

**Anton Grozdanov**

Assoc. prof., PhD., VFU „Chernorizets Hrabar“, Faculty of Law, Bulgaria

## **Legal nature and prerequisites of a trader’s stabilization proceedings (in force from 1<sup>st</sup> July 2017)**

### **Юридическая природа и предпосылки стабилизации торговой стабилизации (в силе 1 июля 2017 года)**

#### **Summary**

By the Law on Amendment and Supplement of the Commercial Act (LASCA), promulgated in State Gazette № 105 of 2016, a new part five “Stabilization of a Trader”, consisting of thirty-six provisions (art. 761–797) was set up. Its coming into force was postponed six months after the promulgation (July 1, 2017). In this respect, the present report is the first attempt to analyze the stabilization procedure in contemporary Bulgarian commercial-and-legal literature.

What will be the practical value of the new regulation is a question, the answer of which is subject of the future. In the next at least 3–5 years, there will still be some legal practice on how to apply it to be formed.

**Keywords:** stabilization, trader, insolvency.

#### **Резюме**

В соответствии с Законом о внесении изменений и дополнений в Закон о торговле (LASCA), обнародованный в Государственном бюллетене № 105 от 2016 года, была установлена новая часть пятая «Стабилизация торговца», состоящая из 36 положений (статья 761–797) вверх. Его вступление в силу было отложено через шесть месяцев после обнародования (1 июля 2017 года). В этом отношении настоящий доклад является первой попыткой проанализировать процедуру стабилизации в современной болгарской коммерческой и юридической литературе. Какова будет практическая ценность нового регулирования – вопрос, ответ на который является предметом будущего. В следующем, по крайней мере, 3–5 лет, все еще будет какая-то юридическая практика относительно того, как ее применять для формирования.

**Ключевые слова:** стабилизация, трейдер, несостоятельность.

1. Concept. Stabilization proceedings is a set of legal norms intended to regulate public relations that arise when a trader is in a state of imminent threat of insolvency.

Apart from the Commercial Act, which, with part five is the main source of the legal framework of the proceedings in question, the Civil Procedure Code (CPC) and the Law on Obligations and Contracts (LOC) find subsidiary application.

The stabilization proceeding of a trader, governed by part five of the Commercial Act, consisting of art. 761–797, includes norms that can be applied to the general part of the Civil law, the Contractual Law, the Commercial Act, the Civil Procedure law, and the Criminal law.

The norms not of the material but of the procedure law prevail.

Next, in this respect, it should be emphasized that the norms concerning stabilization proceedings are imperative in character.

One of the main features of the stabilization process is that it is a judicial proceeding. It is carried out with the direct participation of the court, under its direct control, and in full equality between the chirographic creditors.

The stabilization proceeding of a trader has specific purpose that is manifested toward the debtor and his creditors.

The purpose of the proceeding in question toward the debtor is to protect him from universal; I would rather say individual compulsory enforcement on his property, which inevitably leads to violation of his good name and to substantial imbalance in his relations with the contractors.

The purpose of these proceedings towards the creditors is to protect them from full or partial failing to meet their claims against a trader who is in a state of imminent threat of insolvency, as well as from their possible participation in a slow and costly proceeding such as insolvency proceedings.

2. Premises for initiating stabilization of trader proceedings. The first substantive premise for initiating stabilization proceedings is that the debtor is to be a trader. The Bulgarian Commercial Act restricts these proceedings towards traders.

The definition for a trader is contained in art 1 of the Commercial Act. It has legal and technical meaning which refers to the entire statutory act. Therefore, when art. 761 of the Commercial Act provides for the opening of stabilization of a trader proceedings, the meaning given in art. 1 of the same act gives the concept of a trader.

3. Inapplicability of the stabilization of a trader proceedings.

According to art. 764 of the Commercial Act, the stabilization proceedings do not apply to a public trader enterprise that exercises a state monopoly or has been set up by a special law, both for a bank and for insurer.

Firstly, the envisaged inapplicability of the stabilization procedure concerns most of all two categories of state enterprises performing commercial activity.

The first category includes state enterprises that exercise state monopoly.

The second category include state enterprises that have been set up under specific law.

The common between both types of state enterprises is that they carry out their activity on the basis of a law.

The second category enterprises are not commercial companies. They are always formed by the National Assembly by law.

The legal ground for the first category enterprises is art. 18 (4) of the Constitution of the Republic of Bulgaria.

Second category enterprises, for which stabilization proceedings are inapplicable, are in close relation with art. 62 (3) of the Commercial Act.

According to the cited provision, state-owned enterprises that are not commercial enterprises could be formed by law.

Therefore, the stabilization of a trader proceedings cannot be applicable for single-member companies with state-owned property that exercise monopoly thus established.

Art. 764 of the Commercial Act does not explicitly provide inapplicability of the stabilization of a trader proceedings in relation to public enterprises that exercise exclusive state-owned property.

Despite the exceptional nature of the mentioned provision, by virtue of the rule “per argumentum a fortiori”, it should be considered that the stabilization process is inapplicable to public enterprises that exercise exclusive state-owned property.

It should be noted that from the point of view of Part Five of the Commercial Act, the term “trader – public enterprise” and the term “public-legal organization” within the meaning of art. 43 of the Supplementary Provisions of the Public Procurement Act (PPA) in relation to art. 5 (2) p. 14 of the same law, should not be mixed.

According to the mentioned provision, “public-legal organization” is a legal entity for which the following requirements are met:

- a) it is created with the specific purpose to satisfy public needs of non-industrial or non-commercial character;
- b) it is funded by more than 50 per cent of state, territorial, or local bodies or by other public-legal organizations, or is a subject of managerial control by these bodies; or it has management or supervisory body, most of the half of the members of which are recruited by a public assignor under art. 5 (2) p. 1–14.

Part Five of the Commercial Act does not apply to banks and insurance and reinsurance joint-stock companies, European companies, mutual insurance cooperations, European cooperation companies, including captive insurers and reinsurers.

This approach finds its explanation in two special laws – the Law on Credit Institutions (CIL) and the Insurance Code (IC)

With regard to banks, special supervision is provided in case of a risk of insolvency (Art. 115 et seq. of the CIL).

With regards to insurers are provided capital requirements for solvency (art. 61 of the Commercial Act); solvency margins (art. 208–213 of the CA), as well as measures for recovery of the financial situation (art. 214–218 of the CA).

The stabilization proceeding is also inapplicable for traders who:

- a) have not requested, within the statutory deadlines, to announce (in the Commercial Register, of course) their annual financial reports for the last 3 years before submitting the application for stabilization;
- b) traders for whom stabilization proceedings have been opened in the last 3 years before submitting the application for stabilization;
- c) traders for whom application for opening an insolvency procedure has been submitted before submitting the application for stabilization;
- d) when more than one fifth of the trader's liabilities are toward related persons and to persons who have acquired receivables from persons related to the trader during the last three years (art. 762 (3) of the CA).

The first among the mentioned negative prerequisites for opening stabilization proceedings, has disciplining effect. In this sense, it is well known (mostly to legal practitioners and economists) that some of the commercial subjects for various reasons (poor organization of accounting services, etc.) do not announce their financial statements in due time. It should be noted, however, that the effect of this legislative approach is questionable. This is because in practice the trend is to declare financial statements without all the necessary constituent elements provided for in the accounting legislation. Thus, the creditors of the trader and other interested parties (for example future investors) cannot objectively be able to obtain information about his real estate status.

The need for the third negative premise is obvious and does not require explanation. Stabilization and insolvency are incompatible and do not need explanation. The first aims at avoiding the second.

The notion “related persons” is of importance for the presence of the fourth negative prerequisite, provided in art. 1 of the SP of the CA.

4. It is a deviation from the rule that the stabilization proceedings can be opened only with regard to a trader. Pursuant to art. 763 of the CA, at the same time with the initiation of stabilization proceedings for the trading company, the stabilization process for the unlimited liability partners is also considered to be open.

Obviously, the cited provision is influenced by the provision of art. 610. The motives of the legislator when enacting it, are based on the specific liability of the unlimited liability partners before the company creditors. According to art. 76,

second statement of the CA, the partners in a general partnership are jointly and unlimitedly liable.

According to art. 99 (1) of the Commercial Act, one or more of the partners in a limited partnership are jointly and unlimitedly liable for the company's liabilities, and the rest are liable to the amount of the contracted contribution.

Pursuant to art. 254 (1) statement first of the same law, a limited partnership is established by unlimited liable partners. Art. 258 provides that the Board of Directors shall consist of the unlimited liability partners.

The grounds for a stabilization proceeding for an unlimited liability partner to be considered as started under art. 763 of the CA is to initiate stabilization proceedings for the partnership in which he participates. It is sufficient that there is an imminent threat of insolvency for the company. This state is not required for the unlimited liability partner. From a procedural point of view, in these cases the process of stabilization of the company and that of an unlimited liability partner/partners should be found with the same definition under art. 772 of the CA.

The provision of art. 763 of the CA raises an important theoretical and applicable matter, namely: should it also apply to members of a European Economic Union with registered office in the Republic of Bulgaria (art. 280a of the CA). I believe that this question should be answered in the negative. My arguments in this regard are the following:

Firstly, by explicit provision (art. 280b, para 3 of the CA), the members of European Grouping by Economic Interests (EGEI) are excluded from the scope of 610 of the Commercial Act. This means that the opening of insolvency proceedings for EGEI does not automatically lead to the opening of such proceedings to its members, even though they are jointly and unlimitedly liable to its creditors.

Secondly, we have already found out that stabilization proceeding is a preventive one, that is, its purpose is to avoid insolvency proceedings. (art. 761 of the CA).

Thirdly, since the purpose of the stabilization proceedings is to avoid insolvency proceedings which are not automatically opened to a member of the EGEI – the initiation of the stabilization proceedings for the latter lacks practical meaning.

5. Immediate risk for insolvency. Second material-legal prerequisite for opening stabilization of a trader proceedings, is the immediate for him risk for insolvency. This is the case when in view of the forthcoming maturity of his monetary liabilities within the next 6 months from the date of submitting the application for stabilization will be in a state of inability to pay monetary liabilities due under art. 608, para 1 or may suspend payments (art. 762 (2) of the CA).

The interpretation of art. 762 (2) in relation to art. 608 of the CA leads to conclusions in several directions:

Firstly, in order for there to be an imminent threat of insolvency, it is sufficient for the trader to be unable to fulfill even one monetary liability due that meets the requirements of Article 608, para 1 of the Commercial Code.

Secondly, the law introduces a second (alternative) and presumed condition for falling into a state of imminent threat of insolvency: suspension of payments. The 6-month term is provided for both conditions. No doubt, the suspension of payments has to be objective inability to pay the liabilities under art. 608 of the Commercial Act.

For Art. 762 (2) the reason for the dueeness of the liability is irrelevant. Such may be the demand of the creditor for immediate execution if the liability is without time limit (Art. 69 (1) of the CPA). The due demand may also be based on the occurrence of the time limit agreed between the parties. Time limits become due upon expiry of the time limit. In these cases an invitation is not necessary as the rule that the maturity invites instead of the creditor takes effect. The requisite may occur by request of the creditor a time-limited liability to be fulfilled before the time, when the debtor has become insolvent or by his actions has reduced the securities given to the creditor or has not given him the promised securities (art. 71 of the CPA; art. 432 of the CA; art. 60 of the Credit Institutions Act).

The Act does not provide (as opposed to the part governing the insolvency proceedings) the over-indebtedness within the meaning of Article 742 (1) of the Commercial Act as a prerequisite for opening a procedure for stabilization of a trader. I find this approach correct for the following consideration:

From an economic point of view, there is no meaningful difference between insolvency and over-indebtedness. The Commercial Act provides that a trading company is over-indebted when its property is not sufficient to cover its monetary liabilities. In case of insolvency, similar economic effect is reached. This is because, in both settled cases, it is based on the balance value of the property which in practice is very different from its market value. The latter depends on the total and fast liquidity of the asset.

What is more, the Economic theory and practice are already working with the so-called "Crisis" liquidity. In its calculation, the value of the fixed assets is not taken into account at all. This circumstance, in turn, to a great extent discredits the legal concept of property.