purchase option;
- b) a management contract with a purchase option;
- c) a sale on credit with retention of title;
- d) a sale subject to conditions such as continuing the operation of the enterprise, maintaining the number of employees, investment at specified levels, attainment of certain business targets, and the like.

With regard to auctions, Council of Ministers Decree No. 105 introduced a Regulation on Auctions.² An auction may be held between 30 and 60 days after publication of the announcement (article 6(1)). If there is only one bidder, he is entitled to buy at the initially set price, but only at a second auction held at least 15 and not more than 30 days after the first (article 6 (2) and (3)). Foreign investors may freely participate in auctions. However, in order to participate in an auction that includes immovable property foreign persons must have already registered or filed an application to register a commercial company in Bulgaria under the Law on Commerce.

Finally, it should be noted that state-owned enterprises are excluded from buying privatized property. A legal person with majority state ownership may participate as a buyer in the privatization process without prior permission from the Privatization Agency or the appropriate municipal council (article 5).

² State Gazette No. 50, June 19, 1992, at 7.

1.6. Possible Privatization Methods for Bulgaria's Electronics Industry

1.6.1. Sale of a Company

The most straightforward way to privatize an Electronics Company would be to sell the company to a pre-identified single purchaser or group of purchasers. This is currently the method most favored by the Privatization Agency. There are two ways to achieve this goal: either by prequalification of bidders, or through direct negotiations with ad hoc procedures for identifying potential buyers. Under this method the level of participation that may be required by investors is likely to be in excess of 50 per cent as they will probably require a controlling interest. In some cases, a partial private sale may be followed by full privatization, with the remainder of the shares being sold to the public.

1.6.2. Sale of Assets of a State or Municipal Enterprises

Many state owned enterprises in the electronics industry are not likely to be sold as a going concern. In these cases the sale of assets is the preferred, if not the only option. This method can be based on open competitive bidding, it can be carried out by auction or may be concluded after direct negotiations and sale to a pre-identified interested party. In this sense the advantages and results may be similar to the direct sale of shares described above.

On the other hand, however, this approach may result in residual liabilities for the government. If the products and the assets of an enterprise are of interest to a desirable buyer, the government may decide to dismantle the enterprise and liquidate it

by selling its assets and writing off its liabilities. The entity can then emerge as a private sector company. The lack of Bankruptcy Law, however, may create certain difficulties in using this method.

1.6.3. New Private Investment (Joint Venture)

This technique, although not specifically mentioned, is implied in article 26(2). Moreover, there are legal precedents to form joint-ventures, provided the Ministry of Industry is in agreement. In view of the funding problems of under-capitalized state or municipally owned enterprises in the Bulgarian electronics industry this may provide a convenient method to inject working capital and/or expand operations, where a sale of the whole enterprise may not be possible.

New private investment may be attracted through a primary issue of one or various classes of shares and may be handled in conjunction with the disposal of existing government shares. In general, this may be the preferred method where the government seeks to reduce its proportionate shareholding and where the enterprise is in need of capital.

1.6.4. Public Offering of Shares

Although selling shares to the public is one of the most widely used methods of privatization it is not considered a likely method for firms in the electronics industry. Several factors mitigate against it:

- a) the lack of a Law on Securities;

- b) high inflation;
- c) low level of public savings;
- d) unstable government and other political factors;
- e) absence of a reliable information and reporting system to provide data about company performance;
- f) absence of regulations on purchase and sale of shares.

This method, however, may be used in conjunction with some of the methods discussed above, especially in the case of a successful partial privatization of a company.

1.7. Valuation of Companies

Article 16(1) provides that all enterprises subject to privatization with an estimated value of more than 10 million leva should be appraised by independent Bulgarian or foreign experts or firms licensed by the Privatization Agency. In addition, article 16(2) requires the Council of Ministers to establish procedures and criteria for these appraisals.

Accordingly, the Council of Ministers has issued a Regulation on the Appraisal of Enterprises Subject to Privatization, the main points of which are:

a) an appraisal can be commissioned only after a decision for privatization is adopted;

b) an appraisal consists of a legal analysis of the property of the enterprise, and an economic appraisal of its assets;

c) some methods of appraisal are listed in the regulation but the use of additional methods "following world practice" is encouraged.

d) appraisal licenses are issued for specific branches of the economy, for definite or indefinite periods, and may be revoked for cause. The appraisers can not acquire interests or shares in privatized enterprises.

e) appraisers are to be selected by tender issued by the authority designated by article 3 of the LCP.

In general, Bulgarian accounting methods and practice before 1991 differed significantly from international standards, and Western accounting methods are only slowly being implemented. Therefore one of the concerns of the Privatization Agency is that a shortage of qualified appraisers may slow down the privatization process.

1.8. Preferences

The LCP has two provisions which give employees preferential terms when they wish to buy shares from converted enterprises or whole enterprises and autonomous parts thereof (articles 22 and 31). The difference is that in the first case the discount can be up to 50 per cent off the price, while in the second case the discount can be no more than thirty per cent of the final auction or tender price. In both cases, however, the total amount of the discount cannot exceed the limits specified in article 22. These limits are the following:

a) employees may buy on preferential terms up to 20 per cent of the shares;

b) the amount of discount for an individual may not exceed the value of one years salary;

c) the right to buy shares on preferential terms must be exercised within three months;

d) the shares sold on preferential terms shall be non-voting for a period of three years.

In the context of low salaries, limited savings, and rapid inflation, the narrow scope of preferential terms accorded to employees suggests that it is unlikely that they will have more than a limited effect in Bulgaria. The only likely competition in these sales will come from foreign investors and those few Bulgarians with substantial capital.

In addition article 8 provides that 20 per cent of the shares and interests of privatized enterprises, or their cash equivalent, must be pooled into a Mutual Fund, to be established by the Council of Ministers. In practical terms this means that the purchaser can not buy more than 80 per cent of the shares unless advance authorization is received to contribute money.

1.9. Restitution and Compensation of Former Owners

Article 18 provides for compensation of former owners of property nationalized between 1946 and 1962 when this property still exists and is part of the fixed assets of a privatized company. The approach is to allow such owners to acquire interests or shares in the converted company corresponding to their ownership rights. In practice this may substantially limit the assets available to be sold to the public.

In addition to article 18, a set of laws has been adopted to regulate the restitution of confiscated and nationalized property.³ The previous owners are entitled to receive either the property itself or a proportionate part of the shares or interest of the enterprises into which their property has been incorporated.

The process of land restitution began in February 1991 with the passage of the Law on Ownership of Land and Use of Farmlands. This law provides for restitution of land forcibly collectivized in the 1950's, and aims at reestablishing the land ownership structure as of 1946. This process, however, has proved to be very controversial, and despite a number of amendments introduced, progress has been rather slow and many problems remain unresolved.

³ See Law on Restitution of Ownership of Certain Shops, Workshops, Warehouses and Pharmacies, Law on Restitution of Ownership of Nationalized Immovable Property, and Law on Restitution of Ownership of Certain Nationalized Property.

2. REGULATIONS GOVERNING FOREIGN OWNERSHIP

2.1. General Provisions

The economic rights of foreign persons in Bulgaria are regulated by the 1992 Law on Economic Activity of Foreign Persons and Protection of Foreign Investment ("LFI"). This law repeals the more restrictive Law on Foreign Investment of 1991.

The term "foreign investment" is defined very broadly and includes acquisition of stocks or shares, bonds, and other securities issued by the State or by Bulgarian legal persons, ownership of immovable property, ownership of companies, bank deposits, credit for a term exceeding five years, and any increase in value of an investment (article 9).

Article 3 establishes the principle of national treatment of foreign legal and natural persons, who are allowed to carry on business activities in Bulgaria on terms no less favorable than those accorded to Bulgarian citizens. There are no limits on foreign ownership of a Bulgarian company; 100 per cent foreign ownership is allowed.

The criterion for determining the nationality of foreign companies is their place of registration, while for natural persons the citizenship and a permanent residence abroad are controlling.

Article 7 gives priority to more favorable provisions contained in international agreements to which Bulgaria is a party. This article, for example, allows U.S. nationals to choose between national and most-favored-nation treatment in dealing with Bulgaria, because of the MFN clause in Article 1 of the Trade Agreement between Bulgaria and the United States which became effective on November 22, 1991.

Foreign persons are allowed to open bank accounts, make deposits in foreign currency or in leva, deal in shares, bonds and other securities. In addition, foreign persons have the right to buy currency from Bulgarian banks and repatriate both the principal and income from their investments (articles 13 and 15). Although these provisions of the law are self explanatory, foreign investors should be familiar with the provisions of the Law on the Bulgarian National Bank and the Law on Banks and Banking Activity.

2.2. Licensing and Registration

Although the foreign investment regime in Bulgaria is quite liberal, there are a number of restrictions relating to activities of significant sensitivity to any government. The activities subject to licensing are the following: production or trade in weapons, munitions and military equipment⁴; exploration and extraction of natural resources from the territorial sea, continental shelf and the exclusive economic zone; undertaking of banking or insurance activities.⁵ Foreign investors interested in these areas should proceed very carefully, since non-compliance with the law may entail serious penalties.

⁴ The Council of Ministers issued Decree 115 On the Creation of a Government Commission to Regulate and Control the Regime of Manufacturing and Trade in Military and Specialized Products, State Gazette No. 60, June, 1991 at 2.

⁵ According to Council of Ministers Decree No. 74 of May 11, "On Determining the Rules and Procedure for the Issuance of Licenses for Foreign Investments, State Gazette No. 42, May 22, 1992, at 1, a license for investment in the military industry is issued by the Commission referred to in note 6; licenses for banking are issued by the BNB; licenses for exploration of resources from the territorial waters, continental shelf and exclusive economic zone are issued by the Committee for Geology and Mineral Resources

According to article 11 all foreign investors must register their investments in Bulgaria, and any changes thereto within 30 days. This should be done by filing a declaration with the Ministry of Finance.⁶ This requirement, however, should not be interpreted as imposing an unnecessary burden on foreign investors but rather as a concern of the government to keep appropriate statistics, and, of course, it will be useful for tax enforcement purposes.

It should be noted that there are no restrictions whatever in the LFI or in the Law on Privatization on the right of foreign persons to participate in privatization. The reason for this undoubtedly is the desire of the government for foreign investment and its recognition that privatization cannot succeed without substantial foreign participation.

2.3. Ownership Rights

With regard to real property ownership, the law provides some restrictions applicable to foreign persons (natural and legal). The underlying principle is that foreign persons may not own land, and have only limited rights to own other real property, in Bulgaria. This principle is established in article 22(1) of the Constitution of Bulgaria, which provides that foreign legal and natural persons can acquire ownership rights over land only by inheritance, and even in such cases must transfer ownership. Similar restrictions are applied by many other countries, generally reflecting a fear that

⁶ Ministry of Finance Instruction No.1, of May 11, 1992, on Registration of Foreign Investments, State Gazette No. 43, May 26, 1992, at 7.

the country might be sold out to foreigners. However, there are important exceptions to this principle.

Article 5(1) allows foreign persons to own buildings (but only as a result of new construction in the case of residential buildings) and to acquire "limited property rights," e.g., leasehold rights, to land. This restriction on ownership of residential property should be interpreted in the light of the housing shortage especially in the big cities. It should be noted that under the Law on Obligations and Contracts there is a 10-year restriction on leasing of buildings.

Article 5(2) restricts foreign persons acting without Bulgarian legal personality from owning land, and restricts even Bulgarian companies with more than 50% foreign ownership from owning agricultural land. *Per argumentum a contrario*, a company incorporated in Bulgaria, even if 100% foreign owned, could own non-agricultural land and improvements of any kind, and there would be no restrictions at all if foreign ownership were less than 50%. The evident reasoning is that ownership of land by companies with Bulgarian legal personality creates no contradiction with article 22(1) of the Constitution.

Only experience will show whether the restriction on owning agricultural land is viable and enforceable. It should be noted, however, that according to article 21(2) of the Constitution, arable land may be used only for agricultural purposes, although exceptions may be allowed if justified.

2.4. Labor and Social Security Relations

In article 14, LFI, a great deal of attention is paid to labor and social security issues. The basis for labor relations is the employment contract, which must comply with some mandatory provisions of the Bulgarian labor legislation. On July 5, 1991, the Council of Ministers adopted Decree 129 on the Negotiation of Wages. The Decree, which sets a minimum monthly and hourly wage, is implemented by regulations that have already changed six times. The adoption of a new Labor Code, currently debated by Parliament, should provide a more complete and stable legal framework for labor relations.

2.5. Protection of Foreign Investment

Article 10 is designed to minimize the risk of expropriation and to guarantee compensation if it occurs. Paragraphs 1 and 4 implement in a restrictive manner Article 17 of the Constitution of Bulgaria, which provides that property may be expropriated only for state and municipal purposes that can not be otherwise satisfied, according to law, and after prompt and adequate compensation. Although it does not exclude the possibility of expropriation, this approach is consistent with the U.N. General Assembly Resolution on the New Economic Order, the U.N. Charter of Economic Rights and Duties of States, and is quite similar in this respect to the U.S. Constitution.

Paragraphs 3 - 8 provide additional protection for foreign investors. An investor has the right to choose between compensation in kind or in cash. Compensation must be equal to the value, at market prices, of the expropriated property. Compensation must

be paid before the property can actually be taken, and the whole process may be appealed to the Supreme Court. These are significant guarantees, some of them introduced for the first time in Bulgaria. While the true test of law is often found in its application, this expropriation law meets any reasonable standard.

In addition to investment insurance through various bodies, U.S. investors may expect additional protection through the Bilateral Investment Treaty signed on September 23, 1992.

3. LAWS RELEVANT TO PRIVATIZATION OF BULGARIA'S ELECTRONICS INDUSTRY

3.1. Law on Commerce

The Law on Commerce ("LC") was adopted in 1991 to provide a legal framework for economic activity in Bulgaria corresponding to that in the West, and to create conditions allowing joint economic activities and encouraging investment in Bulgaria. Together with the laws on commercial transactions and bankruptcy, currently on the agenda of Parliament, it is designed to form the nucleus of commercial legislation in Bulgaria.

The LC is a complex law with 284 articles divided into 20 chapters, but its single most important feature undoubtedly is the definition of legal entities entitled to do business in Bulgaria.

Adopting a civil law approach, the law defines a merchant as any natural or legal person who carries on commercial activities by profession (article 1(1)). All commercial companies, cooperatives (except housing cooperatives), and persons involved in activities that are commercial in nature are merchants (articles 1(2) and (3)). Farmers, artisans and craftsmen, members of the professions, and persons renting rooms in their own houses are not merchants. Because of this civil law approach there may be some uncertainty with respect to whether a given business will be considered a merchant. Merchants in Bulgaria may do business personally or through a branch, agency or broker.

The corporate forms for doing business are defined in article 64 and they are:

- a) a general partnership;
- b) a limited partnership;
- c) a limited liability company (OOD);
- d) a stock company (AD); and
- e) a limited partnership with shares.

It should be noted, that the LC imposes a very unusual and burdensome obstacles to non-cash contributions. Such contributions are permitted, but can not take the form of future labor or services, and their value must be assessed by three experts appointed by the court (article 72).

The LC does not differentiate between national and foreign participation, or between local and foreign persons. The LFI, however, limits the legal entities through which foreign persons may conduct business in Bulgaria. The reasoning is that for certain types of activities a person is personally liable for his obligations, and, therefore the LFI requires Bulgarian citizenship, which guarantees the jurisdiction of Bulgarian courts, for doing business as a merchant, to participate in a general partnership, or to be a partner with unlimited liability in a limited partnership or a limited partnership with shares (i.e. activities for which a person bears personal and unlimited liability, article 3(4) LFI). Considering the burdensome procedure for obtaining Bulgarian citizenship it is likely that this provision may be amended in the future.

In addition, the LFI specifically provides that a foreign person may conduct business in Bulgaria through a branch, if registered in his home country, or an agency

(articles 3(6) and 4(1), LFI). On the other hand an agency, which also does not have legal personality under Bulgarian law, may not carry on business activities. It is viewed only as a tool to help and promote business and serve as a representative office.

Today foreign persons operate in Bulgaria mostly through branches, representative offices or limited liability and stock companies.

3.2. Contract Law

The Law on Obligations and Contracts provides the legal framework for contracting. It dates from 1951 and, although it has been adopted in order to repeal the prior "bourgeois" commercial law, its drafters succeeded in keeping a number of provisions which, although with limited applicability in a centrally planned economy, today successfully serve the needs of business.⁷ The Law on Obligations and Contracts is expected to be repealed with the adoption of the new law on commercial transactions.

It should be noted that the commercial agency contract is regulated by the new LC.

3.3. Bankruptcy Law

The concept of commercial insolvency was reintroduced in Bulgaria with the adoption of Decree No. 56 on Economic Activity in 1989. The procedure for declaring bankruptcy consists of four stages: (i) declaration of insolvency; (ii) conciliatory

⁷ See e.g. the provisions on negotiable instruments.

procedure; (iii) declaration of bankruptcy by the court, and (iv) liquidation and conclusion of the bankruptcy procedure.

It should be noted that the provisions on bankruptcy of Decree No. 56 have limited application and do not correspond to the needs of contemporary Bulgarian economy. The oversized debts of state enterprises to the banks and other enterprises threaten a large number of these banks and enterprises with bankruptcy. The lack of an appropriate legal framework has been one of the reasons for the unwillingness to initiate bankruptcy proceedings. As of 1993 only about forty enterprises have been declared bankrupt, although another 380 are deemed to be insolvent. A new comprehensive bankruptcy law, to become a part of the new commercial legislation, has been drafted but has not yet been presented to Parliament.

3.4. Taxation

Bulgarian tax system consists of the following types of taxes:

A. Direct Property Taxes:

1. Tax on land.
2. Tax on buildings.
3. Tax on inheritance.

B. Direct Income Taxes

1. Income tax on physical persons.
2. Income tax on legal persons (tax on profits).
3. Tax on increase of wages.

C. Indirect Taxes

1. Excises.
2. Turnover tax.
3. Customs duties.

The main taxes paid by business entities are the turnover tax and the income tax. Their regulation is spread in a multitude of laws and regulations and their discussion falls beyond the purpose of this brief overview. The main points of the income tax legislation are the following:

- a) income tax is payable by firms on taxable profits defined by the law;
- b) the basic rate is 40 per cent; the same rate applies to foreign persons conducting independent business activity in Bulgaria or to joint ventures where the foreign participation is less than 49 per cent or the annual profits are over 1 million leva;
- c) companies with foreign participation exceeding 49 per cent or when the foreign interest exceeds \$ 100,000 are taxed at 30 per cent as long as annual profits are under 1 million leva (about \$ 37,000);
- d) profits derived from business within free trade zones are tax exempt for the first five years and subsequently are taxed at a 20 per cent rate;
- e) joint venture activities in agriculture, food processing and high-technology sectors, determined by the Council of Ministers, are tax exempt.

Turnover tax is levied at two rates:

- a) 10 per cent for some specified goods (basic commodities) determined by the Minister of Finance;

b) 22 per cent for all other goods and services.

Other taxes:

a) dividends from intellectual property rights are taxed at 15 per cent;

b) dividends from shares and stocks are taxed at 10 per cent;

c) employers must pay social security contributions for employees ranging from 35 to 50 per cent of their wages; they must also contribute 7 per cent from the total payroll to the "Professional Qualification and Unemployment Fund". The insurance premium for foreign workers or employees is set at 20 per cent of their nominal wage;

d) losses incurred during a fiscal year may be deducted from profits over the next five years.

It should be noted that joint ventures and subsidiaries of foreign persons are taxed on their world wide income and, in the absence of double taxation treaties, the problem of double taxation may arise. A tax treaty which will eliminate double taxation problems between the United States and Bulgaria is currently being negotiated.

Recently a set of taxation laws has been presented to Parliament designed to streamline corporate tax legislation. The turnover tax should be replaced by a Value Added Tax in 1994. The Tax Administration Code and the Taxation Procedure Code are also scheduled for amendment.

3.5. Banking Law

In 1991 Bulgaria began a major banking reform aimed at updating its banking system and bringing it into conformity with international standards. The legislative pillars of this reform are the Law on the Bulgarian National Bank ("LBNB"), the Law on Banks and Banking Activity ("LBBA"), and the related regulations.

The main element of this reform is the introduction of a two-tier banking system consisting of an independent central bank - the Bulgarian National Bank ("BNB"), in charge of certain specific tasks - and commercial banks as primary financial intermediaries.

The BNB is charged with maintaining the internal and external stability of the lev, i.e. with determining monetary policy in Bulgaria (article 2, LBNB). Other tasks include note issuance and commercial banks regulation (articles 25 and 44, LBNB). The BNB is the official depository of state funds and thus also serves as the Bulgarian treasury. The BNB has at its disposal three instruments of monetary management: open market operations, discount operations, and reserve requirements.

Ordinance No. 3, of July 10, 1992 "On Payments"⁸ provides that the BNB shall establish an integrated banking system for electronic settlements, in which all licensed banks must participate. Subsequently, a clearing system will be organized and regulated by the Managing Board of the BNB.

The commercial banking system in Bulgaria is still in embryo, because the dozens of state-owned banks must still be consolidated and restructured within the framework

⁸ State Gazette No. 63, of August 4, 1992, at 7.

of the Bank Consolidation Company.⁹ The LBBA, however, is a modern piece of legislation, drafted in accordance with the banking laws of the developed European countries, and it provides the necessary legal basis for the development of commercial banking in Bulgaria.

According to article 64 LC, a bank may be incorporated either as a stock company or as a cooperative organization under the terms of the Law on Cooperatives. A financial institution must obtain a license from the BNB before engaging in banking activities, and the minimum capital requirement (paid-in capital plus reserves) has been increased to 500,000,000 leva (approximately \$ 20 million).

Commercial banks are subject to certain supervisory requirements enforced by the BNB, including: lending limits, reserve requirements, and liquidity ratio requirements. In addition, they must prepare annual reports and are subject to financial audits and on-site inspections.

Foreign banks may operate in Bulgaria through either a branch or a commercial agency (article 10, LBBA). They are subject to a license issued by the BNB and should be registered with the Ministry of Finance and the local District Court (article 18, LBBA).

The implementation of a contemporary banking legal framework is only one part of the process of introducing a viable and effective banking system in Bulgaria.

⁹ The Bank Holding Company ("BCC") was registered in February, 1992, as a holding company, founded by the BNB and the Bulgarian Foreign Trade Bank. See, Directive No. 26 on "Creating Conditions for More Effective Management of State Property in Commercial Banks", State Gazette No. 37, May 6, 1992, at 1.

Currently there are about 70 commercial banks, the majority of which are state owned, and all of which share a heavy burden of bad debt. Following the example of the former Czechoslovakia, the government is currently restructuring the commercial banking system through a Bank Consolidation Company. By doing this the government has two objectives: to reduce the number of banks, and to clean up their balance sheets.

In summary, banking reform in Bulgaria has taken great strides with the passage of the LBNB and LBBA. When these laws are fully implemented over the next two or three years, Bulgaria will have a banking system designed to Western standards, able to support increased business activities and foreign investment.

3.6. Competition Law

The Law on Protection of Competition ("LPC") was one of the first laws adopted after Bulgaria began the transfer toward a market economy, and was the precursor of the privatization law. It contains rules designed to protect against abuse of a monopoly position (Chapters Two and Three, articles 3-10), and against unfair commercial practices (Chapter Four, articles 11-15).

The LPC prohibits monopolies, whether state or municipal, from carrying on activities which restrict competition or harm the interests of consumers. It defines a monopoly position as either having the exclusive legal right to carry on certain types of business, either independently or jointly with related persons, or controlling more than 35 per cent of a market (article 3).

Unfair competition is described as any economic activity that contradicts good

faith commercial practices and damages, or may damage, the interests of competitors, their relations among each other or with consumers (article 12).

The LPC establishes a special watchdog, the Commission on Protection of Competition (article 2), as an independent institution financed by the State budget and appointed by Parliament. The Commission has the authority to ask for the repeal of administrative acts of the executive which contradict the LPC, to monitor abuses of monopoly position or unfair commercial practices and notify the courts of such contraventions.

The court can compel offenders to cease the economic activity constituting the offense and/or declare invalid any transactions or decisions contradicting the law. In addition, the court may impose heavy fines and confiscate any profit derived from illegal activity.

3.7. Securities Law

At this point Bulgaria has neither a comprehensive set of rules governing trade in securities nor the organizational structure needed to support this type of trading. Currently, a number of private commodities and stock exchanges exist but their transactions are not regulated to a significant degree.

Chapter Fourteen of the newly adopted Commercial Law is devoted to stock companies and contains some basic definitions and provisions on securities and debentures. In addition, the Privatization Agency recently established the set of documents required when privatization or transformation of state-owned companies is

initiated, which may be considered as a first step in regulation of disclosure requirements.

The need of a comprehensive regulation of securities trade and markets is obvious, and the government currently is working on a model for securities regulation, drawn mostly from the experience of the EEC, with which Bulgaria is expecting to enter in an association agreement.

3.8 Law on Accounting

The Law on Accounting was adopted in January 1991 and was designed to bring internationally accepted accounting standards to Bulgaria. It contains basic provisions on double-entry book-keeping, accounting documentation, valuation of assets and liabilities, inventory control, accountants and accounting services. The basic problem in this area, however, is the lack of trained personnel, and therefore the successful implementation of this legislation will take substantial time.

3.9. Export Controls

The examination of the Bulgarian import-export regime is a very technical and complicated subject matter mostly because of the constant changes and the lack of a stable and uniform legislative approach. There is one area, however, which is of particular interest in the context of the electronics industry and it concerns the regulation of export controls.

On November 10, 1992 the Council of Ministers adopted a Regulation governing trade in dual-use goods (i.e. those having both military and civil application). The new export control rules are adopted in compliance with the requirements of Committee for multilateral Export Controls ("COCOM") and the Bulgarian government hopes that the country might be removed in the future from the list of proscribed destinations. This already has been the case with Hungary, and the importance of free access to high-technology, especially in the field of electronics can hardly be disputed.

The most important features of the new regulation are the introduction of:

- a) an import certificate: for allowing the import of controlled goods;
- b) a statement by end-user providing information on the importer and the intended use of the controlled goods.
- c) a delivery verification certificate for ensuring that the imported controlled goods have arrived at their destination; and
- d) an export license designed to prevent diversion of imported or domestically produced controlled goods by means of export or reexport.

In addition, an Agency on Foreign Trade Regime has been established within the Ministry of Trade, in charge of supervising and controlling the implementation of the new regime.

3.10. Immigration Law Affecting Business

The immigration authorities in Bulgaria were quick to respond to the new social and economic realities, and on December 30, 1992 the Council of Ministers issued a Regulation on the Rules and Procedure for Issuance of Employment Visas for Aliens in Bulgaria. The regulation applies only to aliens seeking employment in Bulgaria and does not concern foreign investors or businessman engaging in independent activity.¹⁰ The regulation may apply to them, however, if they wish to employ aliens.

The conditions imposed by the regulation are the following:

- a) aliens seeking employment in Bulgaria need an employment visa;
- b) these visas are issued by the Ministry of Labor and Social Care following an application from a Bulgarian or foreign employer registered in Bulgaria;
- c) employment visas are granted only in the absence of qualified Bulgarian citizens, and the number of aliens employed in a company may not exceed more than 10 per cent of all employees.
- d) employment visas are issued for a maximum for one year, which may be extended to not more than two years;
- e) the penalty for employment of aliens without employment visa may amount up to 48 minimum monthly payments.

¹⁰ For them the relevant provisions of the Law on Commerce and the Law on Foreign Investment, discussed above, may apply.

3.11. Environmental Law

Foreign investors should also be aware of the Law on Environmental Protection ("LEP"), adopted in 1991. The LEP incorporates the "polluter pays principle", and establishes certain activities for which the Minister of Environment must require preliminary environmental impact assessment.

CONCLUSION

Bulgaria has established a relatively comprehensive set of privatization laws and has attempted to provide substantial incentives to attract foreign capital. Although much will depend on how these laws are implemented, it is clear that the legal basis for a free-market economy, based on private property and with rapidly declining state sector, has been established.

The future of this process will depend to a large extent on the ability of the Bulgarian government to continue implementing the legal and economic reform, and on its success in attracting foreign investors.

33

APPENDIX I
EXISTING LEGISLATION COVERING INDUSTRIAL PRIVATIZATION

1. Constitution of Republic of Bulgaria, State Gazette 56/1991
2. Law on Conversion and Privatization of State and Municipal Enterprises, State Gazette 38/1992
3. Law on Business Activities of Foreign Persons and Protection of Foreign Investments, State Gazette 8/1992
4. Law on Commerce, State Gazette 48/1991
5. Law on Ownership and Use of Agricultural Lands, State Gazette 17/1991, as amended, State Gazette 18/1992, 28/1992, 46/1992, 105/1992
6. Law on Bulgarian National Bank, State Gazette 50/1991
7. Law on Cooperatives, State Gazette 57/1991, as amended, State Gazette 34/1992, 55/1992
8. Law on Restitution of Ownership over Nationalized Immovable Property, State Gazette 15/1992
9. Law on Restitution of Ownership over certain Nationalized Property, State Gazette 15/1992
10. Law on Banks and Banking Activity, State Gazette 25/1992
11. Law on Accounting, State Gazette 4/1991, as amended, State Gazette 26/1992
12. Law on Protection of Competition, State Gazette 77/1991, as amended, State Gazette 53/1992
13. Decree No. 56 on Economic Activity, State Gazette 4/1989, as amended
14. Law on Turnover Tax and Excises, State Gazette 91/1951, as amended
15. Law on Income Tax, State Gazette 132/1950, as amended
16. Law on Obligations and Contracts, State Gazette 1/1951, as amended