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## Bulgaria's Evolving Legal Framework for Private Sector Development

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## Bulgaria's Evolving Legal Framework for Private Sector Development

Bulgaria's economy is in the midst of a historic transformation from centrally planned to market. Stimulating the growth of a vibrant and productive private sector through both privatization of existing public enterprises and the growth of new private companies is one of the most important challenges Bulgaria faces in this transformation. Any economy needs "rules of the game" to function. While these rules derived primarily from the central planning bureaucracy during Bulgaria's socialist period, a private economy depends heavily on a decentralized legal system to create and enforce such rules. Thus, developing the private sector requires a sound legal framework and supporting legal institutions.

This article describes the current legal framework in Bulgaria in several areas, including real property, intellectual property, company, foreign investment, contract, and bankruptcy law.<sup>1</sup> These areas of law serve to define (i) property rights, (ii) the means to exchange property rights, and (iii) the rules for entry into and

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1. This article is part of a larger research project on evolving legal frameworks in Eastern Europe. Other studies include Cheryl W. Gray et al., *The Legal Framework for Private Sector Development in a Transitional Economy: The Case of Poland*, 22 GA. J. INT'L & COMP L. 2 (1992); Cheryl W. Gray et al., *Romania's Evolving Legal Framework for Private Sector Development*, 7 AM. U. J. INT'L & POL'Y 3 (1992); Cheryl W. Gray & Franjo D. Stiblar, *The Evolving Legal Framework for Private Sector Activity in Slovenia*, 14 U. PA. J. INT'L BUS. L. 2 (1993); Cheryl W. Gray et al., *Legal Reform for Hungary's Private Sector*, 26 GEO. WASH. J. INT'L L. & ECON. 2 (1993); Cheryl W. Gray, *The Legal Framework for Private Sector Activity in the Czech Republic*, VAND. J. TRANSNAT'L L. (Spring 1993). These country studies and additional information on the Bulgarian case (including constitutional and competition law) are brought together in *Evolving Legal Frameworks for Private Sector Development in Central and Eastern Europe*, World Bank Discussion Paper 209, July 1993.

exit from the productive process. In essence they form the bedrock of a legal system for a market economy.<sup>2</sup>

Bulgaria has made impressive strides over the past two years in enacting laws designed to support a market economy. The task of formulating a comprehensive legal framework and creating or reorienting the legal institutions needed to implement it is, however, far from complete. As in the other countries of Central and Eastern Europe (CEE), defining real property rights and designing rules for the exit of ailing firms are perhaps the most contentious and confused legal areas, largely because they tread so heavily on existing vested interests. Other areas of law, including intellectual property, company, foreign investment, and contract law, are less problematic.

## **I. Rights to Real Property**

The reform of property rights is the most complicated legal challenge in Bulgaria. The country faces problems similar to those in other CEE countries emerging from socialism. Marxist attitudes towards property, which shaped the entire economic system of every socialist state, were profoundly different from those of market economies. Reversing these attitudes and the laws and institutions that embody them is a *sine qua non* for private sector development.

### **A. DEFINING THE BASIC LEGAL FRAMEWORK**

Unlike other CEE countries, Bulgaria did not have a comprehensive unified Civil Code governing both property and contract relations among private individuals in the decades prior to the socialist period. Rather, individual property rights were governed by the Property Act, and contracts were governed by the Law on Obligations. Both were based loosely on German civil law and thus embodied the basic civil law concepts common to European capitalist systems of the period.

After World War II Bulgaria moved quickly to strict central planning and control and—unlike Yugoslavia, Poland, or Hungary—it remained tightly centralized throughout the socialist period. In addition to adopting a new socialist constitution with extensive provisions on property, the prewar laws on property and obligations were explicitly abrogated in 1951 and replaced by socialist legislation in line with Marxist doctrine. The 1951 Property Act<sup>3</sup> replaced the prewar version in defining property rights and relations of individuals. Although maintaining

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2. This article does not discuss certain other areas of law that are also important to the private sector, including privatization, banking, taxation, and labor law. Although a critical area of reform, privatization is a transitional issue, whereas this article seeks to address the longer-term legal structure. The other areas of law are omitted due both to space limitations and to likely coverage in other World Bank or external studies.

3. *Zakon za sobstvenostta* [Property Act], *Izvestiya na Prezidiuma na Narodnoto Sabranie*, Issue No. 92 (1951) (most recent amendment at *Darzhaven Vestnik*, Issue No. 77 (1991)).

many civil law concepts, it also added certain new principles and provisions to fit the needs of a socialist state.

One of the unique features of socialist property law was its concept of hierarchy of property based on ownership. The two socialist constitutions of 1949 and 1971 defined the three main categories of ownership. "Social" ownership—ownership by all the people in theory, by the state in practice—was the highest category of ownership and received special protection. Such property included virtually all urban industrial and commercial property, mineral resources, and public utilities. Although in theory regulated by law, it tended to be managed in practice through decisions of the Council of Ministers. Because this kind of property was excluded from individual transactions under the constitution, it was not covered by the provisions of the 1951 Property Act.

The other two forms of property were "cooperative" and "individual" property. Cooperative property included most agricultural land and was governed by the law on cooperatives. "Individual" real property was limited to one residence and one vacation house per household (but not a separate rental house, which was considered a means of production). Individual property rights and transfers were governed during the socialist period by the 1951 Law on Property.<sup>4</sup>

Because of the superiority of social property, the two socialist constitutions provided practically unrestricted rights to the state to expropriate individual property. In urban areas this right was widely used. All industrial property and much residential property were nationalized pursuant to the nationalization laws of 1947<sup>5</sup> and 1948,<sup>6</sup> and small private plots of land were gradually expropriated to secure the land needed for large-scale residential and public construction and often for the needs of the Communist Party and other public organizations. Although the state kept firm control of commercial property, almost all residential property nationalized or later built by the state was sold to tenants at low prices in the 1950s and 1960s.

The Bulgarians moved quickly in 1990 and 1991 to change the basic legal concepts underlying property ownership. The hierarchy of property was eliminated with the amendment of the old constitution in 1990 and the adoption of a

4. During the socialist period other laws suspended temporarily the application of the Property Act to particular transactions, types of property, or regions of the country. One example was the residential property law, *The Property of the Citizens' Act* (1971), which attempted to limit individual ownership and provide affordable housing to all through administrative means, and in effect displaced the Property Act (except in small and relatively unpopulated rural areas) for some twenty years. Widespread application of the Property Act was restored only with the 1990 partial repeal of the *Property of the Citizens Act*.

5. *Zakon za nacionalizatsiyata na chastnite industrialni i minni predpriyatiya* [The Nationalization of Industrial and Mining Enterprises Law], *Darzhaven Vestnik*, Issue No. 302 (1947).

6. *Zakon za Otchuzhdavaneto na Edrata Gradska Pokrita Nedvizhima Sobstvenost* [Expropriation of Urban Property Law], *Darzhaven Vestnik*, Issue No. 87 (1948).

new Constitution in 1991.<sup>7</sup> The new Constitution grants full and equal protection to all property regardless of ownership and it forbids expropriation except for carefully defined public purposes and with full and adequate compensation. The Property Act was also amended in 1990 to eliminate some of the socialist overlay added in 1951. It now refers to private property and state property, rather than individual and social property. The law reflects the basic civil law framework of its prewar predecessor and is thus generally adequate to govern property rights and relations in the private sector. It does not adequately address, however, the entire panoply of difficult problems relating to state-owned property.

## B. ELIMINATING THE STATE MONOPOLY ON PROPERTY OWNERSHIP

A major challenge in developing a market economy in Bulgaria is to eliminate the virtual monopoly of the state over commercial property that existed during the socialist period. This process entails both privatizing commercial property (or "reprivatizing" it to previous owners) and developing an active rental market in property still held by the state.

### 1. *Defining the Public Owner*

Before state property can be sold or leased, one must first define the actual owner—the actual person or entity with full right of use and transfer. Yet ownership of social property was indeterminate during the socialist period. Pursuant to the Marxist doctrine of "indivisibility of ownership," neither local governments nor state-owned enterprises (SOEs) owned the property they used, managed, or transferred; rather they had the ownership-like right of "operational management." SOEs that "operationally managed" property could in some cases lease it, but could never sell it. The relevant overseeing ministries had ultimate decision-making authority with regard to such property. Municipalities had more independent authority than SOEs. Under the Property Act the chairman of the local municipal council could transfer state-owned residential property within municipal boundaries to individuals<sup>8</sup> at prices fixed by the Council of Ministers.<sup>9</sup>

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7. The present Bulgarian Constitution represents a radical departure from its socialist predecessors. Most socialist phraseology is gone, replaced by democratically oriented legal principles and values. In general, the new Constitution provides reasonable protection for the property and economic rights of individuals and creates a favorable legal basis for the development of the private sector for the first time since the end of World War II. KONSTITUTCIYA NA REPUBLICA BULGARIA [Constitution of the Republic of Bulgaria], Darzhaven Vestnik, Issue No. 56 (1991) [hereinafter Constitution-1991].

8. Although the Property Act did not apply to property (including virtually all commercial property) used or transferred exclusively within the public sphere (on the theory that this was no transfer because the owner was still the state), it did apply to property transfers between the state and private individuals, as referred to here.

9. Because of relatively low prices, the right to buy state-owned land was a highly sought-after privilege. A heavy bureaucracy existed to check whether the applicant was qualified to buy the land, and buyers often waited for years for the transaction to be concluded. This process also resulted in corruption related to assignment of the right to obtain the property.

Ownership of SOEs became a major issue in 1990 as Bulgaria began its economic transition in earnest. The 1990 amendments to the 1971 Constitution<sup>10</sup> removed the prohibition against individual ownership of commercial property, and Decree 56 (discussed in greater detail below)<sup>11</sup> for the first time permitted SOEs to enter into joint ventures with private partners. For a brief period in 1990 and early 1991 some Bulgarians thought that SOEs would be able on their own initiative to transfer real property to the private sector, in particular to contribute real property to a joint venture. However, the Law on the Formation of State Property Sole Proprietorship Companies of June 27, 1991,<sup>12</sup> essentially barred such transfers of property by SOEs. The law gave the Council of Ministers all rights as sole owner of the SOEs (as defined under the Commercial Law), including control over all real property. Although this clarification of ownership rights was an important first step in managed privatization,<sup>13</sup> it clearly slowed down the development of a private real estate market (just as it slowed the privatization process more generally).

At present all parties accept the basic principle that the Council of Ministers controls real property attached to SOEs, while municipal governments have the power to transfer other property within municipal boundaries. Private entrepreneurs seeking leases of commercial space therefore generally know with whom they must negotiate. However, the exact powers of municipalities are still uncertain with respect to the property they control, including what property they actually own (rather than just administer), and who sets sale prices and is entitled to sale proceeds. These issues are now being debated and negotiated in the political arena.

## 2. *Reprivatizing Urban Property*

The issue of restitution of previously nationalized property is the subject of intense debate in Bulgaria, as in all other CEE countries. In December 1991 the National Assembly<sup>14</sup> took a first, limited move by passing a law providing for the

10. KONSTITUTCIYA NA NARODNA REPUBLICA BULGARIA [Constitution of the People's Republic of Bulgaria], Darzhaven Vestnik, Issue No. 39 (1971), as amended (most recent amendment at Darzhaven Vestnik, Issue No. 98 (1990)).

11. *Infra* part III.B.

12. Zakon za obrazuvaneto na edinolichni targovski druzhestva s darzhavno imushtestvo [Establishment of Single-Owner Trade Companies with State Property Law], Darzhaven Vestnik, Issue No. 55 (1991).

13. The law was in fact intended to curb the process of "spontaneous privatization," pursuant to which SOE managers could sell SOE assets to private firms they controlled at artificially low prices, and replace it with more managed "top-down" privatization.

14. The National Assembly has one chamber with 240 representatives elected on a proportional basis. Although this structure is similar on paper to that of the previous socialist assembly, the role of the new parliament is very different. During socialist times, the assembly met only twice a year for several days, essentially to rubber-stamp the numerous decrees of the former State Council or laws prepared under the supervision of high-ranking officials of the Communist Party. In contrast, the new National Assembly is a full-time institution designed to have final authority over lawmaking.

restitution of certain small shops and other business premises.<sup>15</sup> Specifically, under this law former owners will be able to reclaim all business premises bought by the state at artificially low prices pursuant to Ordinance No. 60 (1975) of the Council of Ministers. Because the number of such properties is relatively small, this law is not expected to cause extensive uncertainty and disruption in property markets.

Restitution of residential property nationalized after the war is more difficult, because most such property was subsequently sold to new tenants in the 1950s and 1960s. Former owners of residential property that remained unchanged and in state hands will be able to claim restitution under the Restitution of Ownership over Real Property Transferred to the State Law,<sup>16</sup> passed by the Parliament on February 5, 1992. Former owners whose property was subsequently sold to private parties or changed in other ways are entitled to alternative compensation, supposedly to be specified in a later law. Another restitution law was also passed on February 5, 1992: the law for Restitution of Property Alienated Pursuant to the Territorial and Urban Zoning Law, the Planned Urban Construction Law, the Urban Development Law, the State-Owned Real Estate Law, and the Property Law.<sup>17</sup> Its purpose is to return to former owners real property that was expropriated for development purposes by the state, provided that the property, if a building, still exists or, if a plot of land, is suitable for single-home construction.

Restitution of large, industrial properties is not as big an issue in Bulgaria as in East Germany or Czechoslovakia, for example, because Bulgaria's economy was primarily agrarian before World War II. Although no law has yet been passed, the intention of the Bulgarians is to treat those industrial properties that were nationalized the same as urban property, in essence returning them to former owners (either legal persons, if they still exist, or their former partners or shareholders). Such a solution, however, may make little sense given the enormous changes that are likely to have occurred in the business over the past forty years. Some kind of monetary compensation would perhaps be more reasonable.

### 3. *Reprivatizing Agricultural Land*

Because of its traditionally heavy reliance on agriculture, land was always considered the most important means of production in Bulgaria. Land was never

15. Zakon za vazstanovyavane na Sobstvenostta varhu nyakoi Magazini, Skladove, Rabotilnitzi i Atelieta [Law on the Restitution of Property over some Shops, Warehouses, Workshops, and Studios], Darzhaven Vestnik, Issue No. 105 (Dec. 19, 1991).

16. Zakon za vazstanovyavane na sobstvenostta varhu odarzhaveni nedvizhimi imoti [Restitution of Ownership over Real Property Transferred to the State Law], Darzhaven Vestnik, Issue No. 15 (1992).

17. Zakon za vazstanovyavane sobstvenostta varhu nyakoi otchuzhdeni imoti po Zakona za teritorialnoto i selishtno ustroistvo, Zakona za planovoto izgrazhdane na naselenite mesta, Zakona za blagoustroistvoto na naselenite mesta, Zakona za darzhavnite imoti i Zakona za sobstvenostta [Restitution of Property Alienated Pursuant to the Territorial and Urban Zoning Law, the Planned Urban Construction Law, the Urban Development Law, the State-Owned Real Estate Law and the Property Law], Darzhaven Vestnik, Issue No. 15 (1992).

extensively nationalized as it was in the Soviet Union, although large farms were confiscated in 1946-47, broken up into smaller plots, and returned to the peasants. Rather than set up state farms, the state pressured farmers to contribute their land to cooperative<sup>18</sup> farms, and the former owners gradually lost contact with the property. Massive migration to the cities resulted in further loss of attachment to the land. Though many former owners preserved their titles to land, the registration system lost its importance and fell into disuse.

Former land owners in every CEE country have been pressing the state for restitution of agricultural land, and Bulgaria is no exception. On March 4, 1991, the National Assembly passed the Agricultural Land Ownership and Use Law.<sup>19</sup> The law seeks to return land to those farmers (or their heirs) who owned it just after the post-war agrarian reform. Farmers who never owned land before are also eligible to receive it. Each household is limited to twenty hectares (approximately fifty acres), or thirty hectares (approximately seventy-five acres) in certain areas of "intensive land use."<sup>20</sup> In an attempt to prevent land speculation, the law originally prohibited recipients from transferring their plots again for three years, although this prohibition was recently lifted. The restitution is to be carried out by the National Land Board and 269 local land boards. The period for submission of claims was one year from the passage of the law, later extended to fifteen months. By the end of January 1992 some 512,000 claims had been submitted.<sup>21</sup>

The land boards have faced many problems in implementing the law. Proving former ownership can often be difficult, particularly for former owners who have lost old titles. Because of the mergers of cooperatives (especially after 1971) and the neglected registration system, borders of rural property are often unclear. The process of issuing legal titles has also been slow. By April 1, 1993, some 1.07 million hectares (23 percent of total arable land) had been restituted, but legal titles had been issued for only one-half of that land.<sup>22</sup>

Agricultural efficiency is also a concern, especially in the case of crops that cannot be grown efficiently on small plots. Rather than try to preserve large farming units, however, Bulgarian policy makers are depending on the voluntary re-creation of cooperatives in the old Bulgarian tradition, but in a form that is acceptable to the new private farmers now emerging. It appears that the overwhelming majority of new owners (some 90 percent) intend to participate in agricultural cooperatives in some form.

18. The Bulgarian cooperative movement had a strong and well-developed tradition even before the war. After the war, however, collectivization was very often forced, and cooperatives became increasingly inefficient and overburdened by bureaucracy and centralization.

19. *Zakon za sobstvenostta i polzuvaneto na zemedelskite zemi* [Agricultural Land Ownership and Use Law], *Darzhaven Vestnik*, Issue No. 17 (1991).

20. These limits reflect the limits applied in the 1947 agrarian reform. "Intensive land use" is not defined, but specific areas are likely to be designated as was done in the agrarian reform law. *Zakon za trudovata pozemlena sobstvenost* [The Earned Land Property Act of Mar. 9, 1946].

21. 1 BULGARIAN ECONOMIC REVIEW, No. 3, Feb. 11, 1992.

22. Press release by the Bulgarian Ministry of Agriculture (Apr. 14, 1993).



## II. Rights to Intellectual Property

The protection of intellectual property in CEE economies is a controversial subject. Supporters argue that intellectual property protection helps spur domestic invention and creation and attract foreign investment. Opponents argue that intellectual property protection is essentially a one-way street, that it protects industrialized countries (where most inventions and creations originate) at the expense of countries that must import most technology. The most contentious areas tend to be patents for pharmaceuticals and copyrights for computer software and books. All three products are relatively easily copied and are crucial for economic development.

Despite the debate on intellectual property protection, many economies in transition from socialism—including Bulgaria—are moving to adopt western-style intellectual property laws. An important recent development in Bulgaria is the signing of the Trade Agreement with the United States,<sup>23</sup> pursuant to which Bulgaria promises to effectively protect intellectual property.

A new Patent Law that provides patent protection similar to that in industrialized countries was passed by the National Assembly in March 1993. Bulgarian trademarks and industrial designs are protected by the Trade Marks and Industrial Samples Law from 1967.<sup>24</sup> The law is also one of the first in CEE to protect appellations of origin, which is important for many Bulgarian agricultural products, especially quality wines. The Copyright Law of 1951<sup>25</sup> is one of the oldest Bulgarian laws in force. Bulgaria has long been a signatory to the major international conventions on intellectual property, and thus foreigners have always been able to register patents and trademarks in Bulgaria.

The enforcement capacity of the existing Bulgarian agencies varies for the different areas of intellectual property. While copyright has been successfully protected for some time, the lack of experience in dealing with patent or trademark protection over the last forty years makes those areas more problematic. Trademark infringements are growing daily, but little action is being taken despite the existence of the appropriate provisions in the Criminal Code.<sup>26</sup> Very few lawyers specialize in protection of intellectual property outside of the few state institutions active predominately in the protection of copyrights. Enforcement will emerge as a critical issue as the private sector and foreign investment grow. Giving true meaning to these rights will require institutional strengthening in the registration

23. Proclamation No. 6307, 56 Fed. Reg. 29,787 (1991).

24. *Zakon za zapazhenite marki i promishlenite obratzci* [Trade Marks and Industrial Samples Law], *Darzhaven Vestnik*, Issue No. 95 (1967) (most recent amendment at *Darzhaven Vestnik*, Issue No. 56 (1986)).

25. *Zakon za avtorskoto pravo* [Copyright Law], I\* 92 (1951) (most recent amendment at *Darzhaven Vestnik*, Issue No. 30 (1990)).

26. *Nakazatelen Kodeks* [Criminal Code], *Darzhaven Vestnik*, Issue No. 26 (1968) (most recent amendment at *Darzhaven Vestnik*, Issue No. 105 (1991)).

agencies and the courts to insure that infringements can be identified, halted, and punished as appropriate.

### III. Company Law

#### A. HISTORICAL DEVELOPMENT

The first Bulgarian company law, the Commercial Law of May 29, 1897, was based on German commercial law, but also borrowed from other continental legal systems. It was amended several times before 1946, and related laws were passed—including the Law on Limited Liability Companies (1929), the Law on the Cooperatives (1907), and the Law on the Stock Exchange (1912 and 1928).

In 1951 all commercial laws in Bulgaria were abolished and replaced by a legal system designed to meet the needs of a centrally planned economy. For the next four decades, the activities of Bulgarian enterprises were regulated through constantly changing (and sometimes contradictory) decrees of the Council of Ministers. Market-oriented company law ceased to be taught at the only law school in Bulgaria, the University of Sofia. Only a few Bulgarian lawyers maintained exposure to market-oriented company principles while working for foreign trade companies or the few companies with Bulgarian participation registered abroad. A few joint-stock companies continued to be formed by decree of the Council of Ministers, but in practice they operated like other SOEs. Several companies with foreign participation were formed under State Council decree 535/1980, but their activity was very limited.

#### B. DECREE 56 OF 1989

The State Council's issuance of Decree 56<sup>27</sup> in January 1989 was a watershed event in Bulgaria's transition to a market economy, even though at the time the Decree was issued the move to a market economy was not a clearly defined goal. Decree 56 represented Bulgaria's first attempt to restructure and decentralize the management of state enterprises,<sup>28</sup> as well as its first move to allow private investment in commercial activities. Decree 56 reestablished most forms of companies that existed in the prewar Commercial Law, including the joint stock company, the limited liability company, and the "unlimited liability firm" (similar to a limited partnership). State-owned firms were supposed to reorganize into joint stock or limited liability companies. Private and foreign investment could be structured as one of these more formal entities or more informally as "individ-

27. Ukaz 56 za stopanskata deinost [Decree 56 on Economic Activity], Darzhaven Vestnik, Issue No. 4 (1989) (most recent amendment Darzhaven Vestnik, Issue No. 62 (1991)) [hereinafter Decree 56].

28. An earlier, unsuccessful attempt was made in 1987-88 to transfer state enterprise property to employees.

ual," "collective," or "partnership" "firms of citizens."<sup>29</sup> The first version of the Decree restricted the rights of private companies to participate in foreign trade or to hire workers, but these restrictions were subsequently removed.

Decree 56 succeeded in decentralizing some decision making within state enterprises and in stimulating the beginnings of private entrepreneurship in the economy. However, it had many shortcomings. First, its philosophy was somewhat schizophrenic in that it attempted to combine continuing state control with economic liberalization and private entrepreneurship.<sup>30</sup> Second, it was too broad and thus too general. Designed as a comprehensive business code, the Decree covered not only company formation and liquidation, but also taxation, bankruptcy, foreign investment, and even currency regulation and social security. A document of 126 articles and about thirty pages was clearly too short and too general to cover these complex areas adequately. Subsequent implementing regulations issued by the Council of Ministers also failed to clarify outstanding issues.

### C. THE COMMERCIAL LAW OF 1991

The new Bulgarian Commercial Law<sup>31</sup> was the first postwar law drafted by a team of Bulgarian lawyers in line with prewar legal tradition, and in general it is fully satisfactory for the needs of a market economy. While following in general the prewar law, an attempt was made to introduce postwar company forms and concepts from western Europe. These concepts aim primarily for flexibility—for example, flexibility in establishing managing bodies, in assigning voting rights, and in converting bonds into shares in joint-stock companies. Most provisions concerning articles of association are optional and may be changed by the partners. At the same time, care is taken to protect various interests, especially those of small investors and creditors.

The Commercial Law recognizes the five types of companies common in European civil law jurisdictions.

#### 1. *Characteristics of the Joint-Stock Company*

The joint-stock company (JSC) resembles the French S.A., the German AG, and the Anglo-American public corporation. At least two founders are necessary to set up a JSC (or one if the state is a founder).<sup>32</sup> Capital requirements are high relative to those in other CEE countries. Minimum capital of Bulgarian Lev (BGL) one million (about \$40,000) is required, or five million (approximately \$200,000)

29. Of these only the partnership firm of citizens was a registered and taxable legal entity. The individual firm was essentially a sole proprietorship and the collective firm was essentially a "pass-through" general partnership.

30. Unlike in some other CEE countries, economic reform to some degree preceded political reform in Bulgaria. The desire to maintain central power reflects the fact that the communist government was still in firm control when Decree 56 was passed.

31. Targovski zakon [Commercial Law], Darzhaven Vestnik, Issue No. 48 (1991).

32. *Id.* arts. 61, 63, 159.

if raised by public offering.<sup>33</sup> The minimum capital amount may include the value of in-kind contributions as evaluated by three experts appointed by the court upon request of the founders and contributors.<sup>34</sup> The entire capital of the company must be subscribed, but only 25 percent must be contributed prior to the registration.<sup>35</sup> Capital can be increased by issuing new shares, by appreciation of the nominal value of shares already issued, by conversion of convertible bonds into shares,<sup>36</sup> or by partial capitalization of profits upon a decision of the general meeting of shareholders.<sup>37</sup> Bonds (including convertible bonds if so provided by the articles of association) may be issued, but their value may not exceed 50 percent of deposited capital.

Reporting requirements are designed to promote transparency and the flow of information to shareholders and creditors. Financial data on the company must be included in the articles of association and made available to the court prior to registration. They must also be entered in the Commercial Register and published.<sup>38</sup> Raising capital through public subscription requires a detailed prospectus.

The Law provides great flexibility in assigning shareholders' rights. Both registered and bearer shares are allowed and may be exchanged for one another. Shares are transferable, but the articles of association may impose conditions on the transfer of registered shares in addition to entry into the share register.<sup>39</sup> Shareholders are entitled to dividends and liquidation proceeds in proportion to their capital contributions. Interest bearing shares are not allowed. A share entitles the shareholder to one vote in the appropriate meetings,<sup>40</sup> although shares with special voting rights can be issued if so provided by the articles of association. Preferred shares entitled to guaranteed or additional dividends or liquidation proceeds are also allowed.<sup>41</sup> The articles of association may provide that such shares be nonvoting.<sup>42</sup> Shares with equal rights form a separate class, and the rights of such class may be restricted only with the consent of this class of shareholders (with at least 50 percent of the shares represented and at least three-fourths consent of those represented).

The system of corporate governance is similarly very flexible, allowing either one-tier (board of directors only) or two-tier (board of directors and supervisory

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33. *Id.* art. 161. For banking and insurance companies the minimum capital is BGL 10 million.  
*Id.*

34. *Id.* art. 72.

35. *Id.* art. 174.

36. *Id.* art. 192.

37. *Id.* art. 197.

38. *Id.* art. 174.

39. *Id.* art. 185.

40. *Id.* art. 181.

41. *Id.* art. 182.

42. If a dividend is not paid to them for two consecutive years, holders of nonvoting shares acquire the right to vote until the dividend is paid. *Id.* art. 182(3).

board) systems.<sup>43</sup> The former is likely to be more appropriate for companies with fewer shareholders who can readily oversee management, while the latter may be preferable for companies with a larger number of shareholders. In the latter case the supervisory board is supposed to provide an additional check on management without being involved directly in management decisions.

## 2. *Characteristics of a Limited Liability Company*

The limited liability company (LLC) is similar to the French S.A.R.L. and the German GmbH, and to some extent to the private (closed) corporation under Anglo-American law. The LLC is an intermediate form, designed to avoid both the cumbersome procedures and public disclosure requirements of a JSC and the unlimited joint and several liability of the partners in a general partnership. Introduced for the first time in Bulgaria in 1924, the LLC was popular among small and medium-sized companies during the prewar period because it provided flexibility while reinforcing strong personal contacts between the partners. The number of LLCs already formed under the new Commercial Law suggests that it will again be a very popular company form.

The LLC can be formed by one or more persons.<sup>44</sup> The number of partners is not limited as in some other countries. Minimum capital of BGL 50,000 (about \$2,000) is required. Rules are very flexible. Partners are free to negotiate the distribution of voting rights and profits, the quorum needed for the general meeting, and the majority vote required for particular decisions. The share of the partner in the company is proportional to the partner's contribution, but this provision can also be changed.<sup>45</sup> At the moment of registration only 70 percent of the capital must be effectively contributed, with some partners contributing as little as one-third of their individual shares of the equity.<sup>46</sup> Shares are freely transferable among partners. However, transfers to third persons are conditional on approval at the general meeting. Such limitation on outside transfer, designed to preserve strong personal links among the partners, is one of the basic features of the European LLC.

## 3. *Characteristics of the Four Partnership Forms*

Four partnership forms currently exist under Bulgarian law: the general partnership, the limited partnership, the limited partnership divided by shares, and the civil partnership. The first three are governed by the Commercial Law and the last by the Law on Obligations and Contracts. Two major differences among the four forms concern taxation and liability. The three forms governed by the Commercial Law are considered taxable legal entities, while the civil partnership

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43. In the former the general meeting of shareholders elects the directors, while in the latter the general meeting elects the supervisors, who in turn elect the directors. One person cannot be both a director and a supervisor.

44. Commercial Law, *supra* note 31, art. 113.

45. *Id.* art. 127.

46. *Id.* art. 119.

is not.<sup>47</sup> With respect to liability, all partners in the general and civil partnerships—but only the general partners in the limited liability forms—have unlimited joint and several liability. The liability of the rest of the partners in the limited forms is limited to the amount of their agreed contribution.<sup>48</sup> The limited partnership divided by shares, like the JSC, can raise capital through public offerings and is subject to the same requirements in so doing.

#### D. PROCEDURES FOR ESTABLISHING A COMPANY

Establishing a company is relatively easy in Bulgaria from a legal and administrative perspective. Prior to registration, the founders of a company must draft the articles of association, the first general meeting of shareholders must approve the articles, the management must be appointed, and the minimum capital contribution must be made. The articles of a JSC or LLC need not be approved by a notary as in many other European countries,<sup>49</sup> although partnership deeds require notarial approval. The founders then apply to the relevant district court for approval of the articles and for registration in the Commercial Register. This process generally takes less than a week if all documents are drafted properly. The company is deemed incorporated as of the day it is entered in the Register. Upon approval by the court, the decision must be published in the Official Gazette, and the company must register with the tax authorities.

### IV. Foreign Investment

On January 16, 1992, the National Assembly passed a new foreign investment law, the Law on the Economic Activity of Foreign Persons and the Protection of Foreign Investment.<sup>50</sup> The new government formed after the elections in October 1991 had declared that removing obstacles to foreign investment would be a top legislative priority.<sup>51</sup> The new law is extremely liberal, imposing almost no constraints and offering generous incentives for foreign investment.

#### A. FORMS OF INVESTMENT

Unlike its predecessor, the applicability of the new law is reasonably clear. Nonresidents, excluding Bulgarian nationals, are considered foreigners for pur-

47. While not very flexible, the civil partnership is sometimes used by foreign investors because of its favorable tax consequences.

48. Commercial Law, *supra* note 31, art. 99.

49. See, for example, the country studies on Poland and Romania, *supra* note 1.

50. Zakon za stopanskata deinost na chuzhdestrannite litza i za zakrila na chuzhdestrannite investicii [Economic Activity of Foreign Persons and Protection of Foreign Investment Law], Darzhaven Vestnik, Issue No. 8 (1992) [hereinafter Foreign Persons and Protection Law].

51. The new law replaced the previous foreign investment law, Zakon za chuzhdestrannite investicii [Foreign Investment Law], Darzhaven Vestnik, Issue No. 47 (1991) (abolished), which had only been in force for six months. The old law was quite restrictive in comparison to similar laws in other CEE countries.

poses of the law. Resident foreign nationals are not considered foreigners and have unconditional national treatment. Bulgarian nationals with a second dual nationality who are resident abroad may choose how to be treated for purposes of the law.<sup>52</sup> Foreign-owned companies set up and registered in Bulgaria are Bulgarian legal persons and are not considered foreigners.

Forms of investment are governed by domestic law. Foreign investment can be organized in any of the forms recognized in the Commercial Law or as a civil partnership under the Law on Obligations and Contracts.<sup>53</sup> In addition, foreign persons and partnerships without legal personality can be recognized in Bulgaria for purposes of the Commercial Law if registered in their country of residence.<sup>54</sup> The share of foreign ownership is not limited. Foreigners can participate in joint ventures with Bulgarian entities or can operate through wholly owned entities. Foreign companies can also set up branches in Bulgaria.

No investment approval is needed except in a few areas specified in a negative list.<sup>55</sup> The abolition of the complicated and unclear approval procedures of the former law is one of the most important features of the new law.

## B. RIGHTS AND GUARANTEES

Foreigners receive national treatment in all areas except land ownership. No foreigner may own land,<sup>56</sup> and no domestic company with more than 50 percent foreign participation may own arable land. Foreigners may, however, own buildings and acquire rights (including long-term leases) over land if needed for business activity.<sup>57</sup> Foreigners may own residential property with a "construction right" on the underlying land.<sup>58</sup>

The Law guarantees full repatriation of profits (in domestic or foreign currency), foreign debt service payments, and other proceeds (including liquidation or sale proceeds) from the investment.<sup>59</sup> In line with constitutional guarantees, the Law allows expropriation only for important public needs that cannot otherwise be met.<sup>60</sup> Any expropriation of foreign property must be authorized by the Minister

52. Foreign Persons and Protection Law, *supra* note 50, art. 2(2).

53. Discussed *supra* part III.C.

54. Foreign Persons and Protection Law, *supra* note 50, art. 3(6).

55. *Id.* art. 5 (restrictions). Most of the areas on the negative list are sensitive industries for which licenses are also required of domestic investors. These include the manufacture and trade of arms, ammunition, and military equipment; banking and insurance, including the acquisition of shares in banking or insurance companies; and exploration and exploitation of natural resources in the territorial sea, the continental shelf, or the exclusive economic zone.

56. *Id.* art. 5(2), and Constitution-1991, *supra* note 7, art. 22(1).

57. Foreign persons or foreign-controlled companies may not acquire real property in some regions of the country, as designated by the Council of Ministers. Foreign Persons and Protection Law, *supra* note 50, art. 5(3).

58. Such "construction right" is typically granted to owners of apartments in buildings built on state-owned land. It provides that such land cannot be expropriated without regard to the building on it.

59. Foreign Persons and Protection Law, *supra* note 50, art. 13.

60. *Id.* art. 10.

of Finance, and prior compensation is required, either in kind or (upon the consent of the foreigner) in money.<sup>61</sup> Expropriation decisions can be contested in court.

### C. TAX INCENTIVES

To date tax incentives have been covered not by the foreign investment law but by Decree 56.<sup>62</sup> This decree provides, among other things, five-year tax holidays for companies with foreign participation that operate in high-technology industries, agriculture, food-processing, and tourism, as well as companies with foreign participation operating in free-trade zones. Because the government has not provided a specific list of high-technology sectors, the incentives are in practice available to most if not all investors. The same tax incentives are not, however, available to domestic investors even if they operate in the same kind of business. Customs regulations provide for exemption from customs duties of imports to be used for export-targeted production as well as relatively low duties on imports to be used for investment. In general these customs regulations apply equally to foreign and domestic investors.

Discrimination against domestic investment is only one of the problems with tax incentives for foreign investment in Bulgaria and elsewhere. Tax incentives—holidays in particular—can cause large revenue loss and complicate tax administration. Bulgaria can hardly afford significant revenue give-aways at this important period in its stabilization efforts. Nor can it afford to complicate the already daunting task of developing a competent and modern tax administration. Bulgaria should open its doors to foreign investors, but provide treatment that is neither better nor worse than national treatment.

### V. Contract Law

Three major characteristics distinguished Bulgarian contract law from its pre-war predecessor. First, contracts among private parties were treated differently from contracts among state enterprises. The Bulgarian contract law applicable to the limited (generally noncommercial) sphere open to private sector transactions was the Obligations and Contracts Law of 1950.<sup>63</sup> The law in theory applied to socialized enterprises, but in practice contracts among such enterprises tended to be governed by separate legislation or by administrative orders and decrees of the Council of Ministers. Although the law contained extensive socialist phraseology and certain uniquely socialist principles, especially with regard to the priority of the plan, it reflected many legal principles common to continental European legal systems.

61. *Id.* art. 10(7).

62. Decree 56 will continue to govern taxation only until new tax laws come into effect at the beginning of 1994.

63. *Zakon za zadalzhniyata i dogovorite* [Obligations and Contracts Law], *Darzhaven Vestnik*, Issue No. 275 (1950) (most recent amendment at *Darzhaven Vestnik*, Issue No. 12 (1993)).



Second, the idea of contractual freedom, though proclaimed in theory, was in practice subordinated to the needs of the central plan. The plan was adopted annually and had the force of law. Every other related law was drafted to ensure the priority of the plan over individual contracts. A specific category of "precontractual" disputes addressed not the fulfillment or breach of contract, but the very willingness of one of the parties to conclude the contract. Virtually the only way for a party not to conclude such a contract was to prove that the production capacity to fulfill it was not available. Though not used in practice after 1989, such category of disputes was formally removed from the Law on Obligations and Contracts only in 1993.

Third, socialist ideology dominated contract law. Contracts that were consistent with the law but considered inconsistent with the "rules of socialist co-existence" could be nullified.

#### A. THE CURRENT SITUATION

The Law on Obligations and Contracts remains the contract law of the country. Although the central planning agency was closed and central planning abolished in 1990, no changes were made in the Law. Until then, the Law still formally distinguished between contracts among individuals and contracts among socialized enterprises, but all current transactions were regulated by the general provisions applicable for individuals. The 1993 amendments finally eliminated these distinctions.

As noted, this law reflects generally accepted civil law concepts of contract and thus provides an acceptable legal framework. It covers quite a wide breadth of topics, including security interests (Section VII—Guarantees) and negotiable instruments (Section XVIII—Promissory Notes, Bills of Exchange and Checks). However, some important commercial concerns, such as securities and bankruptcy, covered by the prewar Commercial Law were omitted during the 1951 drafting of the Law on Obligations and Contracts because they were no longer considered relevant in a socialist economy.

Currently the aim of Bulgarian lawmakers is to restore the prewar Commercial Law in full (adding a second book to the new Commercial Law to accompany the first book on companies) and thus create a comprehensive legal framework regulating commercial activity. Only private nonbusiness transactions will then be covered by the existing Law on Obligations and Contracts. Most commercially oriented sections of the Law on Obligations and Contracts will probably be transferred again (with some updating) to the Commercial Law. Some types of transactions introduced in continental law after World War II, such as leasing and franchising, will be added. Though complex, the task of redrafting and restructuring the law is likely to be accomplished quickly. It will take more time to build experience with the law, enforcement capability, and a body of judicial interpretation in the courts, and to instill strict discipline for contract fulfillment in the population.

## VI. Bankruptcy

A working bankruptcy system not only provides a critical exit mechanism in a market economy. It is also needed—along with good collateral and debt collection mechanisms more generally—to discipline borrowers and spur the flow of credit to a newly emerging private sector in Bulgaria and other CEE countries.<sup>64</sup> Bulgaria had a well-developed legal framework for bankruptcy before World War II. Bankruptcy Law was incorporated in the Commercial Law and was modeled after the French, Italian, and Romanian Commercial Codes, but with some original provisions. Considerable practice and a body of court practice were built before the bankruptcy provisions were abolished with the rest of the Commercial Law in 1951.

These prewar bankruptcy regulations, though comprehensive, suffered from the same problems of other European systems: long and expensive court procedures, low recovery rates, and the availability of loopholes through which the debtor could transfer property before initiation of the proceedings. Bankruptcy was harsh and meant certain closure of the debtor firm; reorganization was not an option in these prewar systems. A Law on Mutual Agreement Procedure (Concordat) was, however, passed in 1932 to provide an alternative path for insolvent debtors—a framework to negotiate proportional debt reduction with all creditors and thus continue in operation. Similar laws were passed in most CEE countries during the prewar period.

Bankruptcy as a concept was incompatible with a centrally planned economy. The state, as the sole owner of all commercial assets, supported both debtors and creditors and was ultimately responsible for the relationships between them. With all input, output, and prices set by the plan, enterprise “failure” was not necessarily a cause for closure, but rather a cause for restructuring the enterprise, the plan, or both. Indeed, a goal of the system was not to promote competition, but to terminate it altogether. Bankruptcy as a concept was forgotten; if mentioned at all, it was as a negative feature of free-market economies.

Along with its many other tasks in connection with the transition to a market economy, Decree 56 in 1989 attempted to reintroduce the concept of bankruptcy. However, the bankruptcy framework provided by Decree 56 was ill-equipped for the needs of a market economy. It reflected the extensive involvement of the state in enterprise decision making that existed in 1989 when the Decree was adopted. It also reflected a desire to keep insolvent enterprises afloat if possible. Recognizing the shortcomings of Decree 56, the National Assembly is now considering and is expected soon to adopt a new draft bank-

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64. Bankruptcy is a rather blunt tool that works best on the margin in a generally healthy economy. It is not necessarily a good tool to handle the many large loss-making state firms left over from the socialist period, which instead need to be handled together in a coordinated program of privatization, restructuring, and liquidation.

ruptcy law. The new draft law closely follows the bankruptcy provisions in the original 1897 Commercial Law.

Bankruptcy is only one part of the larger framework for debt collection that makes private credit feasible in a market economy. Other parts of that framework will also have to be addressed if Bulgaria is to develop a well-functioning credit system. For example, the system for registering security interests should be updated and broadened to include all types of property under all forms of ownership. Second, the right to pledge or sell state-owned assets must be clarified, a challenge intertwined with the difficult questions of property ownership addressed earlier. As in other CEE countries, institutions to implement debt foreclosure in general and bankruptcy in particular must be developed. Training and expanding the number of bankruptcy judges and receivers should receive high priority. Important cases involving bankruptcies should be published, as was done before the war, to establish a set of precedents to guide the activities of debtors, creditors, and judges. Finally, credit-rating services, which do not yet exist in Bulgaria, need to be established.

## VII. Judicial Institutions

The implementation of the new set of business-related laws discussed above will be the greatest challenge facing the judicial system in Bulgaria over the next few years. The lack of judicial experience, if not dealt with adequately through technical assistance and training, could prove to be a serious obstacle to market reforms.

### A. THE COURT SYSTEM

Under socialism the judicial system was not independent, but was supposed to serve the goals of the state. Although central control over the judicial system relaxed somewhat in the mid- and late 1980s, local communist party committees continued to have decisive influence over the appointment and promotion of judges. Judges in courts of first instance had greater independence than those in higher positions.

Courts in Bulgaria were not involved in commercial cases during socialist times. The private sector was almost nonexistent, and disputes between state enterprises were dealt with in specialized state arbitration boards under the Council of Ministers. These boards have been dissolved, and most arbitrators have joined newly created commercial sections of regular courts. Unfortunately, the experience gained by these arbitrators—primarily oriented to implementing the central plan—has little relevance today. Not only is the subject matter of future commercial litigation likely to differ markedly, but legal procedures are likely to differ as well. In the past enterprises had little incentive to win a case, and little outside evidence was ever used to resolve disputes. Modern principles and techniques of litigation were virtually nonexistent.

The Bulgarian court system is still organized according to the provisions of the Constitution of 1971, although it will soon be reorganized to comply with the new Constitution.<sup>65</sup> The highest judicial body is the Supreme Court, which used to be elected by the National Assembly. It has three chambers: civilian, criminal, and military. Its important decisions are published and widely used by practicing lawyers as references. Below the Supreme Court are the district courts, and below them are the regional (general) courts.<sup>66</sup> Time and training are needed at all levels of the court system to develop the capacity and experience to handle the plethora of new commercial issues emerging as the economy moves toward a market system.

Arbitration could be a useful alternative to court procedures as a means to resolve commercial disputes among private parties. As in other CEE countries, the Bulgarian Chamber of Commerce and Industry has an arbitration commission that specialized during the socialist period in the settlement of international trade disputes. A broader mandate and proper technical support could help this body develop into a viable alternative means for dispute resolution. The legal basis for private arbitration between domestic parties is unclear. Although article 9 of the Code of Civil Procedure<sup>67</sup> restricts private arbitration to disputes between Bulgarian and foreign persons, Decree 56 explicitly allows private arbitration between domestic parties if both parties agree in writing.<sup>68</sup> How a decision reached pursuant to Decree 56 would be executed is, however, unclear.

## B. LAWYERS

As in other CEE countries, the Bulgarian legal profession was divided into two branches during the socialist period: lawyers belonging to a bar association (advocates) and legal advisers within state enterprises (jurisconsults). The jurisconsults handled virtually all commercially related legal work, while lawyers were not generally involved in commercial areas. Now a tug-of-war has developed between these two groups as to who is the more qualified to emerge as the private commercial lawyer of tomorrow.

Setting up private commercial law practice has been allowed in Bulgaria since 1989 and has grown considerably since then. The profession is fully privatized, and the bar is no longer controlled by the state.<sup>69</sup> On the other hand, many legal

65. Zakon za ustroistvo na sadilishtata [Courts Organization Law], Darzhaven Vestnik, Issue No. 23 (1976) (most recent amendment at Darzhaven Vestnik, Issue No. 46 (1991)).

66. The new Constitution also provides for a Constitutional Court, whose roles are to rule upon request on the constitutionality of new laws, to provide binding interpretations of the Constitution, and to rule on the constitutionality of international agreements and their consistency with previous agreements. Constitution-1991, *supra* note 7, art. 149. Although this is a very new institution for Bulgaria, it could grow—as it has, for example, in Hungary—to be a decisive check on the power of the executive and legislative branches of government.

67. Grazhdanski Procesualen Kodeks [Civil Procedure Code] IZVESTIA, Issue 12 (1952).

68. Decree 56, *supra* note 27, art. 98.

69. Zakon za advokaturata [The Bar Law], Darzhaven Vestnik, Issue No. 80 (1991).

and ethical issues surrounding the practice of law in industrial economies—such as liability for advice given, confidentiality, and conflicts of interest—have not yet been addressed.

### **VIII. Conclusion**

The Bulgarian Government is working steadily to create a legal framework in which the private sector can develop. Many new laws, including a new Constitution and new laws on companies, foreign investment, and patents, have been adopted over the past three years, and more are being drafted and debated. Bulgaria's prewar legal framework was quite modern for its time, and most of these new laws draw on prewar Bulgarian tradition.

However, the administrative and judicial machinery for implementing those laws is slower to develop. Laws by themselves are only paper. The legal framework will come to life only when the legal and administrative institutions can enforce the laws and readily resolve the disputes that they inevitably spur, and when the public accepts that the laws are indeed binding. Furthermore, the laws are by necessity general frameworks only. Their content needs to be filled in by more detailed regulations and practice in individual cases, a process that of necessity takes time. The challenge of legal development is as immense as that of economic reform, and the two are inexorably intertwined.