Legal Opinion Executive Summary

This Executive Summary has the purpose to provide a summary of the key conclusions set out in Part C of our Opinion. It does not purport to be complete and must be read in conjunction with Part C and the other parts of our Opinion. It should not be relied upon without referring to the other parts of the Opinion because it is given for the purposes of convenience only.

Bulgaria

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Stefan Tzakov, Managing Partner, Head of Energy

Coverage: EFET Gas, EFET Electricity

Date of opinion: 12 June 2023

Summary

Types of Counterparty *What types of counterparty are covered by the opinion?*	The opinion covers: corporations (incl. publicly-owned corporations), banks, insurers, and other qualified entities under the Financial Collateral Arrangements Act, as well as entities under the Markets in Financial Instruments Act.	Pages 4-14, 28, 105-109 and 111-118
Types of Transaction *What types of transaction are eligible for close-out netting?*	The opinion covers all transaction as per the instruction letter – commodity forwards, options and swaps, as well as physical commodity transactions. Based on Bulgarian law general rules, in principle all transactions should be eligible for close-out netting. Depending on the quality of the parties to such transactions, some specific safe-harbour provisions can exist in addition.	Pages 14-16, 28-32
Automatic Early Termination *Does the opinion require or recommend that automatic early termination applies to a counterparty organised in the jurisdictions?*	Yes.	Pages 17-24
Early termination provision *Is the early termination provision of the agreement enforceable in the jurisdiction?*	The Early Termination mechanism (§ 10.3) is generally compliant with and enforceable under Bulgarian law. Its general admissibility could be grounded with **(a)** the principle of contractual freedom and **(b)** the subsidiary application of the commercial customs to matters not regulated by the Commerce Act and Bulgarian civil legislation. However, when active Early Termination is due to an insolvency based Material Reason (§10.5(c)), it is disputable whether the close-out netting and the calculation of the Settlement	Pages 17-24

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	Amount resulting therefrom are permissible and enforceable under Bulgarian law. Other creditors may argue that these actions are detrimental to them and try to challenge the actions, in particular on the grounds of article 645(3) of the Commerce Act. Therefore, it is recommendable the Automatic Termination (§ 10.4) to be specified as applying in the Election Sheet upon a Material Reason described in § 10.5(c) of the General Agreement.	
Close-out netting *Is the close-out netting provision of the agreement enforceable in a local insolvency?*	Bulgarian law contains a definition of close-out netting. However, this definition and the respective (more beneficial) consequences are relevant only in respect of financial collateral arrangements. It could be nevertheless inferred that the close-out netting approach is generally permissible under Bulgarian law also out of the context of the financial collateral arrangements. A ground for such a conclusion could be found in the cited general principle of contractual freedom and the subsidiary application of the commercial customs to matters not regulated by the Commerce Act and Bulgarian civil legislation. Close-out netting is still not well known in Bulgarian court practice. This makes the analysis of the practical aspects of close-out netting very difficult and the position of Bulgarian courts in respect of close-out netting provisions in case of potential lawsuits unpredictable. In any case we believe that Bulgarian courts would interpret the close-out netting provisions of the General Agreement in the light of the more familiar legal figure of the set-off. It can be concluded that the close-out netting derives from the set-off, but has some additional elements. Therefore, in order to assess the permissibility and enforceability of the termination clauses of the General Agreement under Bulgarian law, the permissibility and enforceability of set-off in case of insolvency proceedings have to be analysed. The insolvency set-off is generally permissible provided that prior to the date of the judgement for institution of the insolvency proceedings both debts have existed and were counter and of the same kind and	Pages 17-27, 36-38 and 64-65

the creditor's claim was due and payable. The set-off may be challenged and declared null and void with respect to the insolvency creditors by the court, in case the creditor has acquired the claim and the debt to the debtor prior to the date of the judgement for institution of the insolvency proceedings, but he knew as at the time of acquiring the claim or debt that inability to pay debts, respectively over-indebtedness, has occurred in respect of the debtor or that a petition for opening of insolvency proceedings has been filed. It is therefore of crucial importance to determine what is the time of acquiring by the Terminating Party of the claims under the Agreement (i.e. under the Individual Contracts) subject of set-off (close-out netting). We believe that this issue might be problematic in case of active (optional, discretionary) Early Termination. It is, therefore, recommendable in the Election Sheet the Automatic Termination clause to be selected in order to reduce the potential risk of successful challenging of the set-off (close-out netting).

It is important that the Early Termination Date coincides with the moment of occurring of the Material Reason under §10.5(c) (e.g., with the moment of filing of a request on opening (institution) of insolvency proceedings) and is not later than this moment. In our view a grace period in §10.5(c)(iv) would create additional legal uncertainty and is to be avoided.

Due to the lack of settled case law, it cannot be predicted how Bulgarian courts would interpret the Automatic Termination, the close-out netting and the calculation of the Settlement Amounts, that is why it cannot be said that by introducing the Automatic Termination mechanism the risk of successful challenging of these actions is eliminated, but this would lead to risk reduction.

It cannot be predicted either what the courts' position in regard to the Termination Amount calculated by the Terminating Party would be. In any case the Terminating Party has to be prepared to prove the exact amount of the damages suffered (i.e. the Termination Amount, the Settlement Amounts and

	all their elements – Costs, Gains and Losses, as defined under §11).	
Characterization of collateral *Would laws of jurisdiction characterize transfer of collateral as effecting an unconditional transfer of ownership or is there risk of re-characterizing such transfer as creating a security interest?*	Transfer of collateral as effecting an unconditional transfer of ownership is valid under the Financial Collateral Arrangements Act, i.e. one of the parties to the Credit Support Annex must be an eligible entity (a financial institution, etc.). Out of this context it can be argued that the transfer of ownership in Cash under the Credit Support Annex is null and void.	Pages 54-62 and 115-117
Further action required *Is any action required to ensure that ownership title continues to rest with Party B?*	No (subject to our previous comment).	Pages 54-57
Amendments necessary *Are there any recommended amendments to the standard documents?*	No amendments are really necessary, but only recommendable – e.g. to exactly specify the Early Termination Date, or gross negligence to be included in § 12.4 of the General Agreement.	Pages 23-24, 65-68 and 69-70
Other remarks *Does the opinion specify issues that you deem to be of specific interest in negotiating an agreement with a counterparty in the jurisdiction?*	1) Please see our comments on the Parent Company Guarantee. 2) Please see our comments on the Bulgarian electricity and natural gas markets and market players. 3) Transactions in natural gas shall be done on the grounds of **written contracts** and/or on an organized natural gas exchange market. Non-compliance with the written form requirement is a condition a contract to be declared null and void by the courts. With a view to that, our recommendation is all Individual Contracts for trading in gas to be concluded always only in writing and this requirement to be explicitly stated in the Election Sheet.	Pages 60-62 Pages 7-14 and 91-93 Pages 72-76

To:
European Federation of Energy Traders (EFET)
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The Netherlands

Attn. Ms. Michaela Duve, Chair EFET Legal Committee

Re. Legal Opinion Regarding the Enforceability of Close-Out Netting and the Validity and Enforceability of the EFET General Agreements Concerning the Delivery and Acceptance of Electricity and of Natural Gas and its Collateral Arrangements.

Sofia, 12 June 2023

Dear Ms. Duve,

Further to EFET's instruction letter dated 11 July 2022 by which EFET assigned Kambourov & Partners to update the legal opinion on the EFET General Agreements concerning the Delivery and Acceptance of Electricity (Version 2.1(a)/21 September 2007) and of Natural Gas (Version 2.0(a)/11 May 2007) (the **General Agreement(s)**), the Allowances Appendices to the General Agreements (Versions 5.0/28 February 2018, 6.1/4 November 2021, 4.0/28 February 2018 and 5.1/4 November 2021) (the **Allowances Appendix/Appendices**), the EFET Credit Support Annex to the General Agreements (Versions 2.0/May 2010 and 3.1/4 November 2021) (the **Credit Support Annex; CSA**) and the E-Notice Agreement as published by EFET on 13 October 2020, as well as all the other documents to be considered, listed in EFET's instruction letter and available on the EFET website (the **Documents**), we express the following Legal Opinion (the **Opinion**):

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A. Introduction

This Opinion examines the validity and enforceability of the General Agreements[1] and the other Documents in the light of the laws of the Republic of Bulgaria (**Bulgaria**) and is based on the EFET's Instruction Letter dated 11 July 2022 (the **Instruction Letter**) which has been provided to us by the European Federation of Energy Traders (**EFET**). It is strictly limited to the matters stated herein and does not extend, and is not to be read as extending by implication, to any other matters. This Opinion is based exclusively on, and relates solely to matters of, Bulgarian law as now (12 June 2023) in force.

This Opinion is addressed exclusively to EFET, the members of the EFET Legal Committee and any other entity who has subscribed to EFET for one or more of the country opinions, is for their sole benefit and may not be relied upon by any other person, entity or corporation whatsoever and may not be disclosed to any other person or legal entity without EFET's prior written approval, but may be made available by EFET members to the appropriate regulatory authorities.

This Opinion shall not be used as the sole basis for entering into Individual Contracts (as defined in the General Agreements), making an investment decision or taking any financial or other commitment.

Capitalized terms used in this Opinion, if not otherwise defined herein and unless the context otherwise requires, shall have the meaning as given to them in the General Agreements or any other of the Documents.

[1] Where we refer to the 'General Agreement', we mean both the Electricity and the Natural Gas General Agreements. In case there are differences as far as the application and enforceability of each of the two General Agreements are concerned, this is explicitly specified in the Opinion.

B. Assumptions. Potential Counterparties. Transactions under the General Agreement

I. Assumptions and Reservations Necessary for the Opinion

1. General Assumptions

- Two counterparties enter into an EFET General Agreement and at least one of the counterparties is incorporated or organised or has its centre of main interest in Bulgaria (**Party A** or the **Bulgarian Party**).

- Party A is a corporation, financial institution or other entity as further described in Appendix A to the Instruction Letter (see also Sec. B.II below). For ease of reference, Appendix A is annexed to this Opinion.

- Each General Agreement and any of the Annexes (incl. the Credit Support Annex) and Appendices is enforceable under the laws of any jurisdiction for purposes of private international law (other than the laws of Bulgaria, for which we have been requested to opine on in this legal opinion) and each counterparty has duly authorized, executed and delivered, and has the capacity to enter into, each document.

- On the basis of the terms and conditions of the General Agreement and other relevant factors, and acting in a manner consistent with the intentions stated in the General Agreement, the counterparties over time enter into a number of Individual Contracts which include all of the Individual Contracts described in Appendix B to the Instruction Letter (see also Sec. B.III below). For ease of reference, Appendix B is annexed to this Opinion.

- The Individual Contracts provide for the physical delivery of Commodities (as defined in Appendix B to the Instruction Letter), green certificates or emission rights in exchange for cash, however, some of them may also provide for cash settlement.

2. Drafting this Opinion we have assumed that the counterparties are duly incorporated, organised and validly existing in accordance with the laws of the jurisdiction of their incorporation and/or the centre of their main interest; each Party has taken all necessary corporate and other appropriate steps to enter into and to perform the General Agreement and the Individual Contracts; all other Representation and Warranties under § 21 of the General Agreement are true and correct; the General Agreement and the Individual Contracts are entered into and performed based on at arm's length principles; all governmental authorisations, approvals, licences, permits and consents of any country which might be required in connection with the entering into, the delivery and the performance of the General Agreement and the Individual Contracts have been or will be obtained.

3. It should be noted that in the last years the use of the General Agreement in Bulgarian trade practice has grown and the number of market players using it is increasing (especially when Bulgarian companies enter into transactions with non-Bulgarian counterparties). Nevertheless, the relevant practice of Bulgarian courts or Bulgarian arbitration courts with

regard to the General Agreement remains scarce. Bulgarian legal doctrine does not review in detail the clauses of the General Agreement either. The General Agreement's structure and many of the terms used in it are not typical for Bulgarian law (it is hard to translate some of them with correct Bulgarian legal terms). Besides, the General Agreement is very general – on the one hand it is a frame (master) agreement and, on the other, it has been drafted in order to be applicable in all EU Member States in which energy trade is being carried out.

That is why, in the absence of relevant settled case law, our legal analysis of the General Agreement is based predominantly on our understanding of general principles of Bulgarian law.

4. The present Opinion does not deal with any tax and financial issues related to the performance of transactions with electricity and natural gas. All provisions of Bulgarian tax legislation are mandatory and the parties to an agreement may not replace them by the agreement's clauses. Any agreements between the parties remain only on the plane of the civil liability (i.e. if one of the parties is obliged by virtue of law to pay certain tax and pays it, but the parties have agreed that this tax shall be paid by the other party, the first party has a claim against the other party for the paid amount). Our recommendation is in each particular case concrete tax advice to be sought.

5. We have given the legal terms in English (and sometimes in German too, since we believe that Bulgarian legal terms can be better explained with German legal terms) and not in Bulgarian (where appropriate we have given in brackets also synonymous English terms). This might impede to some extent the understanding of our Opinion, but it should be clear that it is impossible to guarantee a totally accurate translation or interpretation, especially when such specific matters and terms are concerned.

6. On the basis of the legal analysis we have made of the General Agreement and the other Documents, we would conclude that they are generally compliant with and enforceable under Bulgarian law. Where we consider some clauses contradicting to some extent to Bulgarian law, being not clear enough or just being unusual in Bulgarian contract practice, we have made respective comments in our Opinion below.

II. Potential counterparties

Please consider the following preliminary notes as regards the potential counterparties to the General Agreement in the light of Bulgarian law:

1. Corporations, partnerships, banks/credit institutions

(i) Companies have legal personality under Bulgarian law. The most popular company forms are the private limited company (*Gesellschaft mit beschränkter Haftung* in German, *drujestvo s ogranichena otgovornost* (*OOD*)) and the public limited company (*Aktiengesellschaft* in German, *aktzionerno drujestvo* (*AD*)). The shareholders in those types of companies are not liable for the obligations of the companies.

Bulgarian legislation explicitly regulates the registration of *Societas Europaea* (SE) with the Bulgarian Commercial Register, in case their seat (registered office) is in Bulgaria.

The Bulgarian Commerce Act (published in State Gazette 48/18.06.1991, last amendments published in State Gazette 25/29.03.2022) (the **Commerce Act**) recognizes also the following company forms: unlimited partnership (*sabiratelno drujestvo*) (partners are joint debtors and are unlimitedly liable for the debts of the company; creditors of the company have direct claim against the partners), limited partnership (*komanditno drujestvo*) (some of the partners are joint debtors and are unlimitedly liable for the debts of the company, where the liability of the others is limited up to the amount of their contribution into the company; creditors of the company have direct claim against the partners) and partnership limited by shares (*komanditno drujestvo s aktzii*). As mentioned, these companies play an insignificant role in Bulgarian business life.

These companies should be distinguished from the 'pure' partnership – the so called 'civil partnership' under article 357 of the Obligations and Contracts Act (published in State Gazette 275/22.11.1950, last amendments published in State Gazette 102/01.12.2020) (the **OCA**). The civil partnership is not a legal entity and is thus not entitled to be holder of rights and obligations. Such holders are the single partners. This form of legal presence under Bulgarian law is popular most of all with a view to the establishment of consortia for the purpose of participation in various public procedures (privatization, public procurement, concessions, etc.).

Another form of legal presence in Bulgaria is the cooperation. It is a legal entity incorporated by natural persons and is recognized as a merchant under the Commerce Act. The role of cooperations in Bulgarian business life is low too.

(ii) Foreign companies may establish their subsidiaries (which have legal personality) and/or their branches (which do not have legal personality, but are treated for tax and other purposes as separate entities; transactions entered into by the manager of the branch bind directly the company) in Bulgaria. It is very popular for a foreign company to hold 100 % of the capital of its Bulgarian subsidiary (in the form of a sole-owned private (*EOOD*) or public limited company (*EAD*)).

(iii) The licensing, activity, supervision and winding up of the credit institutions are regulated by the Credit Institutions Act (published in State Gazette 59/21.07.2006, last amendments published in State Gazette 51/01.07.2022). 'Credit institutions' are the banks. It should be noted that the bank insolvency is regulated by a separate law – the Bank Insolvency Act (published in State Gazette 92/27.09.2002, last amendments published in State Gazette 25/29.03.2022).

Banks may be incorporated only in the form of a public limited company.

Pursuant to the Credit Institutions Act, a financial institution is an entity different from a credit institution or an industrial holding whose main activity is carrying out of one or more of the transactions under article 2, para 2, items 1, 2, 6-8, 10-13 of the Act (financial leasing, trade in various financial instruments, etc.), acquiring holdings or granting of credits with funds which have not been raised from receiving deposits or other repayable funds from the public.

2. Publicly-owned corporations

(i) In Bulgaria after the economic changes in 1989, there were many companies (private or public limited companies) owned by the Bulgarian State. Most of these companies have now been privatized and are currently owned by private (including foreign strategic or private equity) investors or jointly owned by the Bulgarian State and private investors.

Generally, the state-owned companies are governed by the same rules as normal commercial undertakings but there are specific rules and regulations as well, such as:

- Reorganisation or winding up of companies 100 % owned by the Bulgarian State shall be done by the Council of Ministers or the respective minister in accordance with his sphere of competence.
- Reorganisation or winding up of companies with more than 50 % state participation in their capital shall be done only with the consent of the Public Enterprises and Control Agency (except for the insolvency cases).

The Bulgarian State is the single owner (single shareholder) in companies with 100 % state participation in their capital. Its shareholder rights are exercised by the Council of Ministers or the respective minister in accordance with his sphere of competence.

The single owner's consent is necessary for the valid entry into some kinds of transactions (loan agreements, establishment of mortgage or pledge over long-term assets of the company, etc.) by the state-owned companies.

In their day-to-day business operations the state owned companies are represented by their respective managing bodies (Managing Director in case of a private limited company and Executive Director in case of a public limited company).

It is therefore to be concluded that a state-owned company may freely enter into the General Agreement provided that (a) no securities as listed above are being established (otherwise the State's consent shall be necessary) and (b) no further restrictions are envisaged in the company's constitutional documents (by-laws, etc.).

If the entity is with 50 % or more state or municipal participation in its capital, the principle is that for the valid entering by it into some kinds of transactions (loan agreements, transactions for securing of receivables, etc.) the consent of the Public Enterprises and Control Agency, respectively of the municipal council shall be necessary as well.

(ii) The Commerce Act provides also for the possibility special 'public undertakings' to be established (by the State or the municipalities) in the form of private or public limited companies, or, if so envisaged in a special law, of state undertakings which are not companies. Such special state undertakings have been established for example in the transport sector (railway, sea, etc.).

(iii) Entities belonging to the public sector shall comply with the provisions of the Public Procurement Act (published in State Gazette 13/16.02.2016, in force as from 15.04.2016, last amendments State Gazette 62/05.08.2022) (the **PPA**) when awarding contracts for delivery of goods (commodities), services and construction (if these contracts are above certain thresholds). Such entities are the state authorities, the bodies governed by public law[2] but also the companies carrying out any of the specific energy, water, transport and other activities listed in the PPA (the so called 'sector assignors' or 'utilities'). For example, the National Electricity Company EAD (**NEC**) (holding *inter alia* a license for power trading) is both a body governed by public law and a sector assignor, therefore, when entering into contractual relations with it, the necessity of a procedure under the PPA shall be assessed on a case by case basis.

We do not believe that the PPA rules have much relevance for the EFET members since the latter carry out wholesale trade and do not supply end customers. Nevertheless, we deem that for the sake of completeness some notes in this regard would be useful.

It can be concluded that entities falling within the scope of the PPA shall carry out a procedure under the PPA if they want to enter into an electricity procurement contract as buyers (the PPA contains special rules for the entering into Framework Agreements within the meaning of public procurement law; such an agreement shall contain the main conditions of the contracts the parties intend to conclude within the next 4 (maximum) years, including '*regarding the prices*'; when entering into the separate contracts on the basis of the Framework Agreement the parties may not amend '*substantially*' the conditions agreed in the Framework Agreement).

This rule shall not apply to electricity procurement contracts entered into by sector assignors (as buyers) carrying out any of the energy related activities listed under article 15(1), item 4 with reference to articles 124, 125 and 128 of the PPA (the provision or operation of fixed networks intended to provide a service to the public in connection with the production, transport or distribution of natural gas, heat or electricity, the supply of natural gas, heat or electricity to such networks, as well as extracting of natural gas and exploration for or extraction of coal or other solid fuels).

It should be further noted that in case of public procurement procedures the awarding entities enclose to the tender documentation a template contract, i.e. the contract to be concluded may not be proposed by the candidates (and as a rule the candidates have to confirm that they accept the template contract's terms & conditions, i.e. they are even not allowed to propose amendments to this contract).

Once concluded, public procurement contracts are generally governed by the common rules of Bulgarian civil and commercial legislation (the Commerce Act and the Obligations and Contracts Act). The main restriction is that the parties to a public procurement contract are not allowed to amend it (amendments are permissible only in any of the cases explicitly listed in article 116 of the PPA).

3. Players on the Bulgarian electricity market (*for the players on the Bulgarian natural gas market, please see the next item 4*)

We believe that a brief description of the Bulgarian electricity market and of the market participants would contribute to the better understanding of this Opinion.

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[2] The PPA contains a rather exhaustive definition of a 'body governed by public law', where the main principle is that these are legal entities which have been established for the purpose of meeting needs in general interest and which are financed and/or controlled by the State, by state authorities or by other bodies governed by public law.

The electricity market in Bulgaria is still in a process of full liberalization. The official (on paper) full market liberalization took place on 1 July 2007, but the real opening lasted much longer and still continues (e.g. households got the real possibility to switch to the liberalized market only in April 2016). The market still has two segments – a regulated and a not regulated segment. Regulation is effected by the Commission for Energy and Water Regulation (the **CEWR**, until 6 March 2015 the name of the Bulgarian energy regulator was 'State Commission for Energy and Water Regulation' /**SCEWR**/). The trade in electricity at freely negotiated prices is being carried out on the free (liberalized) market, incl. on the Bulgarian energy exchange (IBEX - http://www.ibex.bg/en). Main participants in the free market as per article 100 of the Bulgarian Energy Act (published in State Gazette 107/09.12.2003, last amendments published in State Gazette 11/02.02.2023) (the **Energy Act**) are:

- Electricity generators (producers) (nuclear power plant Kozloduy, thermal power plants, hydro power plants and other RES-generators, etc.; all the big generators are established in the form of a public limited company; in order to be able validly to carry out their activity, electricity generators shall have a license for electricity generation issued by the CEWR[3]). In the last years, by amendments to the Energy Act, the electricity generators were obliged to sell their electricity output on the organized electricity exchange, i.e., on IBEX. As of 2 February 2021, this mandatory trade was extended towards all electricity generators with installed capacity 500 kW or more. There are some exceptions from this rule, the most important being that RES-generators put into operation after 1 January 2019 are exempted from the mandatory trading on IBEX.

  The obligation all the electricity generation to be sold on IBEX can be fulfilled either by the generator himself, or by his balancing group coordinator.

- Electricity traders – for trade in electricity a license shall be issued by the CEWR too. Electricity traders purchase electricity from the generators and/or other electricity traders and sell it to the end customers and/or to other electricity traders. In practice electricity traders often also hold the balancing group coordinator license.

  For the sake of clarity it should be mentioned that the electricity traders are an explicitly regulated category of (licensed) participants in the free energy market which should be differentiated from the trader as a general term under the Bulgarian Commerce Act (a trader in the meaning of the Commerce Act is any natural person or legal entity whose business is any of the activities listed in Art. 1(1) of the Commerce Act; traders by definition are also the companies and the cooperations).

- End customers - as from 1 July 2007 all customers had the right to choose their electricity suppliers (i.e. are regarded by the Bulgarian law as eligible). In order to be able to purchase electricity from the free market, they had to be registered on the so called balancing energy market (pre-condition for the registration was the conclusion of certain agreements and the providing of certain securities).

[3] Such a license is not necessary if the total installed electricity capacity of the power plant is up to 5 MW.

After 17 July 2012 by definition only the low voltage customers remained clients of their regional end suppliers, the middle voltage customers were forced to choose an electricity supplier on the free market. Such a supplier could in principle be electricity generators or electricity traders (Art. 15(3) of the Rules for Trade in Electricity) but in practice end customers enter into supply agreements with electricity traders (and not directly with generators).

By mid 2014, the balancing groups (circles) were finally introduced in practice and started functioning. As official start of the balancing energy market in Bulgaria is considered 1 June 2014. The public provider NEC, the Electricity System Operator EAD (**ESO**), the electricity distribution companies, the end suppliers (operating on the regulated market segment) and the suppliers of last resort were licensed as coordinators of special balancing circles, the traders (operating on the liberalised market segment and supplying end customers /and not carrying out wholesale trading/) were licensed as coordinators of standard and combined balancing groups, etc. The coordinators are responsible for the imbalances of their balancing groups. ESO shall execute transactions for settlement of the imbalances with the balancing group coordinators; the financial liability to ESO for the imbalances of the balancing groups shall be borne by the coordinators.

As mentioned, after April 2016 (when the standard load profiles were finally introduced) households got also the possibility to switch to the liberalized market and to change their electricity supplier.

As from 1 October 2020, also the low voltage business customers were forced to choose their electricity suppliers on the free market and currently only the household customers can buy electricity at regulated prices.

- Suppliers of last resort - they shall ensure the supply with electricity of end customers who are not allowed to be customers of the end suppliers, until they choose their supplier, or the chosen supplier does not supply them with electricity due to reasons not depending on the end customers.

- Planning, coordination and management of the Bulgarian electricity system is carried out by ESO and by the operators of the distribution networks. ESO is a separate legal entity having obtained a license for electricity transmission. ESO administers the transactions in electricity and organises the balancing energy market in compliance with the Rules for Trade in Electricity, adopted by the SCEWR (the **Electricity Trade Rules**; current version published in State Gazette 66/26.07.2013, last amendments published in State Gazette 36/21.04.2023).

  Bulgarian legislators chose the Independent Transmission Operator (**ITO**) model as the unbundling option applicable to the Bulgarian Transmission System Operator (**TSO**) – ESO. In order to become approved and designated as the TSO, ESO needed: (i) to be granted an electricity transmission license; and (ii) to be certified as an ITO. In February 2014 the electricity transmission network (incl. all the related assets and liabilities) was transferred from NEC to ESO (by virtue of a spin-off). ESO got a transmission license and NEC's transmission license was terminated. ESO was certified as ITO by the CEWR in July 2015.

- A license for organizing an electricity market was issued by the SCEWR on 31 March 2014 to the company Bulgarian independent energy exchange EAD (100% owned by Bulgarian Energy Holding EAD (**BEH**) at that time, i.e. indirectly by the Bulgarian State). The Bulgarian electricity exchange (Independent Bulgarian Energy Exchange (IBEX) - http://www.ibex.bg/en) finally started functioning in December 2015. Fulfilling a commitment undertaken in EU competition case *BEH – Electricity,* BEH divested its ownership in IBEX and transferred it to the Bulgarian Ministry of Finance; subsequently, on 12 February 2018, the ownership of IBEX was further transferred to the Bulgarian Stock Exchange - Sofia AD (controlled by the Bulgarian Ministry of Finance).

It should be further underlined that:

(i) Until 1 January 2007 a license for any of the energy related activities under the Energy Act was issued by the SCEWR only to a company registered under the Bulgarian Commerce Act, i.e. to a Bulgarian company registered in the Bulgarian Commercial Register. That is why foreign energy companies used to establish local (single-owned) subsidiaries in order to use them as vehicles for obtaining energy licenses. As from 1 January 2007 this restriction is not relevant any more in respect of companies registered in other EU Member States provided that such companies comply with the other requirements of the Energy Act.

(ii) Until 1 January 2007 only NEC, the public provider of electricity, had the right to enter into cross-border transactions in electricity. With the EU accession of Bulgaria this monopoly was legally restricted. Now electricity generators, electricity traders, the public provider, the end suppliers, the suppliers of last resort, the electricity exchange operator and the customers shall have the right to enter into transactions in electricity with local entities of EU Member States, provided that the conditions of article 102 of the Energy Act are met (see also item **C.VIII.**2.3 below). The first auctions for allocation of cross-border (interconnection) capacities were carried out by ESO in September 2007 and are being carried out on a regular basis. Relevant information is published on ESO's webpage (see for example here: https://www.eso.bg/index.php?en – *Operational data*).

4. Regulatory aspects of the Bulgarian gas market. Players on the Bulgarian gas market

We believe that a brief description of the Bulgarian gas[4] market and of the market participants would contribute to the better understanding of the regulatory aspects of wholesale gas transactions in Bulgaria.

As of 1 October 2021, trade in natural gas is subject to licensing under Bulgarian law, after many years in which (in contrast to electricity traders) gas traders did not need to obtain a license.

4.1. The main legal document is the Energy Act (**EA**). Of particular importance are the changes to the EA published: **(1)** on 8 October 2019 because they introduced significant changes,

[4] The commodity subject of trade under the General Agreement will be referred to in this Legal Opinion as 'natural gas' and 'gas', both terms used with one and the same meaning.

giving finally impetus to the liberalization of the natural gas market, which had always lagged significantly behind the electricity market; and **(2)** on 26 June 2020 which introduced the licensing requirement towards gas traders (into force as of 1 October 2021).

The following main pieces of secondary legislation, mainly adopted / approved by the energy regulator – the Commission for Energy and Water Regulation (the **CEWR**) – are noteworthy for the purposes of the present Opinion:

- Ordinance No 3 of 21.03.2013 on Licensing the Activities in the Energy Sector, published in State Gazette 33/5.04.2013, last amendments published in State Gazette 18/24.02.2023 (the **Licensing Ordinance**);
- Rules for Trade in Natural Gas, published in State Gazette 59/04.08.2015, last amendments published in State Gazette 57/19.07.2019 (the **Natural Gas Trade Rules**);
- Natural Gas Market Balancing Rules, published in State Gazette 99/13.12.2016, last amendments published in State Gazette 79/21.09.2021 (the **Balancing Rules**);
- Rules for access to the gas transmission and/or the gas distribution networks and the natural gas storage facilities, published in State Gazette 36/16.04.2013, last amendments published in State Gazette 103/27.12.2016 (the **Access Rules**);
- Methodology for determining the prices for access and transmission of natural gas through the transmission networks of Bulgartransgaz EAD, published in State Gazette 72/29.08.2014, last amendments published in State Gazette 79/08.09.2020;
- Daily Imbalance and Neutrality Charge Calculation Methodology, published in State Gazette 57/19.07.2019.

English versions of the various rules regulating the Bulgarian gas sector can be found on the webpage of the Bulgarian gas TSO – Bulgartransgaz EAD - https://www.bulgartransgaz.bg/en/pages/national-legislation-40.html

4.2. According to Art. 173 of the EA, transactions in natural gas are carried out on the basis of written contracts and/or on an organized natural gas exchange market in compliance with the provisions of the EA and the Natural Gas Trade Rules.

According to Art. 176(3) of the EA, the transactions in natural gas with short-term standardized products and with products with a delivery period of less than or equal to one year are to be concluded on an organized natural gas exchange market. Extraction companies offer not less than 15 percent of the natural gas extracted on the territory of Bulgaria on the organized natural gas exchange market. After 1 January 2025, this obligation remains in force only for short-term standardized products.

There are two licensed operators of natural gas trading platforms acting as organized natural gas exchange market - Balkan Gas Hub EAD[5] (a 100% owned subsidiary of Bulgartransgaz EAD) and Bulgarian Energy Trading Platform AD[6] (a private owned company).

[5] Web page - https://www.balkangashub.bg/en
[6] Web page - https://betp.bg/?lang=en

4.3. The internal gas market is still dominated by the public provider Bulgargaz EAD[7] (**Bulgargaz**) (a 100 % owned subsidiary of Bulgarian Energy Holding EAD (**BEH**), which is 100 % owned by the Bulgarian State) purchasing the imported gas (at freely negotiated prices) and reselling it to the end suppliers (in charge of the supply of the end customers connected to the gas distribution networks) and to the customers directly connected to the gas transmission network (usually large industrial customers). In other words, Bulgargaz is a kind of intermediary envisaged by the law between the wholesale traders (importers) and the end suppliers / large industrial customers. End suppliers / large industrial customers are free to directly purchase gas from a trader (located in Bulgaria or any EU country), but these deals are still a small share of the natural gas market.

There is an obligation of Bulgargaz to offer on the natural gas exchange certain volumes of natural gas on an annual basis for the period 2020 - 2024 in accordance with an agreement for the implementation of a program for release of natural gas concluded between the operator of the gas exchange platform (Balkan Gas Hub EAD) and Bulgargaz – the Gas Release Program Agreement.

4.4. Bulgartransgaz EAD - 100 % owned subsidiary of BEH – is a combined operator performing licensed activities of natural gas transmission and storage (**Bulgartransgaz**)[8]. It is owner and operator of the predominant part of the natural gas transmission infrastructure on the territory of Bulgaria and of the only gas storage facility in Bulgaria – Chiren gas storage facility. Bulgarian legislator chose the Independent Transmission Operator (**ITO**) model as unbundling option applicable to the Bulgarian gas TSO. On 22 June 2015 Bulgartransgaz was certified as an ITO by the CEWR.

Bulgartransgaz performs commercial balancing on the natural gas market and is also responsible for the physical balancing of the gas transmission network.

4.5. The IGB Project (Gas Interconnector Greece-Bulgaria) is being implemented by the joint venture company ICGB AD[9], registered in Bulgaria in 2011, with shareholders BEH (50%) and IGI Poseidon (50%). The IGB gas pipeline connects with the Greek national gas transmission system in the area of Komotini and with the Bulgarian national gas transmission system in the area of Stara Zagora.

Recently, in July 2022, the project company ICGB received the Final Joint Decision for Certification as an Independent Transmission Operator. The Joint Decision of the Bulgarian CEWR and the Greek Regulatory Authority for Energy was announced after a successfully completed approval procedure with the European Commission.

The operational phase of the project is planned to start in October 2022 being expected as the most significant turning point for the development of the gas market in Bulgaria, diversification and security of supplies.

4.6. The gas distribution networks are developed and owned by private companies – distribution system operators – holding a license for this activity for a certain territory. Currently distribution system operators also exercise the functions of end suppliers for the respective licensed territory where they develop the gas distribution networks.

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[7] Web page - https://www.bulgargaz.bg/en
[8] Web page - https://www.bulgartransgaz.bg/en
[9] Web page - https://www.icgb.eu/home

4.7. The CEWR regulates the prices:

- under which the public supplier (Bulgargaz) sells natural gas to the end suppliers and to the heating companies;
- under which end suppliers sell natural gas to customers connected to the respective gas distribution networks;
- for access and transmission of natural gas through gas transmission and/or gas distribution networks, except in cases where the CEWR, at its discretion, approves a methodology to determine the price for access and transmission through the transmission network (i.e., and not the price itself);
- for access and storage of natural gas in storage facilities;
- for connection to the gas transmission or gas distribution networks.

4.8. Extraction companies, natural gas traders, end suppliers, gas transmission system operators, natural gas storage facility operators, LNG facility operators, customers connected to the transmission network, market participants and suppliers of liquidity conclude transactions in natural gas at freely negotiated prices (Art. 176(1) EA).

The public supplier (Bulgargaz) enters into transactions in natural gas at freely negotiated prices in its capacity as a liquidity provider, natural gas trader and market maker.

4.9. As mentioned, as of 1 October 2021, trade in natural gas is an activity which is subject to licensing in Bulgaria. A license may be issued to a company registered in Bulgaria or in an EU Member State. Gas traders should be differentiated from the end suppliers of gas which (es explained above) supply end customers at regulated prices, and which are licensed only for a certain territory.

4.10. Any customer connected to the gas transmission and/or gas distribution network has the right to select a gas trader, irrespective in which EU Member State the trader is registered, as long as the trader complies with the Natural Gas Trade Rules and the delivery security requirements (Art. 180 EA). As already indicated above, despite the current intensive development of the gas market, such transactions still cover only a small part of the market. The main quantities of natural gas for the Bulgarian market continue to be provided by Bulgargaz, which further sells them to end suppliers (selling them downstream under regulated prices to the customers within their licensing territory) or to its customers connected to the transmission network.

Extraction companies and natural gas customers inside and outside Bulgaria may construct direct gas pipelines between each other and may conclude contracts for delivery of natural gas through the said gas pipelines (Art. 176(4) EA).

4.11. A set of standard contracts is published on the webpage of Bulgartransgaz.

A standard contract dealing with the access to and the transmission through gas transmission network (Harmonised contract for access and transport together with the General Terms and Conditions) could be found here.

Before being invited by Bulgartransgaz to sign the transport contract, a trader that wants to book entry/exit capacities to/from Bulgaria has to go through the formal procedure for getting access to its network and for booking of capacities, as described in the Access

Rules. This procedure includes: **(a)** submission of a standard application for access to Bulgartransgaz (available here) with the required enclosures and approval of the application by Bulgartransgaz (*the approval has 6-month validity*); **(b)** registration on the Regional Booking Platform (**RBP**)[10]; **(c)** participation in the procedures for allocation of transmission capacities and confirmation for capacity allocation; **(d)** signing of the transport contract with Bulgartransgaz (within 3 days as from the completion of the capacity allocation procedure Bulgartransgaz shall submit to the participant with allocated capacity draft transport contract in line with the confirmation for allocated capacity at the nominated by the participant entry/exit points); **(e)** effective implementation of the nominations under the transport contract.

According to Art. 6 (4) of the Natural Gas Trade Rules, when entering into a gas transmission contract, the network user shall also enter into a sale and purchase of natural gas agreement for the purposes of balancing with Bulgartransgaz. A sample standard contract for sale and purchase of natural gas for the purposes of balancing is available on the webpage of Bulgartransgaz as well and could be found here. There is also a sample standard contract for using a virtual trading point (there is no obligation to enter into this contract) which could be found here.

Terms and conditions for access to the gas storage facility – Chiren – as well as standard application for access and contract - are available on the web page of Bulgartransgaz as well and could be found here.

4.12. Bulgartransgaz determines prices of access to and transmission through the gas transmission network according to the Methodology for determining the prices for access and transmission of natural gas through the transmission networks of Bulgartransgaz EAD, without such prices to be approved by the CEWR, where the CEWR approves the necessary incomes of Bulgartransgaz and other price forming components.

Information on the access and transmission prices (including price calculator) is available on the webpage of Bulgartransgaz here.

III. Transactions under the General Agreement

1. Bulgarian law makes a distinction between a 'spot' contract and a 'forward' contract, and provides for an explicit definition of what is considered to be an option transaction. Legal definitions are provided by the Commodity Exchanges and Market-places Act (published in State Gazette 93/01.11.1996, last amendments published in State Gazette 52/09.06.2020) (the **CEMA**), as follows:

(i) A 'transaction with immediate performance' (i.e. a 'spot' transaction, although the term 'spot' is not explicitly used in the CEMA) within the meaning of the CEMA is a transaction the parties to which have agreed upon a delivery of available commodities, and the obligations under which are to be fulfilled within 10 business days as from entering into the transaction.

[10] Web page - https://www.bulgartransgaz.bg/en/pages/rbp-126.html

(ii) ‘Forward transaction’ within the meaning of the CEMA is a transaction the parties to which sell or buy a certain commodity at a price fixed at the moment of entering into the transaction and with a preliminary agreed delivery date.

(iii) The CEMA also contains definitions of ‘futures’ and ‘option’ transactions.

"Futures transaction" is a term exchange transaction under which the parties have undertaken to purchase/sell a specific type of commodity on a pre-set date at a price determined on the day of signing the futures transaction. The futures transaction implementation shall be secured by a clearing system in compliance with the parties' orders.

"Option transaction" is a transaction by which the parties agree that within certain period of time one of the parties against payment of a premium shall have the right to acquire by a unilateral statement the right to be buyer, or respectively seller, of a commodity of given type against preliminary agreed price and within definite term. The other party undertakes the obligation to be the counterparty to such a transaction.

2. More precise and detailed definitions of a ‘spot’ contract and a ‘forward’ contract, as well as of the other types of transactions, usually entered into on a (stock or commodity) exchange, are provided by Bulgarian legal doctrine. The main difference between the ‘spot’ and the ‘forward’ contracts is the term for their performance – ‘spot’ transactions require immediate performance; they are ‘real’ or ‘physical’ transactions (i.e. they concern commodities which are really existing – in a warehouse, on a ship, etc.). ‘Forward’ transactions are bound to a certain fixed date in the future on which or after which the parties’ obligations become due and payable (to transfer the ownership over the commodity concerned, to pay the preliminary fixed price, etc.).

3. Taking into consideration the above and the provisions of the General Agreement and the Annexes thereto (as well as the defined transactions as per Appendix B to the Instruction Letter), it could be inferred that, dependent on the concrete delivery conditions agreed in the Individual Contract, the Individual Contracts under the General Agreement could be defined as ‘spot’ contracts or ‘forward’ contracts or as ‘options’ under Bulgarian law (and such transactions should be enforceable under Bulgarian law).

4. Similar to the new Markets in Financial Instruments Directive (MiFID II)[11], the new Bulgarian Markets in Financial Instruments Act (**MiFIA**) (published in State Gazette 15/16.02.2018, last amendments published in State Gazette 8/25.01.2023) provides almost the same criteria for a concrete derivative contract relating to a commodity to be recognized as a “financial instrument” within the meaning and the scope of MiFIA (article 4):

(i) the concrete derivative contract shall be settled in cash; or
(ii) the concrete derivative contract may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event); or
(iii) the concrete derivative contract may be physically settled but in that case the contract shall be traded on a regulated market and/or on a multilateral trading facility (MTF)

[11] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast).

and/or an organised trading facility (OTF) (except for wholesale energy products traded on OTF which must be physically settled, as determined in accordance with Article 5 of Delegated Regulation (EU) No. 2017/565[12]) or the contract is not intended for commercial purposes and have the characteristics of other derivative financial instruments under Article 7, paragraphs 1, 2 and 4 of Delegated Regulation (EU) No. 2017/565.

(Note: In its article 4 the MiFIA refers to '*options, futures, swaps, forward contracts, and any other derivative contracts relating to commodities*' but it does not provide for legal definitions of each type of the mentioned derivative transactions.)

If the concrete derivative contract meets any of the above listed criteria, such derivative contract could be considered as a "financial instrument" subject of regulation under the MiFIA.

Based on the above, each separate Individual Contract under Annex B to the Instruction Letter shall be subject of separate analysis for its classification as a "financial instrument" under the MiFIA. On the other hand, similar to the provisions of MiFID II, the MiFIA provides for some exemptions from the scope of its regulation with regard to the quality of the persons trading in such financial instruments - please refer to item **C.I.**1.3.7 below for more information with regard to the MiFIA and the exemptions under it.

Therefore, it is possible to have a situation where a concrete Individual Contract is to be classified as a "financial instrument" within the meaning of MiFIA but due to the specific quality of the contractual parties (e.g., electricity traders) the transaction itself it is to be excluded from the scope of the MiFIA.

C. Issues / Additional Assumptions / Opinions

I. Enforceability of Close Out-Netting

1. Winding-up, Insolvency or Attachment

1.1. Short overview of Bulgarian insolvency proceedings, laws and relevant terminology applicable to Party A

Following the instructions given in the Instruction Letter, we have provided this part of our Opinion in a separate annex (Annex 1.1).

On the (non-)transposition into Bulgarian law of the EU Restructuring Directive please see item **C.I.2.** below.

1.2. The contract types listed in Appendix B to the Instruction Letter and Bulgarian insolvency rules

[12] Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

In our opinion there are no specific insolvency rules provided by Bulgarian laws regarding the different contract types listed in Appendix B (Commodity Forward, Commodity Option, Commodity Swap and Physical Commodity Transaction), except for the discussed exception under the LPSPS. As discussed in Annex 1.1, the applicable rules depend rather on the capacity of the counterparties to the General Agreement (and not on the transaction type; see also the discussion in item **C.I.**1.3.7 below whether or not the electricity/gas transactions in Bulgaria are regulated by the MiFIA). Therefore, the common legal rules should be applicable, depending on the capacity of the parties to the electricity/gas purchase agreement.

1.3. **Opinion on effects of insolvency proceedings on the General Agreement and transactions arising under the General Agreement, incl. of the Early Termination and close-out netting rights provided for in the General Agreement**

Preliminary note: §10.3 in relation with §10.5 (defining the Material Reason) of the General Agreement envisages an active (or optional) early termination clause, where §10.4 (in relation with §10.5(c)) contains an automatic early termination clause.

Additional assumptions:

- The relevant General Agreement is governed by any law (including German or English law or the laws of Bulgaria);

- After entering into the Individual Contracts and prior to the maturity thereof, Party A becomes the subject of voluntary or involuntary proceedings under the insolvency laws of Bulgaria and, subsequent to the commencement of the insolvency, either Party A or an insolvency official seeks to assume the confirmations representing profitable Individual Contracts for the insolvent counterparty.

1.3.1. **Would you recommend to elect Automatic Termination to apply upon a Material Reason described in § 10.5(c) of the EFET General Agreement or upon other events not specified therein? If yes, would it be necessary or advisable to modify the scope of Automatic Termination (e.g. by (i) deleting or modifying some of the events listed in § 10.5(c) which would trigger the termination and/or (ii) by adding other Material Reasons upon the occurrence of which Automatic Termination should also apply and/or (iii) by limiting those insolvency events specified in §10.5(c) which would trigger the Automatic Termination) or to specify, or to refrain from specifying, a certain grace period as contemplated in §10.5(c)(iv) of the EFET General Agreement to provide for optimal timing of such termination under local law? If you are recommending that a grace period be made applicable in respect of §10.5(c)(iv), what, in your best estimation, is the minimum reasonable period of time required by a party whose creditor(s) have instituted an unsubstantiable or otherwise clearly frivolous involuntary bankruptcy proceeding against it in the insolvency courts of your jurisdiction to have that proceeding dismissed or otherwise terminated? If you are recommending that Automatic Termination be made applicable in respect of parties subject to the insolvency laws of your jurisdiction, what is the optimal timing for that Automatic Termination to take effect? Please supply specific language for purposes of customizing §10.4 of the EFET General Agreement to implement your recommendation and the optimal termination timing.**

(i) The Early Termination mechanism (§ 10.3 of the General Agreement) is generally compliant with and enforceable under Bulgarian law. Although some of its elements (the close-out netting (§10.3(b), third sentence and §10.3(c), second sentence) in particular) are unusual in Bulgarian commercial practices, its general admissibility could be grounded with **(a)** the principle of contractual freedom (Art. 9 OCA: '*The parties to a contract may freely determine the contract's content, as far as this is not in contradiction with the mandatory legal rules and the bona fide (die guten Sitten) principles*') and **(b)** the subsidiary application of the commercial customs to matters not regulated by the Commerce Act and Bulgarian civil legislation (Art. 288 of the Commerce Act) (i.e. in case of a dispute it could be contended that such close-out netting provisions have become common practice in European energy trading (industry standard) and thus have the status of European commercial custom).

However, when active Early Termination is due to an insolvency based Material Reason (§10.5(c)), it is disputable whether the close-out netting and the calculation of the Settlement Amount resulting therefrom are permissible and enforceable under Bulgarian law. Other creditors may argue that these actions are detrimental to them and try to challenge the actions, in particular on the grounds of article 645(3) of the Commerce Act (see for more details item (iv) below).

<u>Therefore, it is recommendable the Automatic Termination (§ 10.4 of the General Agreement) to be specified as applying in the Election Sheet upon a Material Reason described in § 10.5(c) of the General Agreement.</u>

Please find below a discussion on the relevant legal aspects on which we base this conclusion.

(ii) Close-out netting and set-off

It should be noted that Bulgarian law contains a definition of close-out netting (in the FCAA, see item 1.1.6(ii) of Annex 1.1). This definition and the respective (more beneficial) consequences are relevant, however, **<u>only in respect of financial collateral arrangements</u>** - see item 1.1.6(iv) of Annex 1.1 ('netting' is used as a term (but without a definition) also in other Acts, for example in the Credit Institutions Act, see item 1.1.2.1(iii) of Annex 1.1). Therefore, the legal nature of the close-out netting and its legal treatment under Bulgarian law should be scrutinized in the light of more traditional legal terms, such as the set-off (*Aufrechnung* in German) and the novation (*Novation, Schuldumschaffung* in German).

The set-off is regulated in articles 103 to 105 of the OCA as one of the mechanisms for payment (extinguishing) of debts. Pursuant to article 103(1) OCA, the necessary pre-conditions for the set-off are: **(a)** identity of the parties to the claims subject of the set-off[13] (i.e. the claims to be between the same two parties); **(b)** the claims to be monetary or for replaceable commodities of one and the same kind; **(c)** the claim of the setting-off party ('the active claim'; the other claim is the 'passive claim') to be due and payable; **(d)** its

[13] Deviations from this rule are admissible only if explicitly provided by the law – e.g. in the case of providing a collateral (pledge) for the debts of a third party, the collateral provider may request set-off with claims of the **debtor** (and not of the collateral provider) against the creditor (Art. 151 OCA). See also Art. 142 OCA according to which the guarantor may set-off a claim of the **debtor** to the creditor (i.e. the beneficiary) against the claim of the creditor to the guarantor, even if the debtor has waived this right or has acknowledged his debt.

grounds and amount to be determined ('liquidity' of the claim; there are numerous theories regarding the legal nature of this pre-condition, including an opinion that such a pre-condition is not necessary[14]; the prevailing opinion in case law, especially in the newer and binding case law (*see for example Interpreting Judgements of the Supreme Court of Cassation No 1 of 4 January 2001 in case No 1/2000, item 6 and No 1 of 9 December 2013 in case No 1/2013, item 4*), puts a sign of equality between '*liquid*' and '*undisputed*'; if the receivable is disputed by the debtor, it is not liquid and the legal effect of the out-of-court set-off shall be considered as not having occurred; if the party that has made the set-off statement wishes to have the effect of the set-off, it will have to make the set-off statement (or to file a counter claim) in the court proceedings (if its counterparty files a claim for its receivable (i.e. the passive receivable) which has been subject to the set-off); once the receivable is confirmed by the court, it will become liquid (i.e. its grounds and amount will be determined by the court).

The above condition under letter d) means that if the Termination Amount is disputed, the close-out netting could be considered not effective under Bulgarian law. On the other hand, the discussed interpretation of the 'liquidity' requirement is based on the case law of the Supreme Court of Cassation dealing with set-off, i.e. it is rather not to be considered an internationally-mandatory (overriding) provision of Bulgarian law and this risk should not concern General Agreements governed by any other law where such a requirement does not exist.

The set-off is effected by a unilateral statement of the setting-off party. Bulgarian law (in contrast to French law, for example) does not recognize the automatic set-off by operation of law (*ipso jure*).

As a result of the set-off the two mutual (counter) claims of the parties are deemed redeemed (liquidated) up to the amount of the smaller claim as of the date on which it was possible the set-off to be effected (*ex tunc*).

The novation is another mechanism for extinguishing of debts (article 107 OCA). A debt is novated when it is exchanged with another debt by virtue of an agreement with the creditor. The collateral provided by third parties for securing the old debt shall remain effective for the new debt only if such third parties explicitly grant their consent.

Therefore, if the close-out netting would be characterized as novation under Bulgarian law, the collateral provided by third parties (only) would be lost, if they do not grant their consent (i.e. this rule would apply only if the collateral is provided by third parties). Apart, we do not consider this rule an internationally-mandatory (overriding) provision of Bulgarian law, because it protects the interest of limited circle of parties (the parties to the respective transactions in electricity/gas), and not the public (broader) interest.

With a view to the above it can be concluded that the close-out netting derives from the set-off, but has some additional elements (in general, the close-out netting has two main elements: the ***close-out part*** and the ***netting/set-off part***): **(a)** event of default or any other event made equal by the parties to an agreement to non-performance under this agreement; **(b)** upon the occurrence of this event the agreement is usually terminated (automatically, or following a termination notice) and the obligations of the defaulting party become due and payable (or are transformed in monetary obligations, which are also due and payable,

[14] V. Popova, '*The Set-off. Substantive legal issues*', Fenea, 2002, p. 74.

this is the novation element); **(c)** the setting-off party (the Terminating Party under the General Agreement) calculates its gains and losses and sets-off its claims against the defaulting party's claims; **(d)** if there is a difference (Settlement Amount), the setting-off party requires from the other party payment of the residual amount.

It could be inferred that the close-out netting approach is generally permissible under Bulgarian law also out of the context of the financial collateral arrangements. A ground for such a conclusion could be found in the cited general principle of contractual freedom (article 9 OCA) and the subsidiary application of the commercial customs to matters not regulated by the Commerce Act and Bulgarian civil legislation (Art. 288 of the Commerce Act).

Therefore, in order to further assess the permissibility and enforceability of the termination clauses of the General Agreement under Bulgarian law, the permissibility and enforceability of set-off in case of insolvency proceedings have to be reviewed (*analogia legis*).

(iii) Permissibility of the set-off under Bulgarian insolvency law

The conditions for a set-off in case of insolvency proceedings have been reviewed in item 1.1.1**(ii)** of the Annex (they are contained in article 645 of the Commerce Act). The insolvency set-off is generally permissible provided that prior to the date of the judgement for institution of the insolvency proceedings both debts have existed and were counter and of the same kind and the creditor's claim was due and payable. The statement for set-off shall be sent to the insolvency receiver.

(iv) Challengeability of the set-off under Bulgarian insolvency law

The set-off may be challenged and declared null and void with respect to the insolvency creditors by the court, in case the creditor has acquired the claim and the debt to the debtor prior to the date of the judgement for institution of the insolvency proceedings, but he knew as at the time of acquiring the claim or debt that inability to pay debts, respectively over-indebtedness, has occurred in respect of the debtor or that a petition for opening of insolvency proceedings has been filed. Such a claim may be filed by the receiver or (if he fails to do so) by any insolvency creditor within one year as from the date of opening the insolvency proceedings.

It is therefore of crucial importance to determine what is the time of acquiring by the Terminating Party of the claims under the Agreement (i.e. under the Individual Contracts) subject of set-off (close-out netting). We believe that this issue might be problematic in case of active (optional, discretionary) Early Termination: for instance, a petition on opening of insolvency proceedings is filed against a Party under the General Agreement; the other Party learns about that and sends a notice of Early Termination designating the Early Termination Date (which is, for example, in 7 business days); if the claims are deemed to occur at the time of termination of the General Agreement, it is for sure that at this date the Terminating Party already knows about the filed petition and that the above rule about challenging the set-off may be applied.

It is, therefore, recommendable in the Election Sheet the Automatic Termination clause to be selected in order to reduce the potential risk of successful challenging of the set-off (close-out netting) (see also next items (vi) - (xi)).

A set-off shall be further null and void with respect to the insolvency creditors if it has been effected by the debtor (Party A) after the initial date of the inability to pay debts, respectively the over-indebtedness (i.e. within the suspect period) - but not earlier than one year prior to the lodging of the request for opening of the insolvency proceedings - except for the part that the creditor would acquire after the distribution of assets converted into cash, regardless of the time of occurrence of both counter debts (article 645(4) of the Commerce Act).

(v) Challengeability of the entering into the General Agreement and the Individual Contracts

As regards the risk the entering into the General Agreement and the Individual Contracts to be challenged by the receiver and/or the insolvency creditors, this is possible in our view only if they fall within any of the hypothesis explicitly provided by the Commerce Act as challengeable transactions in the course of the insolvency proceedings (articles 645 – 647, see item 1.1.1**(ii)** of Annex 1.1). Some of them concern economically unequal transactions which should not be relevant for the case at hand. Actions and transactions effected after the date of the judgement for institution of the insolvency proceedings do not fall under the reviewed scenario either (because the General Agreement and the Individual Contracts have been concluded prior to the commencement of the insolvency proceedings).

Therefore, of particular importance are most of all the challengeable actions / transactions entered into within the suspect period (i.e. after the initial date of the inability to pay debts, respectively the over-indebtedness, as determined by the insolvency court). As mentioned (1.1.1**(i)** of Annex 1.1), the court has the almost unrestricted right on its own motion (based on the evidence collected, of course) to fix this date by its judgement on opening of the insolvency proceedings. There is no legal limit in the Commerce Act how long backward in time this date may be fixed. This lead to problems and uncertainty in practice with a view to the possibility some transactions concluded and payments made within the 'suspect period' to be challenged by the insolvency receiver, respectively by the creditors of the debtor.

That is why in February 2013 rules were introduced into the Commerce Act that limited the date back in time until which certain transactions can be challenged as null and void (for more details see item 1.1.1**(ii)** of Annex 1.1).

Reviewing the hypotheses listed in the Commerce Act, we do not consider that there is a significant risk the entering into the General Agreement and the Individual Contracts itself to be successfully challenged by the receiver and/or the insolvency creditors.

Such a risk exists in principle with respect to the providing of collateral since in the list of challengeable transactions fall the '*establishing a pledge or a mortgage for the securing of a debt that has not been secured so far (made within 1 year prior to the lodging of the request for opening of the insolvency proceedings)*' (article 646(2), item 2).

However, this rule applies only if the collateral is provided in the form of pledge or mortgage; this is a difference from the legal regime applicable until February 2013 which included in the list of challengeable transactions '*and other security'*. If the collateral is Cash or Letter of Credit, as per the CSA, the rule shall not apply.

The rule shall not apply either in case the collateral is provided in relation to a transaction under the General Agreement concluded (a) between qualifying parties (e.g. a bank and a trader), and (b) supplemented by a CSA and Eligible Credit Support in the form of Cash has been provided - see item 1.1.6(iv) of Annex 1.1).

Particular attention should be also paid to the hypothesis '*payment of a due and payable debt, regardless of the manner of performance (made within 6 months prior to the lodging of the request for opening of the insolvency proceedings)*' (wording until February 2013: '*performance of a debt regardless of the way of performance*') which provision is not clear enough and gives ground for various interpretations by the judges (this rule corresponds to the special rule of article 645(4) of the Commerce Act, as cited above, which is applicable only as regards the set-off).

(vi) With a view to all stated above we would reiterate our recommendation in the Election Sheet the Automatic Termination to be selected as applicable upon a Material Reason described in § 10.5(c) of the General Agreement (and in § 10.5(c)(iv) in particular) in order to reduce the potential risk of successful challenging of the set-off (close-out netting) and calculation of the Settlement Amounts, respectively of the Termination Amount (as discussed, it cannot be predicted how Bulgarian courts would interpret the Automatic Termination, the close-out netting and the calculation of the Settlement Amounts, that is why it cannot be said that by introducing the Automatic Termination mechanism the risk of successful challenging of these actions is eliminated, but in any case this would lead to risk reduction).

(vii) In our opinion it is not necessary the scope of Automatic Termination to be further modified. We do not deem that any additional specific recommendation on efficacy of making the Automatic Termination operative *vis-à-vis* the Bulgarian Party is necessary. It is, however, important that the Early Termination Date coincides with the moment of occurring of the Material Reason under §10.5(c) (e.g. with the moment of filing of a request on opening (institution) of insolvency proceedings) and is not later than this moment.

(viii) It should be clear that for some of the Material Reasons under § 10.5(c) of the General Agreement it is really difficult or even impossible to determine whether and when they have occurred and to bind the Automatic Termination to such occurrence. One example – the inability to pay debts is ascertained by the court in an open insolvency procedure, with the support of experts, the application of coefficients and formulas, etc. If such a procedure is not initiated, how could the Non-defaulting Party know about such inability to pay debts of the other Party and respectively know that the Agreement should be deemed terminated? Therefore, the Automatic Termination scenario is feasible in the cases where the occurrence of the respective Material Reason can be easily evidenced (e.g. by a submitted document – a petition for opening of insolvency or liquidation (*Abwicklung* in German) proceedings).

(ix) It is up to the Parties to the General Agreement to decide whether to limit any of the events specified in §10.5(c) which would trigger the Automatic Termination. Our recommendation is in any case §10.5(c)(iv) to be kept as a Material Reason for Automatic Termination.

(x) It is further up to the Parties to agree upon a certain grace period as contemplated in §10.5(c)(iv) of the EFET General Agreement. In our view such a grace period would create additional legal uncertainty and is to be avoided.

Besides, it is not likely the insolvency court to dismiss the (unsubstantiated) petition within a reasonable term (e.g. 30 days). According to the Commerce Act, the court shall open a case under the filed petition on the day the petition was filed and shall pass a judgement after four months at the latest; besides, this term may be longer, because it is merely instructive and not binding for the court; from our practical experience we would rather say that this term is approx. 8 months, and often even longer. It must be said in this regard that Bulgarian insolvency proceedings are very bureaucratic and lengthy. Therefore, the hypothetical advantage of the grace period does not work in practice[15], but its disadvantages remain. That is why we would not recommend such a grace period to be envisaged in the Election Sheet.

For the sake of completeness, it is to be mentioned that under the Commerce Act (article 631a), if by an entered into force judgement a creditor's petition to institute bankruptcy proceedings has been rejected, the debtor shall be entitled to indemnification if the creditor has acted intentionally or gross negligently. Indemnity shall be due for all material (property) and immaterial (non-property, moral) damages which are the direct and immediate consequence of the harm. If the petition to institute bankruptcy proceedings has been filed by several creditors, they shall be held jointly liable.

(xi) As regards the optimal timing for the Automatic Termination to take effect, please note the following:

We know that in order to reduce the risk, certain actions which have been performed on the date of the judgement on opening of the insolvency proceedings to be considered by virtue of law as effected **after** the institution of the insolvency proceedings[16] (and to be challengeable on this ground), even if these actions precede the taking of the judgement ('zero hour principle'), under some jurisdictions it is considered in the Election Sheet to be specified that the termination effect of the Automatic Termination shall be at 11.59 p.m. on the day before the occurrence of the Material Reason.

We do not consider such approach feasible and necessary under Bulgarian law. First of all, we have doubts that the Parties may give such retroactive effect to the Automatic Termination. Secondly, with a view to the 'zero hour principle' (although the insolvency

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[15] In our view the grace period approach could work in limited scenarios – e.g. if the company against which the petition was filed wants to avoid insolvency proceedings and can pay the debt and pays it within the grace period, and the petition for insolvency is also withdrawn within the grace period (this is the maximum that can be achieved within short grace periods (like 15 days).

[16] See e.g. article 634a of the Commerce Act according to which the insolvency proceedings shall be deemed opened on the date of the judgement on opening of the proceedings; if certain actions (e.g. payment of obligations to the debtor) are committed on this date, they are deemed to be done **after** the institution of the insolvency proceedings. In the list of actions Art. 645 regulating the insolvency set-off is not explicitly included.

set-off is not explicitly included in Art. 634a of the Commerce Act, as discussed in the footnote below), one can argue that the discussed approach is a clear case of circumvention of the law and of this principle in particular (and shall be thus null and void).

Besides, if the mere filing of the petition for opening of insolvency proceedings is the Material Reason and leads to termination of the Agreement, then the risk related to the very date of the judgement on opening of the insolvency proceedings (which is later in time) is to be regarded as remote. Last but not least, actions which have been performed on the date of the judgement on opening of the insolvency proceedings represent an isolated (rare) case.

That is why, it should be sufficient in our view in the Election Sheet to be specified in respect to any Bulgarian incorporated Party to the General Agreement that the Early Termination Date coincides with the moment of occurrence of the Material Reason under §10.5(c) and to be further clarified that with respect to §10.5(c)(iv) this is the moment of filing of a request on opening (institution) of insolvency proceedings, for example:

'***§ 10.4 Automatic Termination:*** *§ 10.4 shall apply to Party xxx* [to the Bulgarian incorporated Party/Parties to the General Agreement] *and with termination effective (Early Termination Date) on the moment a Material Reason under §10.5(c) occurs. With respect to §10.5(c)(iv) this moment coincides with the moment of filing of a petition on institution of insolvency proceedings (article 625 of the Bulgarian Commerce Act)*.'

1.3.2. **Assuming you recommend Automatic Termination to apply, are the provisions of the General Agreement terminating the EFET General Agreement (including all Individual Contracts) upon the occurrence of a Material Reason described in § 10.5(c) of the EFET General Agreement (adjusted as necessary pursuant to the laws of Bulgaria) enforceable under the laws of Bulgaria <u>or</u> is there a risk that the Automatic Termination could be challenged by a liquidator, administrator, receiver or third party? Will there be a difference in the treatment of electricity/natural gas and green certificates traded separately or in combination?**

(i) Under §10.5(c) of the General Agreement as a Material Reason for termination of the Agreement shall be considered *inter alia* also the institution of 'a proceeding seeking a judgement of insolvency or bankruptcy' (point (iv)). Our understanding is that here the mere fact of submission of a request on opening (institution) of insolvency proceedings (by the debtor itself or by its creditors) shall be regarded as a Material Reason, and not the court's judgement on opening of the proceedings (see item 1.1.1**(i)** of Annex 1.1).

(ii) Since the mere filing of a request on opening (institution) of insolvency proceedings will have terminating effect on the General Agreement (if, of course, the Early Termination Date specified in the Election Sheet coincides with the moment of filing of such a request) and will have also as effect the replacement of all existing duties and obligations of the Parties by the obligation of one Party to pay damages to the other Party in an amount calculated in accordance with §11.1 of the General Agreement, all the conditions for valid set-off stated in article 645(1) of the Commerce Act will have been fulfilled before the date of the judgement for institution of the insolvency proceedings (*unless, of course, the counterparty disputes the claims of the Terminating Party – see above **C.I.**1.3.1(ii) regarding the 'liquidity' requirement*). Consequently, in our view the Automatic Termination and the related close-out netting are generally permissible and enforceable under Bulgarian insolvency law. If the insolvency proceedings have been already opened, the set-off statement has to be directed to the insolvency receiver (if it is submitted to the receiver of a bank, the statement must be with notarised signatures (article 59(2) of the BIA)).

(iii) Our understanding of the Automatic Termination concept is that even if the creditor (the Terminating Party) learns about the filed petition on opening of insolvency proceedings on the same day of filing, this should not lead to voidness of the set-off since his claims have already occurred as of the moment of submission of the petition.

It should be, however, noted that this conclusion is not indisputable (at least for the reason that there is no relevant court practice). One can try to argue for example that, since the 'damages' (the Costs and Losses as defined under § 11(2)) are incurred by the Terminating Party as result of the termination of the Individual Contracts and their amount is <u>consequently</u> calculated by the Terminating Party, therefore, as at the time of acquiring the claims the Terminating Party already knew about the initiated insolvency proceedings. We do not deem that there are enough solid legal arguments in favour of this opinion but the existing legal unclarity and uncertainty should not be underestimated.

(iv) Therefore, in our opinion the Automatic Termination should not be regarded as circumventing Bulgarian insolvency law. There is a provision, indeed, empowering the insolvency receiver to terminate each contract party to which is the company against which the insolvency proceedings have been opened (article 644 of the Commerce Act, see item 1.1.1**(i)** to Annex 1.1; as mentioned, this is part of the insolvency receiver's 'cherry-picking rights' under the Bulgarian law). This power is relevant, however, at a later stage – when the procedure has been already opened and the receiver has been appointed, whereas the Automatic Termination is bound to the filing of a claim 'seeking a judgment of insolvency'.

(v) Some legal concerns exist, however, in our view as regards the understanding in the light of Bulgarian law of the close-out netting mechanism under the General Agreement and in particular the calculation of the Settlement Amounts and the Termination Amount by the Terminating Party (see below item 1.3.3).

(vi) **Will there be a difference in the treatment of electricity/natural gas and green certificates traded separately or in combination?**

In our view there should be no such a difference.

1.3.3. **Are the provisions in § 11 of the EFET General Agreement providing for the netting of all positive and negative Settlement Amounts in determining the Termination Amount enforceable under the laws of Bulgaria or is there a risk that such determination could be challenged by a liquidator, administrator, receiver or third party?**

(i) It is important to be underlined that the mechanism under § 11 of the General Agreement of calculation of gains, costs and losses in case of termination of a contractual relationship is not known in Bulgarian law. Besides, the preliminary determining of the compensation ('*obligation of one Party to pay damages*[17] *for non-fulfilment to the other Party*' -

[17] Note: in the official German version of the General Agreement the word 'damages' is not used, § 10.3(b) reads as follows: '*Am vorzeitigen Kündigungstermin werden die Rechte und Pflichten beider Parteien aus dem Vertrag*

§10.3(b)) due in case of termination of the General Agreement (the Termination Amount) could lead to the conclusion that this is a kind of liquidated damages (*неустойка* in Bulgarian, *Vertragsstrafe* in German) agreed between the parties. On the other hand, the mechanism of calculating the Termination Amount is nearer to the general way for calculation of compensations under Bulgarian law.

Furthermore, the Terminating Party has certain discretion to determine the Termination Amount (it is restricted merely by the requirement to do this in a '*commercially reasonable manner*', which requirement of course can be interpreted in various ways and does not create sufficiently stable legal ground for the calculation of the Settlement Amounts) which might lead (and will lead in our view) to objections on the part of the other Party and, in case of insolvency proceedings, on the part of the insolvency receiver and/or the other creditors, respectively.

A possible approach to reduce the related risks and to create more legal clarity would be a kind of reference basis (that can be proven in case of a dispute) for the calculation of the Termination Amount to be agreed in advance between the Parties - e.g. as such a reference basis can be taken the prices at which the Electricity System Operator buys, respectively sells electricity at the balancing energy market, and/or the prices on the Bulgarian energy exchange (IBEX) (http://www.ibex.bg/en).

With a view to all the above it cannot be predicted what the courts' position in regard to the Termination Amount calculated by the Terminating Party would be. We believe that in any case the Terminating Party has to be prepared to prove the exact amount of the damages suffered (i.e. the Termination Amount, the Settlement Amounts and all their elements – Costs, Gains and Losses, as defined under §11). This is so of course also with regard to the proving of the pre-conditions for a valid set-off / close-out netting (as mentioned above) and in particular of the requirement the claim(s) of the setting-off party (the Terminating Party) to be due and payable and its grounds and amount to be determined.

(ii) As regards the payment of the Termination Amount, it is our understanding that, if there are no guarantees and securities under the General Agreement (§16 and §17) for the claims of the Terminating Party, and insolvency proceedings are opened against the other Party, the Terminating Party will not have any privilege for the residual amount resulting from the settlement under §11 (i.e. for the Termination Amount) but will have the right to be satisfied *pari passu* together with the other creditors in accordance with the general rules of the Commerce Act (article 722, see item 1.1.1**(vii)** of Annex 1.1).

1.3.4. **Do the laws of Bulgaria recognize that the close-out netting provisions in section §§ 10 to 11 of the EFET General Agreement apply to all Individual Contracts or could it be challenged by a liquidator, receiver or third party? Would we need the single agreement concept in order to preserve the enforceability of the termination right and the ability to calculate a net amount? If the single agreement concept is particularly important in your jurisdiction, please elaborate in a detailed and circumstantiated manner on whether or not, and if so, the degree to which, provisions allowing or providing for the termination of some Individual Contracts but not all Individual Contracts under the EFET General Agreement might impact termination**

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inclusive sämtlicher Einzelverträge ersetzt durch die Verpflichtung einer der Parteien zur Zahlung des gemäß § 11.1 berechneten Kündigungsbetrages (der „Kündigungsbetrag") an die andere Partei'.

and close out rights generally, as well as subsequent rights to terminate Individual Contracts remaining under the EFET General Agreement following a previous Partial Close-Out.

It is our understanding that the Single Agreement concept is explicitly envisaged in the General Agreement and that the Early Termination provisions apply to all Individual Contracts under the General Agreement (including to the Allowances Transactions under the Allowances Appendix) ('*All Individual Contracts and this General Agreement shall form a single agreement between the Parties (collectively referred to as the '**Agreement**'). The provisions of this General Agreement constitute an integral part of each Individual Contract'* - §1.1; '*If a Material Reason with respect to a Party has occurred and is continuing, the other Party may terminate the Agreement by giving the other Party notice'* - §10.3(a)).

We believe that the Single Agreement concept is necessary in order for the enforceability under Bulgarian law of Early Termination rights and the ability to close out net to be preserved. If, for any reason, it is necessary an Individual Contract or Transaction to be severed from the Master Agreement, this can be done in the wording of this Individual Contract or Transaction. Thus, on the grounds of §2.2 the specific terms agreed in the Individual Contract or Transaction 'shall prevail for the purposes of that Individual Contract', where the Single Agreement concept shall remain unaffected.

Respectively, if the Parties want to create a mechanism for termination of some Individual Contracts only, this can (and must) be done by an explicit agreement (like the additions made by the Allowances Appendix in §10.3(a) and §10.5) between them, regulating the conditions for such partial terminating and partial close-out. In our opinion such a provision should not impact the enforceability of the Single Agreement concept because it is an exception from the general rule that the General Agreement and the Individual Contracts are terminated as a whole. This means that if Partial Close-Out is made (on the grounds of an explicitly agreed rule), this should not impact the enforceability of subsequent rights to terminate Individual Contracts remaining under the General Agreement.

Please note that the single agreement concept is not known in Bulgarian legal theory and practice, hence the above conclusions are based merely on our own considerations and represent only one of the possible interpretations.

1.3.5. **Is the insolvent counterparty's obligation to pay the amount of any compensation claim in Euro, USD or GBP (as agreed between the parties in the Election Sheet) enforceable under the laws of Bulgaria or could the calculation or demand of such amount in a foreign currency be challenged by a liquidator, administrator, receiver or third party?**

In principle, pursuant to article 103 OCA, a sufficient pre-condition for a valid set-off is the claims to be monetary. No requirement is envisaged in the sense that the claims have to be proven / claimed in the currency of the country where the Bulgarian insolvent counterparty is based (i.e. in Bulgarian leva (BGN)). This has been confirmed by the court practice as well (e.g. in judgement of 1 November 2001 of the Sofia Appellate Court in civil case No 233/2001 it is explicitly stated that *'whether the counter debts are in USD or in BGN is of no importance, because in both cases we have generic determined* *goods of the category 'money'. The value of the one debt towards the other is a matter of calculation according to the respective exchange rate as at the date of making the statement for set-off... regardless of the currency these are goods of one and the same kind – money.'*). Therefore, the insolvent counterparty's obligation to pay the amount of any compensation claim in Euro, USD or GBP (as agreed between the parties in the Election Sheet) is enforceable under the laws of Bulgaria.

It should be, however, noted that according to §2 of the additional provisions to the Commerce Act, claims in foreign currency shall be converted in Bulgarian leva at the exchange rate of the Bulgarian National Bank as of the date on which the judgement to institute insolvency proceedings was taken.

1.3.6. **Please specify, if and as applicable, the degree to which termination and close-out rights in case of opening of insolvency proceedings against a party based in your jurisdiction are dependent upon, or otherwise effected by, the status of one or more of the concerned parties falling within a particular category of classification of entity. Specifically, do these rights differ as the result of a party being a financial institution, ordinary corporate entity or any other categorization or regulatory or legal status?**

See Annex 1.1 regarding the different legal treatment of the different types of entities and the references made to the various legal rules applicable in case of their insolvency (in the respective sections dealing with the insolvency rules particular attention is paid to the rules (if any) regulating the set-off and the close-out netting within the insolvency proceedings of the different types of entities).

Furthermore, as mentioned (item 1.1.6(iii) of Annex 1.1), the Financial Collateral Arrangements Act (FCAA) provides for some special rules protecting the creditors (collateral takers) in case of insolvency proceedings. These rules (including the close-out netting rules), however, apply **only in respect of collateral financial arrangements within the meaning of the FCAA** (see item 1.1.6(iv) of Annex 1.1) and provided that parties to the arrangement are entities/ institutions under item 1.1.6(i) of Annex 1.1, sub-items (a) to (p), or a trader and an entity/institution under sub-items (a) to (p). The special (more beneficial) legal treatment shall **not** be applied in cases not explicitly mentioned in the FCAA. Bulgaria has not expanded (in contrast to Luxembourg, for instance) the scope of Directive 2002/47/EC.

1.3.7. **We are also interested in whether the insolvency law provides for a "safe harbor" for certain derivatives or other contract types and/or entities and whether the contract types listed in Appendix B and which of the entities listed in Appendix A would benefit from such provisions.**

(i) Until the end of year 2010 a kind of 'safe harbour' was envisaged in the Public Offering of Securities Act (**POSA**), articles 109a to 109c regulating the settlement systems for transactions in securities. The provisions were compliant with Directive 98/26/EC on settlement finality in payment and securities settlement systems. However, these provisions did not deal with trade in other financial instruments (derivatives), but only with securities.

With the amendments made to the POSA and to the Law on the Payment Services and Payment Systems (**LPSPS**, published in State Gazette 23/27.03.2009) on 28 December 2010, in force as from 30 June 2011, the above mentioned 'safe harbour provisions' (articles 109a to 109c of POSA) were deleted from the POSA and were moved (with amendments and supplementations) to a new Chapter V(a) of the LPSPS.

New Law on Payment Services and Payment Systems was adopted in 2018 (published in State Gazette 20/06.03.2018 and effective as of 06.03.2018, last amendments published in State Gazette 8/25.01.2023).

The provisions of the new LPSPS (Chapter VIII, articles 128-153) repeat the provisions of Chapter V(a) of the revoked LPSPS regarding the start of reorganisation measures or winding-up proceedings (or insolvency procedure) and provide that the start of reorganisation measures or winding-up proceedings (or insolvency procedure) shall not have retroactive effects on the rights and obligations of the participants in the payment system and may not lead to the re-calculation of the receivables and liabilities of participants arising from or in connection with their participation in the settlement finality system prior to the start of such procedure (Art. 131(4) of the LPSPS).

The transfer orders and *netting* shall be legally binding even in the event of reorganisation measures or winding-up proceedings opened against a participant in the settlement finality system and shall be binding to third parties provided that the transfer orders were entered into the system **before** the moment of the opening of the reorganisation measures or winding-up proceedings (Art. 132(1) of the LPSPS). There is a legal definition of *netting* in the LPSPS: '*the conversion* [*into one net claim or one net obligation*] *of all claims and obligations resulting from transfer orders which a participant or participants either issue to, or receive from, one or more other participants with the result that only a net claim can be demanded or a net obligation be owed*'.

Where the transfer orders are submitted into the settlement finality system after the moment of imposing the reorganisation measures or opening of winding-up proceedings and were executed within the business day, they shall be legally enforceable and binding on third parties only if, after the moment in which the orders have become irrevocable, the system operator is able to prove that it was not aware, nor should have been aware of the opening of such procedures. The moment of submitting the transfer order into the settlement finality system shall be established by the rules of the concrete system. The business day shall cover both day and night-time settlements and shall encompass all events happening during the business cycle of a settlement finality system.

The provisions of the effective legislation relating to the invalidity or invalidation of transactions and payments executed before the moment of imposition of reorganisation measures or opening of winding up procedures shall not apply to netting and may not result in revoking of the netting (Art. 132(8) of the LPSPS).

The rights of a system operator or of a participant in a settlement finality system to collateral security provided to them in connection with a system or any interoperable system, and the rights of central banks of the Member States or the European Central Bank to collateral security provided to them, shall not be affected by reorganisation measures or winding-up proceedings against a security provider participant, a system operator of an interoperable system which is not a participant, a counterparty to central banks of the Member States or the European Central Bank, or any third party which provided the collateral security (Art. 134(1) of the LPSPS). A collateral security shall be any realisable asset, including financial collateral within the meaning of Art. 4 of the Financial Collateral Arrangements Act, provided under a pledge, including money provided under a pledge, a repurchase (repurchase agreement) or similar agreement, for the purpose of securing rights and obligations arising in connection with a settlement finality system, or provided to central banks of the Member States or to the European Central Bank.

(ii) As per the abovementioned Markets on Financial Instruments Act (**MiFIA**), transposing into Bulgarian law the MiFID II (Art. 227a(5)), the provisions of Chapter VIII, Section I of the LPSPS (as discussed in the previous item (i)) shall also apply to settlement systems established for the settlement of transactions in *securities*. The previous (until 2019) regulation (Art. 109a of the POSA) referred to settlement systems established for the settlement of transactions in *financial instruments* under the meaning of Art. 4 of the MiFIA, i.e. the scope of the settlement systems seemed broader (the MiFIA considers most of the derivative transactions (forwards, futures, swaps, options and other derivative transaction based on commodities) as transactions in financial instruments, along with the transactions in securities). Nevertheless, Art. 227b of the MiFIA refers also to settlement of transactions in *financial instruments* concluded and accepted for execution in the settlement system. I.e., it could be argued that transactions in financial instruments can also be concluded through the settlement systems established for the settlement of transactions in securities, and that the cited 'safe harbour' under Chapter VIII, Section I of the LPSPS should be applicable to them as well. This would mean that if the entering into Individual Contracts is to be qualified as entering into derivative contracts with financial instruments within the meaning of the MiFIA, then the respective regulatory regime under the MiFIA, incl. the above discussed safe harbour provisions, should be applicable as well. See, however, the discussion below on the exemptions from the scope of the MiFIA and our conclusion that that it is likely the entering into Individual Contracts **not** to fall within the scope of the MiFIA.

(iii) The subject of MiFIA shall include *inter alia* the following financial instruments (other than securities) (article 4):

(a) options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities (i.e. including electricity/gas) that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event);

(b) options, futures, swaps and any other derivative contracts relating to commodities (i.e. including electricity/gas) that can be physically settled provided that they are traded on a regulated market and/or on a multilateral trading facility (MTF) or on an organised trading facility (OTF) (except for wholesale energy products traded on OTF which must be physically settled, as determined in accordance with Article 5 of Delegated Regulation (EU) No. 2017/565 or that are not intended for commercial purposes and have the characteristics of other derivative financial instruments under Article 7, paragraphs 1, 2 and 4 of Delegated Regulation (EU) No. 2017/565);

(c) options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, emission allowances or inflation rates, or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event).

Therefore, comparing the definitions of the contract types in Appendix B to the Instruction Letter (Commodity Forward, Commodity Option and Commodity Swap) and the definitions of financial instruments under MiFIA, it could be concluded that the contract types listed in Appendix B in principle fall within the scope of the MiFIA (with the exception of Physical Commodity Transaction - it is our understanding that for this transaction type only physical settlement (‘*actual delivery*’) is envisaged, with no option for cash settlement).

(iv) However, the exemptions from the scope of the MiFIA (which repeat the exemptions under article 2 of the MiFID II, as amended by Directive (EU) 2021/338) should be taken into consideration in each particular case, and in particular the so called ‘*ancillary activity exemption*’ (article 5(1), item 10):

This Act shall not apply to the following persons, unless otherwise provided for herein:

…

10. (a) persons dealing on own account, including market makers, in commodity derivatives or emission allowances or derivatives thereof, excluding persons who deal on own account when executing client orders;
or
(b) persons providing investment services, other than dealing on own account, in commodity derivatives or emission allowances or derivatives thereof to the customers or suppliers of their main business;

In both cases under letter (a) and letter (b) above the exemption shall be applicable provided that:

- for each of those cases individually and on an aggregate basis, the activity is ancillary to their main business, when considered on a group basis, according to the criteria set by Commission Delegated Regulation (EU) 2017/592[18],

- those persons are not part of a group the main business of which is the provision of investment services within the meaning of Directive 2014/65, the performance of any activity listed in Art. 2 of the Credit Institutions Act and Annex I to Directive 2013/36, or acting as a market maker for commodity derivatives,

- those persons do not apply a high-frequency algorithmic trading technique[19], and

[18] Commission Delegated Regulation (EU) 2017/592 of 1 December 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the criteria to establish when an activity is considered to be ancillary to the main business. Despite of the recent amendments to the MiFIA, the Bulgarian legislator did not take into account that Delegated Regulation (EU) 2017/592 was repealed by Commission Delegated Regulation (EU) 2021/1833 of 14 July 2021 supplementing Directive 2014/65/EU of the European Parliament and of the Council by specifying the criteria for establishing when an activity is to be considered to be ancillary to the main business at group level.

[19] As per MiFIA, “High-frequency method for algorithmic trading" is a technique for algorithmic trading, which is characterised by:

a) infrastructure designed to minimise network and other types of delays, which includes at least one of the following items for submission of algorithmic order: shared use, hosting a short distance or high-speed direct electronic access;

- those persons report upon request to the competent authority (in Bulgaria this is the Financial Supervision Commission) the basis on which they have assessed that their activity under points (a) and (b) is ancillary to their main business.

Analysing the above exceptions in the light of the Bulgarian energy market, we believe that it is likely the entering into Individual Contracts **not** to fall within the scope of the MiFIA (and the regulatory regime and the safe harbour provisions provided therein should be thus **not** applicable to the parties to the respective General Agreement). Of course, this should be checked on a case-by-case basis with a view to the concrete circumstances (incl. the parties to the particular transaction).

The main reason for this conclusion is because of the current status of the Bulgarian energy market and the capacity of the parties to such transactions in Bulgaria: the market is still not developed enough and derivatives trading has hardly developed; the rule is that physical electricity/gas is being traded between classical energy companies (such as electricity traders) whose main business is namely trading in energy on own account and to the best of our knowledge there are no financial institutions or similar entities whose main business is not trading in electricity that are parties to such transactions. Derivative contracts are still rather an exception on Bulgarian energy market.

So, our understanding is that - despite that in principle the contract types listed in Appendix B of the Instruction Letter fall within the scope of MiFIA - because of the capacity of the Parties to energy transactions in Bulgaria (e.g., electricity traders) such transactions are excluded from the scope of the MiFIA (and from the safe harbour provisions accordingly).

Of course, in case a transaction under the General Agreement is entered into which (a) is to be qualified as entering into derivative contracts with financial instruments within the meaning of the MiFIA, and (b) such a transaction is not exempted from the MiFIA according to any of the above exemptions, the contractually agreed close-out netting provisions should benefit from the safe harbour provisions cited above (item 1.3.7.(i)).

(v) As far as the question is concerned whether the insolvency law provides for a "safe harbor" for certain entities and which of the entities listed in Appendix A would benefit from such provisions, please refer also to the above item 1.3.6, as well as to Annex 1.1 to this Opinion.

1.3.8. **A general description of limitations under Bulgarian law, if any, applicable to set-off of claims (both in an insolvency related <u>and</u> non-insolvency related Early Termination scenario and otherwise):**

(a) between Parties of claims arising <u>under</u> the EFET General Agreement

(i) Bulgarian law does not recognize the legal set-off (automatic set-off by operation of law (*ipso jure*)). The set-off is regulated in articles 103 to 105 of the OCA as one of the mechanisms for payment (liquidation) of debts. As mentioned above (**C.I.**1.3.1(ii)), the

b) determination by the system of the initiation, generation, targeting or performance of an order without human intervention for individual transactions or orders, as well as

c) in a large number of messages throughout the day, which represent orders, quotations or cancel orders, determined in accordance with Article 19 of Delegated Regulation (EU) 2017/565.

necessary pre-conditions for the set-off are: identity of the parties to the claims subject of the set-off; the claims to be monetary or for replaceable commodities of one and the same kind; the claim of the setting-off party ('the active claim') to be due and payable; its grounds and amount to be determined (i.e. the claim to be 'liquid' - undisputed, according to case law). As result of the set-off the two mutual (counter) claims of the parties are deemed redeemed (liquidated) up to the amount of the smaller claim as of the date on which the set-off could have been effected (article 104(2) OCA).

The conditional set-off or the set-off under a specified term is in principle inadmissible.

Like in German law (§ 388 BGB (German Civil Code)), the set-off under Bulgarian law is effected by a unilateral statement of the setting-off party. Creditor's consent on the set-off shall be necessary in case claims resulting of intentional tort (*Delikt*), or claims for taxes[20], or claims over which no forced execution is permissible are being set-off.

Of course, set-off may be effected also by virtue of a contract concluded between the parties having mutual claims (this approach is even better than the unilateral set-off because each party contractually recognizes the other party's claim and has no objections against it, which might be a problem in case of set-off effected by a unilateral statement of one of the parties).

(ii) Bulgarian legal doctrine and court practice deal in detail also with the objection for set-off, made by the defendant in a lawsuit (and explicitly mentioned only in article 298(4) of the Civil Proceedings Code (published in State Gazette 59/20.07.2007, in force as from 1 March 2008, last amendments published in State Gazette 11/02.02.2023). The objection for set-off is often preferred to the counter claims, because no state fee shall be paid for the objection (in contrast to the counter claim).

(iii) The pre-conditions for a valid set-off in the insolvency proceedings (article 645 of the Commerce Act) have been reviewed in detail in item 1.1.1**(ii)** of Annex 1.1.

(iv) Our understanding is that the claims arising under the General Agreement have to comply with the pre-conditions for set-off as per article 103(1) of the OCA (see the above item (i)) in order for the set-off to be enforceable under Bulgarian law. In an insolvency related Early Termination scenario the pre-conditions under article 645 of the Commerce Act must also be complied with.

(b) between Parties of claims arising <u>outside</u> the General Agreement if contractually provided for in an amendment to the General Agreement

In our opinion the Parties may agree also their mutual claims outside the General Agreement to be set-off (such a set-off is permissible also if effected by a unilateral statement of the setting-off party, but, as mentioned above, the contractual set-off is in principle more recommendable). The OCA does not require the mutual (counter) claims to originate from one and the same legal relation (i.e. from one and the same contract). Of course, for the enforceability of the set-off the pre-conditions under the above item (i) shall be met.

[20] Please note that there are special rules under Bulgarian law for set-off of taxes and other public liabilities.

(c) between Affiliates or Credit Support Providers of Parties if contractually provided for in an amendment to the General Agreement.

(i) As mentioned above, one of the necessary pre-conditions for set-off under Bulgarian law is the identity of the parties to the claims subject of set-off. Exceptions from this rule are admissible only if they are explicitly provided by the law; see next item (iii).

Therefore, even if the Parties to the General Agreement generally agree also claims between their Affiliates or Credit Support Providers to be set-off, these entities have in principle to become creditors, respectively debtors under the claims to be set-off.

(ii) This can be achieved by virtue of a contract for assignment of claims or by a contract for assumption of debts (depending on the concrete situation).

For the sake of clarity, we would like to provide you with a summary of the relevant legal provisions regulating the assignment of rights and assumption of obligations under Bulgarian law:

Assignment of rights

Articles 99 and 100 of the OCA regulate the assignment (transfer) of rights (claims) (*цесия* in Bulgarian, *Vertrag über Abtretung von Forderungen, Zessionsvertrag* in German). Such a transfer is principally permissible, unless the contract, the law or the nature of the right does not allow it.

The transfer of rights has effect towards third parties and the debtor as from the date of receipt of the notification about the transfer by the debtor. Pursuant to article 99(4) of the OCA the notification shall be made by the transferor (i.e. by the assigning party) and not by the transferee.

Bulgarian legal theory[21] recognises the admissibility of the transfer also of future rights (this view is, however, not indisputable, incl. in the light of the case law – e.g. Judgement No 32 of 9 September 2010 of the Supreme Cassation Court, Commercial Department, case No 438/2009). Such a transfer shall have effect once the claim arises.

Assumption of debts

Articles 101 and 102 of OCA regulate two different forms of assumption of debts (obligations), as follows:

- article 101 – entering into debt (*встъпване в дълг* in Bulgarian, *Schuldbeitritt* in German): the entering into a debt may be effected upon an agreement of the entering party with the creditor or with the debtor. In this case the creditor shall have two debtors who are jointly liable (*Gesamtschuldner* in German).

- article 102 – debt substitution (*заместване в дълг* or *поемане на дълг* in Bulgarian, *Schuldübernahme* in German): for the debt substitution the creditor's explicit consent is necessary. In this case the substituted debtor shall be released from liability towards the creditor.

[21] See for example '*Contractual law*', Prof. Angel Kalaidjiev, 4th edition, Sibi 2007, page 486.

After the valid effecting of any of the above acts (taking into consideration the aimed purpose) the set-off will be enforceable. It is common business practice in Bulgaria trilateral and multilateral agreements to be concluded in order for the above operations (in various combinations), including set-off, to be effected in a fast and effective manner.

(iii) As regards the Credit Support Providers, there are in principle two legal provisions which under the concrete circumstances (e.g. depending on the particular credit support provided) could allow also the Credit Support Providers to participate in the set-off (each particular scenario should be separately scrutinized in order for its admissibility under Bulgarian law to be checked):

Art. 151 OCA – Set-off in the hypothesis of provided pledge or mortgage for securing the debt of a third party

According to the cited provision, in the case of providing a pledge for the debts of a third party, the collateral provider may request set-off between claims of the **debtor** (and not of the collateral provider) against the creditor and the secured creditor's claim.

Bulgarian legal doctrine[22] discusses whether it is admissible the collateral provider to make a set-off between **his** claim against the creditor and the secured creditor's claim. There is no legal provision allowing the collateral provider to do this[23]. That is why the conclusion is made that the collateral provider does not have such a right but a proposal *de lege ferenda* is made such a possibility to be explicitly included in the law.

It is inadmissible the debtor to make a set-off between a claim of the collateral provider against the creditor and the secured creditor's claim.

Art. 142 OCA – Set-off in the hypothesis of provided guarantee for securing the debt of a third party in the form of a guarantee agreement[24] (*Bürgschaftsvertrag* in German)

According to the cited provision, the guarantor may set-off a claim of the **debtor** to the creditor (i.e. the beneficiary under the guarantee agreement) against the claim of the creditor to the guarantor (arising out of the guarantee agreement; this is actually the secured debt of the main debtor, but the prevailing opinion is that the debt of the guarantor has separate existence), even if the debtor has waived this right or has acknowledged his debt.

Bulgarian legal doctrine discusses whether it is admissible the guarantor to make a set-off between **his** claim against the creditor and the secured creditor's claim. Although there is no legal provision allowing the guarantor to do this, the prevailing opinion is that the guarantor has such a right. A ground for the different treatment compared to the collateral provider securing third party's debt (see previous paragraph) is found in the circumstance

[22] V. Popova, '*The Set-off. Substantive legal issues*', Fenea, 2002, p. 134.

[23] In contrast to other legal systems – e.g. German law – see § 268(2) BGB.

[24] This rule is applicable with respect to guarantee **agreements** only; it is disputable whether unilateral guarantees (e.g. a parent guarantee) are enforceable under Bulgarian law at all, see below item **C.III.9** dealing with the Parent Company Guarantee.

that the guarantor is liable with all his assets (and the collateral provider – only with the pledged assets).

Since the guarantor is joint debtor with the main debtor, the creditor should have the right to make a set-off between his secured claim and a debt he has to the guarantor.

(iv) The effect of the set-off can be achieved also by an instruction (*delegatio*) for payment (*Anweisung* in German). This is appropriate in trilateral schemes, where one of the parties is creditor to the second party (claim A) and debtor of the third party (claim B). In such a case the first party instructs the second party to pay its debt (claim A) directly to the third party. After payment (assuming, of course, that claim A and claim B are of the same amount) by the second party claim A and claim B shall be considered liquidated. This is probably the fastest approach for debt settlement between more than two parties. Also in this case, however, it would be recommendable written evidence (letters of confirmation, agreements, etc.) to be produced in order for maximum legal certainty and clarity to be achieved. It should be further noted that this approach is not to be defined as set-off under Bulgarian law.

1.3.9. **Do Bulgarian laws consider early termination, set-off and close-out netting as legally distinct and separate rights, similar or related rights or do they make no such distinctions between them?**

(i) It should be once again noted that Bulgarian law contains a definition of close-out netting which is merely for the purpose of the financial collateral arrangements. As mentioned (see item 1.1.6(ii) of Annex 1.1), under article 10(2) of the FCAA, a close-out netting provision is a provision of a financial collateral arrangement, or, in absence of such provision, any statutory rule, by which, in case of non-performance:

- the obligations of the parties become immediately due and transform into obligations to pay an amount representing their estimated current value, or are terminated and replaced by an obligation to pay such an amount; and/or
- the obligations of the parties are redeemed up to the amount of the smaller obligation, where the party owing the larger amount remains debtor to the other party for the net sum equal to the balance of the account.

'Netting' is used as a term also in the Credit Institutions Act (see item 1.1.2.1(iii) of Annex 1.1) but there is no legal definition.

A definition of 'netting' is provided by the Law on the Payment Services and Payment Systems (see above item 1.3.7.(i)).

Comparing the above definition of close-out netting with the provision of article 103 OCA as discussed above, it can be confirmed that close-out netting derives from the set-off and is a similar legal figure under Bulgarian law (as already mentioned, even the last part of the definition under FCAA is taken from the definition of set-off under the OCA). In case obligations are replaced by an obligation to pay an amount representing their estimated current value, the close-out netting has also elements of a novation.

(ii) However, close-out netting has also its specificities (as discussed above)[25]. Close-out netting under the FCAA is a contractually agreed mechanism the effect of which occurs **automatically** where set-off under the OCA is effected by a unilateral statement.

This is confirmed also by the Bulgarian legal doctrine – '*The* [*close-out*] *netting institute is similar to the set-off but is not its synonym. The term 'netting' has broader content than the set-off. In contrast to the set-off (article 104(1) OCA), there is no necessity of a unilateral statement by the one party to the other. The netting clause has significantly more advantages compared to the ordinary set-off and in contrast to the set-off guarantees the validity and the non-repealability of the effected payment*'[26].

It should be underlined that close-out netting is still not well known in Bulgarian court practice. Bulgarian legal doctrine is not very exhaustive either (it focuses on the close-out netting merely on the plane of the financial collateral arrangements and the settlement of relations between banks). This makes the analysis of the practical aspects of close-out netting very difficult and the position of Bulgarian courts in respect of close-out netting provisions in case of potential lawsuits unpredictable. In any case we believe that Bulgarian courts would interpret the close-out netting provisions of the General Agreement in the light of the more familiar legal figure of the set-off.

(iii) As regards the close-out netting under the General Agreement, we understand its mechanism as follows: upon occurrence of a Material Reason and termination of the Agreement (automatically under §10.4 or by a notice under §10.3(a)), with effect from the Early Termination Date (coinciding with the moment of occurring of the Material Reason under §10.5(c)(iv) or as designated in the Early Termination notice), all existing duties and obligations of the Parties shall become due and payable, the Terminating Party will calculate the Settlement Amounts/ the Termination Amount and will notify the other Party of the Termination Amount (if any) to be received or paid by it.

It is not fully clear in our opinion whether the set-off element of the close-out netting under the General Agreement occurs automatically or not. On the one hand, the Automatic Termination has as effect that '***with effect from the Early Termination Dat****e all further payments and performance in respect of all Individual Contracts shall be released (and not merely suspended) and* ***existing duties and obligations of the Parties shall be replaced by the obligation of one Party*** *to pay damages for non-fulfillment to the other Party in an amount (if any) calculated in accordance with § 11.1*' (§ 10.3(b)) – this might lead to the conclusion that the close-out netting effect occurs automatically. On the other hand, the calculation of the Termination Amount (Gains less the aggregate of the Losses and Costs) shall be done by the Terminating Party and notified to the other Party (§ 11) – this resembles the unilateral set-off statement. This ambiguity could lead to additional difficulties in the application and interpretation of the close-out netting mechanism under the General Agreement (e.g. potential interested parties may claim that since the close-out netting effect under the General Agreement occurs automatically this is in breach of the rule under Bulgarian law that set-off is effected by a unilateral

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[25] See also *The Principles on the Operation of Close-Out Netting Provisions*, adopted by the International Institute for the Unification of Private Law (UNIDROIT) in May 2013.

[26] '*Legal regime of the netting in the Financial Collateral Arrangements Act*', Ivan Mangachev, Commercial and Competition Law, issue 5/2008, page 54, '*The new legal regime of the financial collateral arrangements*', Ivan Mangachev (Ciela 2011), page 129.

statement of the setting-off party and that on this ground the close-out netting is not valid and enforceable under Bulgarian law; in such a case as counterargument could be pointed out that by signing the General Agreement the Parties have agreed their relations to be settled namely by this mechanism (contractual freedom) but in any case potential disputes in this regard should be kept in mind).

(iv) One further legal figure familiar to Bulgarian legal doctrine and court practice should be mentioned as well, called 'compensation (set-off) of the damages against the gains' (*compensatio lucri cum damno*). This figure is relevant when damages have been caused (regardless of whether due to breach of a contract or to liability resulting of tort (*Delikthaftung* in German)) but the prejudiced party has also obtained some profits, gains as result of the infringement. The idea is that the function of the compensation for damages should be the damages to be compensated (repaired) and not the prejudiced party to be enriched. The gains have to be concrete and actual and not future, and to be evaluable in money. There must be causation between the unlawful behavior which has caused the damages and the gains. The set-off of damages against gains must be compliant with *bona fide*. Such a set-off is made upon request of the party who has caused the damages. This party bears also the obligation to prove the gains and their amount. According to Bulgarian legal doctrine this legal figure is not set-off within the meaning of article 103 of the OCA (as described above). However, no further detailed considerations regarding the distinction between the two set-offs is provided.

In our view this set-off resembles to some extent to the set-off / close-out netting under the General Agreement and the related calculation of the Settlement Amount (§ 10.3 and § 11). However, since as mentioned above such a mechanism for settlement of the parties' contractual relations is not popular in Bulgaria and to the best of our knowledge is not known in Bulgarian court practice, it is hard to predict whether Bulgarian courts will regard the close-out netting and the calculation of the Settlement Amount under the General Agreement as a pure set-off under article 103 of the OCA, as a contractually agreed set-off, as a set-off of the damages against the gains (*compensatio lucri cum damno*) (as described above) or as something different (e.g. as a novation[27]).

(v) As regards the Early Termination, our understanding is that it is a contractually agreed mechanism for termination of the Agreement. It allows one of the Parties to terminate the Agreement by a unilateral statement if a Material Reason has occurred with respect to the other Party. Such an approach is generally permissible under Bulgarian laws – see for example Art. 20(2) OCA: '*The contracts may be amended, **terminated**, rescinded or annulled only upon mutual consent of the parties or upon any of the grounds envisaged by the law*' – i.e. the Parties may agree in the Agreement the mechanisms to terminate the Agreement. The close-out netting and the set-off are consequences of the Early Termination.

1.3.10. **Please specify if any of your conclusions in this Section I would be changed or qualified if the Parties would enter into several Individual Contracts for multiple types of products (e.g., some Individual Contracts would provide for delivery of electricity/natural gas, other ones for green certificates) under the same General**

[27] As mentioned, the novation is another legal mechanism for extinguishing of debts under Bulgarian law (article 107 OCA) which is effected by a contract between the creditor and the debtor.

Agreement? Is there a risk that any safe harbour provisions applicable to one type of product, but not the other, would cease to apply as a result?

It is our understanding that if the Parties enter into several Individual Contracts for multiple type of products under the same General Agreement our above conclusions would not be changed. As discussed, the safe harbour provisions depend rather on the type of counterparties and not on the type of product. Of course, each particular case should be assessed on its own, with a view of its specificities.

2. Preventive restructuring frameworks

Please discuss the issues outlined above in the context of the implementation of Directive (EU) 2019/1023 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt of 20 June 2019 (the „EU Restructuring Directive“) and its impact on netting and close-out netting in Bulgaria.

2.1. The EU Restructuring Directive was adopted on 20 June 2019 and the EU Member States had to transpose it into their laws, regulations and administrative provisions by 17 July 2021. Bulgaria has failed to do so (one of the reasons is the continuing political crisis in Bulgaria in the last 25 months). The work on the transposition of the EU Restructuring Directive into Bulgarian law is still in progress (see item 2.3 below).

2.2. Of particular importance with regard to the matters discussed in this Opinion are the provisions of recital 94 and Art. 7(6) of the EU Restructuring Directive, the latter being quoted below due to its importance:

‘*Article 7(6). Member States may provide that a stay of individual enforcement actions does not apply to netting arrangements, including close-out netting arrangements, on financial markets, energy markets and commodity markets, even in circumstances where Article 31(1) does not apply, if such arrangements are enforceable under national insolvency law. The stay shall, however, apply to the enforcement by a creditor of a claim against a debtor arising as a result of the operation of a netting arrangement.*

The first subparagraph shall not apply to contracts for the supply of goods, services or energy necessary for the operation of the debtor's business, unless such contracts take the form of a position traded on an exchange or other market, such that it can be substituted at any time at current market value.’

2.3. On 26 July 2022 the Council of Ministers of Bulgaria adopted a decision to approve a Bill on amendment and supplementation of the Commerce Act with the purpose to transpose into Bulgarian law the EU Restructuring Directive (the **Bill**). On the same day the Bill was submitted with the Parliament. However, the Parliament held its last session on 29 July 2022 and was dismissed. New parliamentary elections will took place in Bulgaria on 2 October 2022.

The 48th Bulgarian Parliament had its sessions in the period 19 October 2022 – 03 February 2023. In this period there were several Bills on amendment and supplementation of the

Commerce Act with the purpose to transpose the EU Restructuring Directive, all of them aiming to improve the Bulgarian insolvency proceedings. The Bills were not finally voted by the 48th Parliament.

As from 12 April 2023, in Bulgaria functions the 49th Parliament. In principle, there are Bills on amendment and supplementation of the Commerce Act with the purpose to transpose the EU Restructuring Directive submitted for voting to the Parliament. However, it cannot be predicted when the new Parliament will vote such Bills and how they will look like once finally voted.

According to the EU law portal EUR-Lex, Bulgaria has not transposed the EU Restructuring Directive yet - https://eur-lex.europa.eu/legal-content/BG/NIM/?uri=CELEX:32019L1023

2.4. Nevertheless, it deserves mentioning that we were not able to identify in the Bills anything corresponding to the provision of the quoted Art. 7(6) of the EU Restructuring Directive. In one of the tables comparing the provisions of the Bill with the provisions of the Directive in this section there was only a note stating that the provision of Art. 7(6) of the Directive is not binding and not subject to mandatory transposition.

It further deserves mentioning that Art. 645 of the Commerce Act, regulating the insolvency set-off, remains intact by the current Bills.

3. Termination (§10, §11) for Non-Insolvency Related Material Reasons

Please discuss the issues outlined above under 1.3.4, 1.3.5, 1.3.6 and 1.3.10 in the context of non-insolvency related Material Reasons, as well as the following question:

Are the rights of the Terminating Party to terminate and close-out the General Agreement enforceable in accordance with the terms of the General Agreement, irrespective of the insolvency of Party A?

(i) The cited principle of contractual freedom (article 9 OCA) prescribes that the parties to a contract are free to determine the contract's clauses, provided that any mandatory legal provisions and common ethics (*bona fide*) are not breached. In our opinion the Material Reasons (other than due to insolvency) as defined in § 10.5 of the General Agreement and the Early Termination for such Material Reasons (§ 10.3) do not contradict mandatory legal provisions and common ethics and are therefore enforceable under Bulgarian law.

(ii) However, in respect of close-out netting and the calculation of the Termination Amount (§ 10.3 and § 11) our comments under the above item **C.I.**1.3.3 and 1.3.9 should be taken into consideration – they remain fully relevant also in the context of a non-insolvency related Material Reason.

(iii) For the sake of clarity, a differentiation between termination and rescinding of a contract under Bulgarian law should be made. In case of rescinding (article 87 OCA) one of the parties is always in default (i.e. there is a breach of the concluded contract), where in case of termination (usually) there is no defaulting party. Termination is not explicitly regulated by law, where articles 87 and 88 of the OCA regulate the pre-conditions for rescinding and the consequences thereof (sending a prior written notice to the defaulting party and giving it a period to remedy the breach (as well as the cases in which such a notice ought not to be sent), what kind of contracts may be rescinded only in court proceedings (real estate related contracts), compensation in case of rescinding (negative interest), etc.). The rescinding has in principle effect *ex tunc* (for the past) where the termination has effect *ex nunc* (for the future). Due to that, in case of rescinding a contract the rules for unjust enrichment shall apply where in case of termination the provisions of the terminated contract shall apply.

Reviewing the Material Reasons under § 10.5 of the General Agreement one can come to the conclusion that some of them (Non-Performance, Failure to Deliver or Accept, Breach of Representation or Warranty) are grounds for rescinding the General Agreement rather than grounds for its termination with all the legal consequences resulting thereof – obligation for sending a prior written notice to the defaulting party and giving it a period to remedy the breach, etc. We believe, however, that the counterparties should have the freedom to determine in the contract the events the occurrence of which will be considered as a material reason for termination (and not for rescinding) of this contract without being restricted by the rules of articles 87 and 88 of the OCA. Arguments in support of this opinion can be found in the court practice as well (for instance in judgement No 1694 of 11 November 2002 of the Supreme Court of Cassation in civil case No 1265/2002).

(iv) Regarding the Single Agreement concept please see our comments in the above item **C.I.**1.3.4.

(v) Regarding the currency of the claim issue please see our comments in the above item **C.I.**1.3.5.

II. Multibranch Parties

Prior to proceeding with the analysis of the constellations under Part II of the Instruction Letter, several preliminary notes need to be made.

1. Assumptions and preliminary observations

1.1. It is our understanding that it is within the scope of this Opinion to analyze the situations where the Multibranch Party has entered into the General Agreement with <u>one and the same counterparty</u> domiciled in a different jurisdiction, whereas the Individual Contracts have been concluded either by the Multibranch Party itself or by its branches. Multibranch Party is to be regarded to have its center of main interest (**COMI**) alternatively in Bulgaria (Party A – Bulgarian Multibranch Party), or outside Bulgaria (Party F – Foreign Multibranch Party).

1.2. Council Regulation (EU) No 848/2015 of 20 May 2015 on Insolvency Proceedings (recast) (the **EU Insolvency Regulation**)

1.2.1. As mentioned (item 1.1.3 of Annex 1.1; for the better understanding of our comments in this section of our Opinion we deem it necessary to reiterate some of the comments already made), the EU Insolvency Regulation is in force since 26 July 2017 (before that, Council Regulation (EC) No 1346/2000 of 29 May 2000 on Insolvency Proceedings applied for insolvency related matters between EU Member States (*such Regulation is referred to as 'the old Insolvency Regulation'*)). Thus, in case the Multibranch Party has its COMI[28] in either Bulgaria, or another Member State, the EU Insolvency Regulation shall have to be applied (see recital 25: '*This Regulation applies only to proceedings in respect of a debtor whose centre of main interests is located in the Union*').

Our analysis of the potential issues connected with the EU Insolvency Regulation is done predominantly on the basis of the conclusions of the legal doctrine at the EU Community level, as well as on the basis of the judgments of the Court of Justice of the European Union (**ECJ**). In addition, we are going to comment the possible outcomes of the case study on the basis of our experience and logic which may not be completely shared and accepted by the Bulgarian judicature, as the case may be.

Note: The legal doctrine and the ECJ judgements we are referring to were issued predominantly during the application of the old Insolvency Regulation, but because the main principles under the old and the new Insolvency Regulation have not changed, we believe that they are still relevant and we have thus kept the references thereto in the updated version of our Opinion.

1.2.2. In case the COMI of the Multibranch Party is within the EU, <u>main insolvency proceedings</u> are to be opened in the particular Member State within the territory of which the debtor's COMI is situated, whose courts should be regarded to have been allocated the exclusive jurisdiction to hear the insolvency case (Art. 3(1) of the EU Insolvency Regulation).[29] Moreover, the law of that very Member State is to govern as a whole the insolvency proceedings (in its capacity as *lex fori concursus principalis*) (Art. 7 of the EU Insolvency Regulation).

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[28] We consider the meaning of the contents of the term center of main interest to be settled in the legal doctrine for which reason we will not elaborate further on that matter. See for example: *Fletcher, F.* in "*The EC Regulation on Insolvency Proceedings – A Commentary and Annotated Guide*", editors – Gabriel Moss, Ian Fletcher, Stuart Isaacs, Oxford University Press, 2002, p. 39, as well as *Virgos-Schmit Report*, para 75, as well as *recital 13 of the old Insolvency Regulation* itself. However, some commentators showed that certain issues amongst national jurisdictions have arisen on occasions of interpretation of the rebuttable presumption under Art. 3, para 1*, sent. 2* of the old Insolvency Regulation which, in its turn, may lead to a positive conflict of jurisdictions. See for example *Torremans, P. – "Coming to Terms with the COMI Concept in the European Insolvency Regulation*" in "International Insolvency Law – Themes and Perspectives", ed. by Paul J. Omar, Ashgate, 2008, p. 178 and following, as well as the court practice cited therein and especially the judgment of ECJ on *Eurofood IFSC Ltd* Case C-341/04 [2006]. <u>According to the ECJ, the COMI is the place on which the debtor conducts the administration of its interests on a regular basis and is therefore ascertainable by third parties. The COMI "*must be identified by reference to criteria which are both objective and ascertainable by third parties*"</u>. The ECJ holds that the presumption can be rebutted for example in the case of a "letterbox" company not carrying on business in a Member State.

[29] The COMI criterion should be able to ensure sufficient degree of certainty, forseeability and flexibility. With its help the EU legislator clearly envisages that there should be one single court to deal with the cross-border insolvency matter within the EU. However, the old Insolvency Regulation has been also criticized as not taking into consideration the specific issues related to insolvency of corporate groups. That is why, in the new EU Insolvency Regulation an entirely new Chapter V was introduced which deals with the insolvency proceedings of members of a group of companies (articles 56-77).

In case the Multibranch Party maintains an establishment in any other Member State, secondary proceedings upon the start of the main proceedings may be opened (Art. 3(2) and (3) of the EU Insolvency Regulation). The secondary proceedings are governed by the law of the respective Member State (in its capacity as *lex fori concursus secundi*). It is not necessary to re-examine the insolvency of the debtor separately from the main proceedings in order that a secondary proceeding could be validly opened (Art. 34). The effects of secondary insolvency proceedings shall be restricted to the assets of the debtor situated within the territory of the Member State in which those proceedings have been opened.

Furthermore, in case the requirements and conditions of Art. 3(4) of the EU Insolvency Regulation are met, independent territorial proceedings may be opened even prior to the main insolvency proceedings as per the place of the COMI of the respective debtor. The territorial proceedings may operate exclusively against the assets of an "*establishment*" of the debtor situated in the respective Member State[30]. The mere presence of assets, even if they are in a considerable value, is not sufficient. The territorial insolvency proceedings under Art. 3(4) of the EU Insolvency Regulation are governed by the local law. As a result, a plurality of insolvency proceedings and applicable legal orders is possible, which can create difficulties by the application of the Regulation.[31] When main insolvency proceedings are opened, the territorial insolvency proceedings shall become secondary insolvency proceedings.

1.2.3. The Instruction Letter requires that the different scenarios described are analyzed as regards "*branches*" of the Multibranch Party by whose operation some of the Individual Contracts have been executed. In that regard, and taking into consideration that the EU Insolvency Regulation shall apply, the correlation between the two terms, i.e. "branch" and "establishment" should be discussed in order that characterization problems could be avoided.

(i) The term "branch" is unfamiliar to the EU legislator in the field of cross-border insolvency. The autonomous community characterization of the term may not be excerpted from any similar acts of the secondary EU legislation either as regards the European Private International Law (i.e. the measures passed under Art. 61 and 65 of the EC Treaty). In case Bulgarian law is to be applied as *lex fori concursus*, the Bulgarian courts will be obliged to apply Art. 39 of the Private International Law Code and will make characterization according to *lex fori*. Thus, "branch" would be understood in compliance with Art. 17 of the Commerce Act, that is, as having no distinctive legal personality different from the one of its mother-company[32]. Notwithstanding that the branch must have a branch manager (so has a certain degree of independence from the mother company and is subject to the managerial decisions of the branch manager), the branch may not own any property. It executes contracts in the name of and with effect for the mother company.

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[30] According to the EU Insolvency Regulation, *'establishment' means any place of operations where a debtor carries out or has carried out in the 3-month period prior to the request to open main insolvency proceedings a non-transitory economic activity with human means and assets*.

[31] See further commentary on the matter in Israël, Jona – "*The European Cross-Border Insolvency Regulation*", Intersentia, 2005, p. 291 - 292.

[32] It has merely a kind of limited legal personality for tax and employment law purposes.

(ii) The EU legislator would rather operate with the term "establishment". The latter has been explained with an autonomous definition in Art. 2(10) of the EU Insolvency Regulation. In order that the full meaning of the term could unfold, the respective practice of the ECJ interpreting the term "establishment" as per Art. 5(5) of the Brussels I Regulation (Art. 7(5) of the recast version) should be taken also into consideration. The ECJ defines the term "establishment" as a place of business which has the appearance of permanency, has a management and is materially equipped to negotiate business with third parties. The establishment should act as the prolonged arm of its principal, whereas it needs a minimal amount of equipment and personnel (e.g. in case the only person employed is the entrepreneur himself, an establishment cannot be said to exist).[33] An establishment under the terms of the international insolvency requires not only passive presence of the debtor in a Member State.

1.2.3.1. Thus, in case the branch of the Multibranch Party registered in any Member State (including Bulgaria) does not meet the preconditions for existing of an establishment as defined in Art. 2 of the EU Insolvency Regulation and as interpreted by the ECJ, the branch would be regarded only as assets and property of the Multibranch Party in the respective jurisdiction.

On the contrary, if the branch meets the requirements for an 'establishment', secondary insolvency proceedings may be opened in the Member State where this branch is located.

For the purposes of this Opinion, we assume that the branches of the Multibranch Party qualify as establishments within the meaning of the EU Insolvency Regulation.

1.2.3.2. For the sake of completeness, it should be noted that according to the Bulgarian insolvency law no insolvency proceedings could be commenced as regards the branch itself as long as it does not possess any legal personality and is not to be regarded a "trader" according to the Bulgarian Commerce Act (according to whose Art. 607a and following, insolvency proceedings are admissible only as regards traders – companies or sole proprietors).

1.2.3.3. In case the establishment of the Multibranch Party in Bulgaria is organized not in the form of a branch but rather as a separate subsidiary or affiliated company, the EU Insolvency Regulation would have to be applied separately for each separate legal personality. Art. 3(1) of the Regulation will give primary insolvency jurisdiction to the courts of different Member States for each separate affiliated company having its COMI in the EU.

In addition, as mentioned, the Regulation already provides specific provisions (Chapter V) to deal with the insolvency of groups of companies (according to the definitions in the Regulation, *'group of companies' means a parent undertaking and all its subsidiary undertakings; 'parent undertaking' means an undertaking which controls, either directly or indirectly, one or more subsidiary undertakings. An undertaking which prepares consolidated financial statements in accordance with Directive 2013/34/EU of the European Parliament and of the Council shall be deemed to be a parent undertaking*).

[33] See the judgments of ECJ on the following cases: Somafer SA v. Saar-Ferngas AG (Case 22/78 [1978] ECR 2183), Blanckaert & Willems PVBA v. Luise Trost (Case 139/80 [1981] ECR 819), SAR Schott GmbH v. Parfians Rothschild SARL (Case 218/86 [1987] ECR 4905, Lloyd's Register of Shipping v. Societe Campenon Bernard (Case C-439/93 [1995] ECT I-961).

The new regulation contains rules for cooperation, communication and coordination between courts and insolvency practitioners appointed in cross-border group insolvency proceedings, incl. rules for group coordination proceedings. '*With the "group coordination proceeding" (GCP), the Recast EIR also introduces a novel "meta proceeding" separate from the already pending group members' individual insolvency proceedings. In a GCP, a group coordinator is appointed who is tasked with developing a solution for the group members' insolvency. The introduction of the GCP should allow for the development of centralized group solutions in cases where the centres of main interests ("COMI") of the insolvent group members are not (all) located in the same Member State. Group members participate in a GCP on a voluntary basis. In comparison with its predecessor, the Recast EIR undoubtedly allows for a more coordinated approach to cross-border insolvency proceedings involving groups. Chapter V's new provisions have, however, been met with scepticism. Cross-border communication, cooperation and coordination between insolvency practitioners and courts may be insufficient, because such activities do not necessarily prevent fragmentation of the group, disturbance of the chain of command and a domino effect, even if a GCP is opened*.[34]'

Note in this regard that '*The rules on cooperation, communication and coordination in the framework of the insolvency of members of a group of companies provided for in this Regulation should only apply to the extent that proceedings relating to different members of the same group of companies have been opened in more than one Member State'* (recital 62 of the EU Insolvency Regulation).

1.2.4. Issues connected with the **set-off** under the EU Insolvency Regulation

(i) As already stated, the EU Insolvency Regulation envisages a combination between two distinctive rules for the set-off: Art. 7(2)(d) and Art. 9. The alternative application of either the *lex fori concursus*, or the law governing the insolvent debtor's claim (the 'passive claim') has been provided for.

The commentators dealing with that matter[35] provide a universal explanation that the provision of Art. 7 established the basic rule of the system of cross-border insolvency of the EU. However, special rules should be provided for the law governing the set-off as a special mechanism to effect the discharge of the debtor's obligations. **Art. 9 of the EU Insolvency Regulation provides an exception to Art. 7 in order to protect the legitimate expectations and the certainty of transactions especially in cases where the set-off is seen as a form of security for the creditor.** See in this regard recital 70 of the EU Insolvency Regulation: '*If a set-off of claims is not permitted under the law of the State of the opening of proceedings, a creditor should nevertheless be entitled to the set-off if it is possible under the law applicable to the claim of the insolvent debtor. In this way, set-off would acquire a kind of guarantee function based on legal provisions on which the creditor concerned can rely at the time when the claim arises'*. The law governing the passive claim is known in advance and does not depend on the place in which the

[34] '*Defining groups of companies under the European Insolvency Regulation (recast): On the scope of EU group insolvency law*', Sid Pepels, Wiley Online Library, 5 December 2020, https://onlinelibrary.wiley.com/doi/full/10.1002/iir.1402

[35] See for example Virgós, M., Garcimartin, F. - "*The European Insolvency Regulation – Law and Practice*", Kluwer Law International, 2004, p. 116.

insolvency proceedings have been initiated and opened. Thus, Art. 9 is seen more or less as a guarantee that the creditor will be given the possibility to have "*two bites at the set-off cherry*"[36] and in addition adds to the predictability and certainty of the EU legislation.

(ii) *Lex fori concursus* is to be considered to govern also the conditions for executing and making efficient of a right to set-off, even the one that has originated upon the opening of the insolvency proceedings. To the contrary, the law applicable to the passive claim may be invoked only as regards claims that could have been extinguished by way of set-off prior to the opening of the insolvency proceedings.[37] The mutual claims must have existed and must have been incurred prior to the opening of the insolvency proceedings in order that the law applicable to the passive claim could be relied upon by the creditor. "*Article 6* [of the old Insolvency Regulation which is analogous to Art. 9 of the new Insolvency Regulation] *applies when the claims arose out of contracts or other dealings entered into prior to the opening of the insolvency proceedings, even they were, at that moment, mature or immature, contingent or not*".[38] The law applicable to the passive claim may be any law, including a law of a non-Member State. This conclusion is in line with the provisions of Regulation (EC) No 593/2008 of the European Parliament and of the Council on the law applicable to contractual obligations (Rome I). According to its Art. 17 the law applicable to set-off is the law chosen by the parties and in case of absence of choice of applicable law, the set-off is regulated by the law governing the passive claim. On the other hand, in compliance with Art. 3 of Regulation Rome I parties are free to choose any law to govern their contractual relations and they are not restricted to choose only among the legal orders of the EU Member States.[39] Bearing in mind that the set-off/close-out netting as provided for under the General Agreement could be qualified as a contractual agreement, the last conclusion seems to be even more undisputable, as long as under Art. 12(1)(d) of Regulation Rome I the contractual statute (the scope of applicable law) determines the "*various ways of extinguishing obligations*". Thus, it could be anticipated that the law of the passive claim would often coincide with the law governing the General Agreement as a whole. Thus, all the Individual Contracts and the possible set-off arising out of them are going to be governed by one and the same applicable law (if Art. 9 of the EU Insolvency Regulation applies).

The actions of voidness, voidability or unenforceability which might affect the set-off under Art. 9 of the EU Insolvency Regulation are subjected to the *lex fori concursus* (Art. 9(2) in relation with Art. 7(2)(m)). Art. 9(2) of the Regulation is however to be interpreted in conjunction with Art. 16 thereof which allows for an exclusion of the application of the provisions of the Regulation in case the respective act proves to be legally unquestionable according to the respective applicable law (see also Annex 1.1 to this Opinion, item 1.1.3).

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[36] See Virgos/Schmit Report on the Convention on Insolvency Proceedings, Paragraph No 109. The exclusion of Art. 6 of the old Insolvency Regulation (analogous to Art. 9 of the new Insolvency Regulation) was designated to protect creditors in case no set-off would be possible under the law governing the main proceedings.

[37] See Virgos/Schmit Report on the Convention on Insolvency Proceedings, Paragraph No 110.

[38] Thus Virgós, M., Garcimartin, F. - "*The European Insolvency Regulation – Law and Practice*", Kluwer Law International, 2004, p. 117.

[39] On the contrary Virgós, M., Garcimartin, F. - "*The European Insolvency Regulation – Law and Practice*", Kluwer Law International, 2004, p. 117, Paragraph 189.

(iii) Another issue connected with the set-off and the opening of secondary (independent territorial) proceedings may be considered in brief: what should be the solution in case of conflicts between the provisions of the *lex fori secundi, lex fori principalis* and the law applicable to the passive claim[40]. Some commentators have grounded an opinion that the opening of secondary (independent territorial) proceedings could affect the possibility to set-off. Commentators interpreted this issue in connection with Art. 2(g), last indent of the old Insolvency Regulation according to which claims are to be located in the Member State in which the third party debtor has its COMI (compare with Art. 2(9)(viii) of the new Insolvency Regulation). This allows the localization of the claim of the insolvent debtor (in its capacity as creditor) against its debtor (third party debtor). It may well turn out that the active claim (the claim of the third-party debtor) is not covered by the definition mentioned. Thus, it does not fall into the ambit of the law governing the secondary insolvency proceedings. In case, however, the law applicable to the main insolvency proceedings permits the set-off (prohibited by the secondary insolvency proceedings), this solution should be respected.[41]

1.3. In case the Multibranch Party has its COMI, or is incorporated in a third state, out of the EU, the rules of **Bulgarian Private International law** as regards the cross-border insolvency shall apply.

Unfortunately, those rules are not exhaustive and are out of date. In the course of the reform of the Bulgarian Private International Law, the issues connected with the cross-border insolvency were not included into the new Bulgarian Private International Law Code (**PILC**). The existing legal provisions are several very brief conflict-of-laws rules that appear in the Bulgarian Commerce Act - Art. 757 – 760. Some of the more important rules are:

- Bulgaria shall recognize <u>on the basis of mutuality</u> (only!) foreign judgments on the declaring of insolvency provided they are taken by an authority of the state where the debtor's <u>registered seat</u> is located (i.e. the Commerce Act uses the older formal approach and not the COMI).

- The receiver appointed by a foreign court shall have the powers envisaged in the state where the insolvency proceedings are initiated, provided they do not contradict Bulgarian <u>public policy rules</u>.

- A Bulgarian court is not obliged but is granted the discretion to open auxiliary insolvency proceedings against an insolvent foreign trader that possesses <u>considerable property (assets)</u> in Bulgaria (i.e. in contrast to the EU Insolvency Regulation, the presence of assets (and not necessarily of an establishment) would be sufficient for such auxiliary insolvency proceedings to be opened). The competence of the Bulgarian court is limited strictly to these assets in Bulgaria only. Such proceedings may be opened upon request filed either by the debtor, the foreign receiver or by a creditor.

[40] For example in case the law of the passive claim allows for set-off and the *lex fori concursus secundi* does not, but in the same time the *lex fori concursus principalis* allows for the set-off, in its part.

[41] Such a manner of reasoning has led some authors to state that the set-off is regulated only by the *lex fori concursus principalis*, or *lex fori concursus secundi*, depending on the location of the insolvent debtor's claim only. In that manner the balance with Art. 2 (g) of the old Insolvency Regulation is ensured. See more details on this in Israël, Jona, *op. cit.*, p. 299.

Taking into account the ill structured and inefficient legal provisions of Bulgarian Private International Law as regards the cross-border insolvency cases outside the scope of application of the EU Insolvency Regulation (which in practice leads to unpredictability of the courts' position as regards potential insolvency cases to be dealt with outside the scope of the EU Insolvency Regulation), as well as the lack of relevant court practice on the application of the cited rules of Art. 757 – 760 of the Commerce Act, we would rather examine in detail only the hypotheses falling under the EU Insolvency Regulation. In addition, we believe that this will be the most probable and customary issues that may arise taking into consideration the fact that Parties to the General Agreement are going to be mainly companies that are domiciles of the EU.

2. Bulgarian Mulitibranch Party

Additional assumptions:

- Party A has entered into Individual Contracts under the General Agreement through offices in Bulgaria, as well as through one or more branches located abroad. After entering into these Individual Contracts and prior to the maturity thereof, Party A becomes the subject of a voluntary or involuntary proceeding under the insolvency laws of Bulgaria.

2.1. Would there be any change in your conclusions reached under C.I.1 above based upon the fact that Party A has conducted business under the EFET General Agreement on a multibranch basis prior to its insolvency?

2.1.1. The main conclusions reached under **C.I.1** above could be supported. Party A has conducted business under the General Agreement on a multibranch basis prior to its insolvency and since Party A has its COMI in Bulgaria, the EU Insolvency Regulation shall apply and Bulgarian courts will be competent to pass a judgement on opening of the main insolvency proceedings and Bulgarian law shall apply in respect of those proceedings, as discussed above in **C.I.1**. Unless secondary proceedings are opened, Bulgarian law shall apply also with respect to the Individual Contracts entered into by the branches of Party A (i.e. the single agreement concept, the Automatic Termination and the close-out netting/set-off should be permissible, subject to our comments and reservations expressed above). Party A's counterparty under the General Agreement has to lodge its claims (if any, e.g. for the outstanding amount (the Termination Amount) after the termination of the General Agreement and the close-out netting) against Party A in the main insolvency proceedings in Bulgaria.

2.1.2. The courts of the other state(s) where Party A has branches will have the jurisdiction (upon request filed by the receiver in the main proceedings or by local creditors) to open secondary insolvency proceedings against Party A, where the effect of those proceedings will be restricted to the assets of the debtor situated in this state. For these territorial proceedings the respective local law would apply.

In particular, the local receiver could argue that the insolvent debtor Party A has assets in his jurisdiction, being Party A's claims under Individual Contracts concluded by the local branch. He might be tempted to separate these claims from the other claims under the General Agreement (under Individual Contracts concluded directly by Party A) and turn them into a local insolvency estate from which local creditors are to be satisfied. In principle, the resolving of this issue depends on the concrete local law applicable to the secondary insolvency proceedings which law could contain regulations as regards the set-off that differ sharply from the provisions of the Bulgarian law and thus the conclusions drawn as regards the admissibility of close-out netting with regard to that the claim governed by the law of this respective jurisdiction may have to be changed. This potential risk, however, may not be predicted in advance and would rather be assessed on case by case basis taking into consideration the concrete peculiarities of the respective constellation.

On the other hand, if we assume that the General Agreement is enforceable under the laws of any jurisdiction (see the assumptions on page 8 of the Instruction Letter), then we should assume that the single agreement concept, the Automatic Termination and the close-out netting/set-off are permissible also under the laws of the state where the secondary insolvency proceedings are opened and that therefore there would be no conflict of laws detrimental to the interests of Party A's counterparty under the General Agreement.

2.2. Would the EFET General Agreement be treated as a single unified agreement by the Bulgarian receiver under the laws of Bulgaria, regardless of the treatment of the EFET General Agreement or Individual Contracts by an insolvency official in a country where close-out netting may be unenforceable?

In our view the treatment of the General Agreement and the Individual Contracts by an insolvency official in a country where close-out netting is unenforceable should not have impact on the treatment of the Agreement by the Bulgarian receiver/court, provided that Bulgarian law shall apply in respect of the main insolvency proceedings and the Bulgarian receiver/court considers the close-out netting provisions of the General Agreement enforceable under Bulgarian law.

3. Foreign Multibranch Party

Additional assumptions:

- A corporation, a bank, an investment services provider, an insurance company, an investment fund management company or any other similar financial institution ("**Party F**") incorporated, organized or having its centre of main interest in a country ("**Country H**") other than Bulgaria has entered under the EFET General Agreement into Individual Contracts both through its home office and through one or more branches located in other countries including in each case a branch of Party F located in and subject to the laws of Bulgaria (the "**Bulgarian Branch**").

- After entering into these Individual Contracts and prior to the maturity thereof, Party F becomes the subject of voluntary or involuntary proceedings under the insolvency laws of Country H.

- As mentioned above, we further assume that Country H is an EU Member State, i.e. the EU Insolvency Regulation shall be applicable. As regards cases in which the COMI of Party F is outside the EU, please see **C.II.**1.3 above.

3.1. Would there be separate proceedings in Bulgaria with respect to the assets and liabilities of the Bulgarian Branch upon the start of the insolvency proceeding for Party F in Country H? Or would the relevant authorities in Bulgaria defer to the proceedings in Country H, so that the assets and liabilities of the Bulgarian Branch would be handled as part of the proceedings for Party F in Country H? Could local creditors of the Bulgarian Branch initiate separate proceedings in Bulgaria even if the relevant authorities in Bulgaria did not do so?

3.1.1. It should be noted once again that branches are not legal entities under Bulgarian law and that a contract concluded with the branch of a company is actually concluded with the company itself (but 'through its branch'). Claims arising out of direct relations with the branch may be filed at the seat of the branch but are again deemed to be filed against the company.

3.1.2. Observations regarding the insolvency proceedings in Bulgaria as regards the branch of Party F, whereas the latter is a **corporation** (company)

3.1.2.1. As made available above, the provisions of the EU Insolvency Regulation shall apply in this case. Thus, <u>secondary</u> insolvency proceedings under Art. 3(2) in connection with Art. 34 and following of the Regulation may be commenced in Bulgaria upon the start of the main insolvency proceedings in Country H (where Party F has its COMI). The secondary insolvency proceedings shall be directed against the debtor Party F and shall have regard only to the assets of its establishment organized as a branch in Bulgaria (see **C.II.**1.2.3 above for more details). The debtor's insolvency declared in the course of the main insolvency proceedings may not and must not be re-established under the secondary proceedings in Bulgaria. With the help of the secondary insolvency proceedings creditors of the Bulgarian branch of Party F could retain any special advantages which they could enjoy under the terms of Bulgarian law.

One of the tools to ensure the interrelationship between the main insolvency proceedings and the secondary insolvency proceedings is the provision of Art. 45(1) of the EU Insolvency Regulation which establishes the principle that "*any creditor may lodge his claim in the main proceedings and in any secondary proceedings*".[42]

3.1.2.2. As per Art. 37(1) of the EU Insolvency Regulation, eligible to request the opening of the secondary insolvency provisions are the receiver under the main proceedings and any person or authority entitled to do so according to the provisions of the *lex fori concursus secundi*, that is, in the discussed scenario, the Bulgarian insolvency law in force. Further to Art. 625 of the Bulgarian Commerce Act, the insolvency proceedings in Bulgaria could commence and be opened upon a respective petition by the debtor himself, by his liquidator, <u>by one of his creditors</u> under a commercial transaction, or by the National Revenue Agency.

Therefore, local creditors are entitled to initiate separate secondary insolvency proceedings in Bulgaria.

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[42] Further and more detailed commentary on that issue was made by Fletcher, Ian – "*Insolvency in Private International Law – National and Internationals Approaches*", Second Edition, Oxford, 2005, p. 433 – 444.

3.1.3. Observations regarding the insolvency proceedings in Bulgaria as regards the branch of Party F, whereas the latter is a **bank**

3.1.3.1. The EU Insolvency Regulation does **not** apply as regards the insolvency proceedings of banks (Art. 1(2)(b) and recital 19 of the Regulation). Thus, the specific provisions of the Bulgarian law in force shall apply.

3.1.3.2. The Bulgarian legislator distinguishes between two types of branches of foreign banks that could operate in Bulgaria – branches of banks licensed in other Member States and branches of banks of third states outside the EU. The branches of banks licensed in other Member States do not have to obtain a specific additional license for execution of their activity in Bulgaria, whereas the branches of banks of third states must at any case be issued an additional license in order to be allowed to operate in Bulgaria.

3.1.3.3. According to the Bulgarian law in force, no separate insolvency proceedings may be initiated as regards a branch of a bank in Bulgaria. The Bank Insolvency Act is to be applied only as regards banks having their seat (registered office) in Bulgaria. Thus, in our opinion, the assets and liabilities of the bank's branch in Bulgaria will have to be added to the main insolvency estate of its mother company and will have to be handled in it.

3.1.3.4. Another view is also possible. Article 612(2) of the Commerce Act states that insolvency proceedings of a bank shall be regulated by a special law but the provisions of the Chapter of the Commercial Act dealing with insolvency shall apply in cases where the special law does not provide anything else, i.e. it could be grounded that articles 757 – 760 of the Commerce Act as outlined above are applicable (incl. the possibility auxiliary insolvency proceedings to be opened in Bulgaria).

3.1.3.5. Further to Art. 139 of the Credit Institutions Act, the judgment for opening of insolvency proceedings against a bank of another Member State which bank is operative in Bulgaria through a branch is to be recognized directly and without any formalities whatsoever. Such a judgment should be registered with the Commercial Register. The applicable law is the law of the Member State in which the main insolvency proceedings have been opened (in its capacity as *lex fori concursus*), unless something different is provided by the Credit Institutions Act (see for example the cited Art. 144 of the Credit Institutions Act, according to which the adoption of reorganisation measures or the opening of a winding-up procedure of a bank shall not affect the right of creditors to demand the set-off of their claims against the claims of the bank, where such a set-off is permitted by the law applicable to the bank's claim).

In that regard it is worth mentioning once again that further to Art. 145, it. 2 of the Credit Institutions Act in the course of the development of the insolvency proceedings the law applicable to netting agreements is *lex causae* (the law governing the very netting agreement), without prejudice to the provisions of Art. 100 and Art. 103 of the Act on Recovery and Resolution of Credit Institutions and Investment Intermediaries. Thus, the Bulgarian legislator with an explicit provision envisages a powerful tool to enable the prevailing of the provisions of a netting agreement over the law applicable to the insolvency proceedings. In this way it could be considered that the priority application of a close-out netting agreement is attempted to be ensured, when it goes to insolvency proceedings commenced against a bank.

3.1.4. Observations regarding the insolvency proceedings in Bulgaria as regards the branch of Party F, whereas the latter is an **insurance company**

3.1.4.1. The EU Insolvency Regulation does **not** apply as regards the insolvency proceedings of insurance undertakings (Art. 1(2)(a) and recital 19 of the Regulation). Thus, the specific provisions of the Bulgarian law in force shall apply.

3.1.4.2. In accordance with Art. 624(1) of the Insurance Code, the judgment for opening of insolvency proceedings against an insurance company licensed in another Member State is enforceable in Bulgaria as of the date on which it causes its effect in the respective Member State. Going out of this provision, it could be concluded that the Bulgarian legislator does not envisage the possibility that separate insolvency proceedings could be opened in Bulgaria as regards a branch of an insurance company for which main insolvency proceedings have been opened abroad. The judgment of the foreign court dealing with the insolvency should be enforced in Bulgaria, thus, in our opinion, the assets and liabilities of the Bulgarian branch of such company would have to be added to the main insolvency estate.

3.1.4.3. Another view is also possible. According to Art. 612(2) of the Insurance Code the provisions of the Commerce Act find a subsidiary application to the matters of insolvency of insurance companies (with the exception of those explicitly listed therein, articles 757 – 760 of the Commerce Act are not explicitly excluded). Thus, *analogia juris* with article 759 of the Commerce Act could turn out to be possible. As mentioned, according to the cited regulation auxiliary separate insolvency proceedings may be opened (upon the discretion of the competent Bulgarian court) only as regards a foreign trader that has considerable assets in Bulgaria. For that reason, it could possibly be concluded that in case the requirements of Art. 759 of the Commerce Act are fulfilled, separate proceedings as regards the assets and liabilities of the Bulgarian Branch of Company F, being an insurance company, could be admissible.

3.2. If there were separate proceedings in Bulgaria with respect to the assets and liabilities of the Bulgarian Branch, would the receiver or liquidator in Bulgaria and the Bulgarian courts, based on the facts above, include Party F's position under the EFET General Agreement, in whole or in part, among the assets of Bulgaria, and, if so, would the receiver or liquidator and the Bulgarian courts recognize the close-out netting provisions of the EFET General Agreement in accordance with their terms? The most significant problem arising would be if a Bulgarian receiver, liquidator or court considering a single EFET General Agreement were to require a counterparty of the Bulgarian Branch of Party F to pay the mark-to-market value of Individual Contracts entered into with the Bulgarian Branch to the liquidator or receiver of the Bulgarian Branch, while at the same time forcing the counterparty to claim in the proceedings in Country H for its net value from other Individual Contracts with Party F under the same EFET General Agreement. In considering this issue, please assume that close-out netting under the EFET General Agreement would be enforced in accordance with its terms in the proceedings for Party F in Country H.

3.2.1. We assume that secondary insolvency proceedings are opened in Bulgaria with respect to the assets and liabilities of the Bulgarian Branch of Party F. For these territorial proceedings Bulgarian insolvency law would apply (Art. 35 of the EU Insolvency Regulation). Pursuant to Art. 7(2)(b) and (c) of the EU Insolvency Regulation, *lex fori* *concursus* regulates the question of which assets form part of the estate, as well as to determine also the powers of the receiver.

3.2.1.1. As stated above, the branch of a foreign company does not have any legal personality according to the Bulgarian company law in force. In addition, all assets, rights and liabilities of the branch are considered acquired in the name of its mother company and are directly and automatically allocated to it.

On the other hand, the Bulgarian Branch of the Party F must have a separate accounting for taxation purposes according to Bulgarian accounting and taxation law. From the accounting books it can be clearly visible what kind of contracts have been entered into by the branch itself and what from accounting and purely economic point of view could be characterized as assets and liabilities of the branch.

3.2.1.2. Thus, it is a matter of interpretation, initiative and will on the part of the Bulgarian receiver in charge. He has the sole discretion to consider the rights and obligations as per the Individual Contracts as allocated to the establishment of the branch. The receiver, may, however, decide also on the contrary – that these assets and liabilities are to be allocated to the mother company, i.e. must be dealt with within the main insolvency proceedings.

Therefore, in principle, as regards Party F's claims under Individual Contracts concluded by the Bulgarian Branch, the local receiver might be tempted to separate these claims from the other claims under the General Agreement (under Individual Contracts concluded directly by Party F) and undertake the necessary actions (e.g. to challenge the close-out netting) to turn them into a local insolvency estate from which local creditors to be satisfied (i.e. at least theoretically it is possible that the Bulgarian receiver requires the counterparty of the Bulgarian Branch of Party F to pay its obligations under the Individual Contracts entered into with the Bulgarian Branch to him). This is applicable of course only in case the counterparty has its COMI in Bulgaria (see Art. 2(9) of the EU Insolvency Regulation).

Whether the Bulgarian receiver would do so depends mainly on whether he would accept that the single agreement concept, the Automatic Termination and the close-out netting/set-off are **not** enforceable under Bulgarian law. As discussed above, they should be enforceable in our opinion but due to various circumstances (lack of court practice and legal doctrine on these issues, not fully clear and unambiguous provisions of the General Agreement, etc.), it cannot be predicted nor guaranteed whether the Bulgarian receiver would share the same view and would recognize the system of functioning of the close-out netting under the General Agreement enforced in Country H.

3.3. Please consider your answer to our question assuming instead that Party F has no branch located in Bulgaria, but has assets in Bulgaria.

3.3.1. The answer to this question depends mainly whether the assets would qualify as an 'establishment' in the light of the EU Insolvency Regulation. With a view to our considerations above (**C.II.**1.2.3), the conclusions can be made that: **(i)** the mere presence of assets located in Bulgaria does **not** qualify as an 'establishment', **(ii)** therefore, no secondary insolvency proceedings may be opened in Bulgaria with respect to these assets, **(iii)** the receiver in the main insolvency proceedings will have the power to include these assets in the main insolvency estate under his supervision (subject to articles 8 and 10, see article 21(1) of the Regulation) and their treatment will be governed by the *lex fori concursus*.

3.3.2. As regards cases in which Party F's COMI/registered seat is outside the EU (i.e. Country H is not an EU Member State), particular attention should be paid to the cited rule of Art. 759 of the Commerce Act empowering Bulgarian courts to open auxiliary insolvency proceedings against a foreign trader declared insolvent by the foreign court, if the trader possesses <u>considerable assets</u> in Bulgaria (i.e. in such scenarios the 'establishment'-test is not relevant). The competence of the Bulgarian court is limited strictly to these assets in Bulgaria. What does 'considerable' mean is to be assessed on case-by-case basis with a view to all concrete circumstances.

III. Collateral

Additional assumptions:

- Although it is a bilateral form in that it contemplates that each party may be required to post collateral to the other, we assume that (i) Party A is at all times Transferor under the EFET Credit Support Annex and (ii) that the collateral is owned by Party A or that Party A is authorized and empowered to transfer ownership in the collateral.

- The counterparties agree that Eligible Credit Support will include cash, Letters of Credit and Parent Company Guarantee (**PCG**). Cash is denominated in a freely convertible currency and is held in an account under the control of Party B maintained in the jurisdiction of the relevant currency.

Please discuss and advise on the following issues:

1. Under the laws of Bulgaria, what law governs the transfer of ownership in the various forms of Eligible Credit Support deliverable under the EFET Credit Support Annex?

1.1. We understand that under the Credit Support Annex there are two types of Eligible Credit Support: **(a)** Cash (an amount of money in Base Currency or any Eligible Currency, as agreed, and held in an account under the control of Party B as stipulated above), and **(b)** Letter of Credit (a standby letter of credit, bank guarantee or similar document in a format acceptable to the Transferee issued irrevocably by a leading commercial bank which obliges the bank to pay the amount guaranteed therein upon first demand of the Transferee).

For the sake of clarity, the PCG is separately discussed in **C.III.9** below.

1.2. The law applicable to the General Agreement (as agreed in § 22.1 thereof) should be in principle applicable to the Credit Support Annex as well ('*This Credit Support Annex shall … form part of and be subject to, any General Agreement between the Parties …*' – page 1).

1.2.1. This, however, does not mean that this law will be necessarily applicable with respect to the Letter of Credit as well. Since the Letter of Credit is a unilateral statement (and not a contract), the respective specific rules and international commercial customs (depending on the particular type of the guarantee) shall apply with respect to it. E.g., under the

Uniform Rules for Demand Guarantees (**URDG**), if the guarantee letter does not provide otherwise, the law of the State where the guarantor has its place of business shall apply (respectively, the law in the location of the guarantor's branch which has issued the guarantee) (article 27 of the URDG 458 version); unless otherwise provided in the guarantee, its governing law shall be that of the location of the guarantor's branch or office that issued the guarantee (article 34 of the URDG 758 version). Therefore, if in the Letter of Credit concrete law is pointed out, this law shall be applicable to the Letter of Credit (incl. as regards the assessment of its validity); if there is no such an express clause, the law in the place of business of the guarantor shall apply. Of course, the Parties may (and should) agree in advance the law applicable to the Letter of Credit. If the Letter of Credit issued does not comply with this agreement, the Transferor shall be deemed incompliant with his obligation to provide Eligible Credit Support.

1.2.2. As regards the providing of Cash, in our opinion to this collateral the law agreed in the General Agreement and respectively applicable to the Credit Support Annex as well should apply, since the Cash is not a separate document (statement made by a third party) in contrast to the Letter of Credit.

1.3. With a view to that, following should be taken into consideration, if Bulgarian law is agreed as governing law under the General Agreement:

1.3.1. In our opinion the transfer of ownership in collateral is **not** permitted under Bulgarian law **<u>outside the context of the financial collateral arrangements</u>** (title transfer financial collateral arrangements – see 1.1.6 of Annex No 1.1[43]). According to article 152 of the OCA, '*An agreement which stipulates in advance that if the obligation is not performed the creditor shall become owner of the property, as well as any other agreement which stipulates in advance a manner for satisfying the creditor other than the one provided for by the law shall be invalid*'.

Therefore, on the grounds of the cited provision it can be argued that the transfer of ownership in the Cash under the Credit Support Annex (which is made by a payment of the Cash onto an account of Party B (and not, for example, onto an escrow account)) is null and void[44]. Such a conclusion would be in line with the court practice (which is, however, on a bit different plane – transfer of real estates for securing of debts).

Whether the practical consequences of such nullity are so crucial for Party B is another question (for example, if Party A has a claim against Party B for reimbursement of the invalidly transferred Cash and Party B has an outstanding claim against Party A arising out of their contractual relations, Party B may set-off both claims and thus the collateral effect of the transferred Cash would be achieved, despite of the invalidity of this transfer).

Cash can be subject of a pledge under Bulgarian law (both under the OCA and the Special Pledges Act) – this is made by virtue of an agreement for pledge of a receivable (i.e. of the receivable of the pledgor against the bank in which the cash is kept) – but we understand

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[43] See also the reasons to the Bill on the FCAA: '*This Bill regulates not only the pledge agreements but also the agreements for transfer of ownership rights with the purpose of securing financial obligations between the entities mentioned above, <u>what regulation is not existing under the Bulgarian law in force</u>*'.

[44] As far as we know, such an approach is not fully unfamiliar in commercial practice, but this does not make it legally compliant.

that this is security interest which is undesired under the Credit Support Annex, that is why we do not elaborate on such an approach.

1.3.2. It should be noted that for the sake of legal clarity the legislator has included an explicit provision in the FCAA that article 152 of the OCA shall not apply to the financial collateral arrangements within the meaning of this Act.

With a view to that, a possible approach for avoidance of the application of the above rule would be the Parties to enter into a financial collateral arrangement within the meaning of the FCAA (a title transfer financial collateral arrangement) - see item 1.1.6(iv) of Annex No 1.1. However, a necessary pre-condition for the application of the provisions of the FCAA is parties to the arrangement to be entities/ institutions under item 1.1.6(i), sub-items (a) to (p) of Annex No 1.1, or a trader and an entity / institution under sub-items (a) to (p). Therefore, taking into account the current stage of development of the Bulgarian energy market, we consider the application of the FCAA in regard to the relations regulated by the General Agreement limited.

1.3.3. As regards the transfer of ownership in the Letter of Credit, it could be interpreted in a broader sense. Bulgarian law and practice do not deal with the term 'transfer of ownership' when standby letters of credit and bank guarantees are concerned. They use terms like 'notification' of the beneficiary under the letter of credit (article 435(1) of the Commerce Act) or just 'delivery' of the bank guarantee. With a view to that it could be speculated that the transfer of ownership of the Letter of Credit is namely its delivery which is fully compliant with Bulgarian law. Argument for this can be found in § 1.2 of the Credit Support Annex: '*References to 'transfer' in this Annex mean, in relation to Cash, payment, and <u>in relation to other assets, delivery</u>*'. Therefore, the 'transfer of ownership' (i.e. the delivery) of a Letter of Credit would not contradict the above cited rule of article 152 of the OCA.

2. Would the laws of Bulgaria characterize each transfer of collateral as effecting an unconditional transfer of ownership in the assets transferred? Is there any risk that any such transfer would be re-characterized as creating a security interest? If so, is there any way to minimize such risk? What would be the consequences of such a re-characterization?

2.1. Please see 1.3.1 above regarding the potential invalidity of the transfer of ownership in Cash.

2.2. As regards the transfer of the Letter of Credit, we do not deem that there is a risk this to be considered as creating a security interest (see 1.3.3 above).

3. Assuming that Party B receives absolute ownership in the collateral, will it need to take any action thereafter to ensure that its title therein continues? Are there any requirements in Bulgaria necessary or advisable, including any filing, registration, notification, stamping, notarisation or any other action or the obtaining of any governmental, judicial, regulatory or other order, consent or approval? Are there any other procedures that must be followed or consents or other governmental or regulatory approvals that must be obtained or established, to enforce, or continue such ownership interest?

3.1. The particular actions to be done under Bulgarian law in order for a collateral to become enforceable depend on the type of the collateral provided (just a few examples – a mortgage is to be registered in the Immovable Property Register, the pledges under the Special Pledges Act require registration in the Central Registrar of the Special Pledges and some of them also in the Commercial Register, etc.).

3.2. The collateral discussed in the case at hand does not fall under any of the hypothesis provided by Bulgarian laws in which such special additional actions are required in order for these collaterals (Cash and Letter of Credit) to be enforceable.

However, as discussed above, it can be grounded that the transfer of ownership in the Cash contradicts Bulgarian law and is thus unenforceable.

The transfer of the Letter of Credit, i.e. its delivery to the Transferee, is a sufficient condition for its enforceability (subject of course to the particular conditions of the Letter of Credit – e.g. deadline in which the demand for payment may be made, etc.).

3.3. In addition, please note that under Bulgarian law certain transactions require prior approval by the energy regulator EWRC, such as:

- establishing security (pledge/mortgage) over assets by which a licensed energy company performs its operations (e.g. electricity generation assets);
- transactions that could endanger the security of supply in consequence of the indebtedness of the licensed energy company, such as transactions exceeding 20% of the licensee's assets according to its last audited annual financial statement.

4. What is the effect, if any, under the laws of Bulgaria of the right to substitute collateral pursuant to § 6 of the EFET Credit Support Annex? Does the presence or absence of consent to substitution by Party B have any bearing on this question?

4.1. The right of the Transferee to substitute the collateral is explicitly regulated in the FCAA (article 9) – '*The parties to a financial collateral arrangement may agree on provision of additional financial collateral, and on substitution or withdrawal of the financial collateral*'.

4.2. Based on the principle of contractual freedom, the Parties to the General Agreement may also agree such a possibility also outside the context of the financial collateral arrangements. They can do this in advance (as this is done in the Credit Support Annex), or subsequently.

4.3. We do not consider, however, that the special rule of article 9(5) FCAA (stating that the substitute financial collateral **(a)** shall be treated as having been provided at the same time as the original financial collateral was first provided and **(b)** shall be subject to the same conditions to which the original financial collateral was subject) would be applicable in case of substitution of the collateral under the Credit Support Annex, except for the cases referred to in item 1.1.6(iv) of Annex No 1.1 (i.e. in the cases where a qualifying party under the FCAA (e.g. a bank) enters into a General Agreement plus a CSA with a Bulgarian electricity/gas company, and cash is provided as collateral). In particular, any privileges relating to the initial collateral (e.g. due to the date of providing of the initial collateral) shall not apply to the substitute collateral. It will be deemed provided as of the actual date it is provided.

4.4. The presence of consent to substitution by Party B is a required pre-condition for the substitution under § 6 of the Credit Support Annex, but it has no bearing on the above given answer.

5. Party B's right in relation to the transferred collateral upon termination of the relevant master agreement will be governed by § 11 of the EFET General Agreement together with §11 of the EFET Credit Support Annex. Assuming that § 11 of the EFET General Agreement is valid and enforceable in Bulgaria insofar as it relates to the determination of a net amount payable by either Party on the termination of Individual Contracts, is § 11 of the EFET Credit Support Annex also valid to the extent that it provides for the value of the collateral provided <u>and not yet transferred</u> to be included in the calculation of a net amount payable under § 11 of the EFET General Agreement as "other amounts payable"?

5.1. Please see 1.3.1 above regarding the potential invalidity of the transfer of ownership in Cash.

5.2. As regards the Letter of Credit, our understanding how the mechanism under § 11 of the Credit Support Annex in relation with § 11 of the General Agreement would function under Bulgarian law, is as follows:

Party B's rights depend in principle on what is stated by the bank in this letter but in any case we understand that it will contain a statement that the bank undertakes to pay the amount guaranteed therein upon first demand of the Transferee. Since § 11 of the General Agreement shall apply in case of Termination for Material Reason/Automatic Termination, this should mean that all the obligations of the Parties have become due and payable as from the Early Termination Date. This would mean that if in the process of calculation of the Termination Amount Party B (the Terminating Party / Transferee) ascertains that after the close-out netting Party A will still have a debt towards Party B (only then the payment under the Letter of Credit would qualify as 'other amounts **payable**' in the meaning of § 11 of the General Agreement), Party B would have the right to demand payment from the bank under the Letter of Credit[45] and to include the amount so received (or to be received) in the calculation of the Termination Amount (see also § 11 of the Credit Support Annex).

Then it will be in burden of Party A to prove (if this is the case) that this demand was illegal, incl. to undertake actions to stop the payment by the bank (e.g. to impose an attachment (*да наложи обезпечителна мярка „спиране на плащането"* in Bulgarian, *einstweilige Verfügung* in German) on the payment), to prove that the termination was groundless (e.g. because no Material Reason has occurred), that the calculation of the Termination Amount by Party B was not correct (e.g. because it has included in the calculation claims which do not exist or are at least disputable), etc.

[45] As recommended in the Practice Notes to the EFET/IECA Commodities Schedule to the CPMA, '*Parties should pay particular attention to the expiration date on any Letter of Credit that they receive to ensure that adequate time will be allowed for the Close-Out process to occur before the Letter of Credit expires*'.

6. Are the rights of Party B enforceable in accordance with the terms of the EFET General Agreement and the EFET Credit Support Annex, irrespective of the insolvency of Party A?

6.1. The rights of Party B in case of collateral provided in the form of Letter of Credit should be enforceable as per the above-described scenario (item 5.2). As regards the transfer of ownership in Cash, please see 1.3.1 above regarding its potential invalidity.

6.2. Of course, the rights of Party B would be enforceable under Bulgarian law only if § 11 of the General Agreement is valid and enforceable in Bulgaria as well. With a view to that, our comments under the above items **C.I.**1.3.3 and 1.3.9 in respect of close-out netting and the calculation of the Termination Amount (§ 10.3 and § 11) should be taken into consideration.

7. Will Party A (or its receiver or other similar official) be able to recover any transfer of collateral provided to Party B during a certain "suspect period" preceding the date of the insolvency? If so, how long before the insolvency does the suspect period begin? If such a period exists, does the substitution of collateral by a counterparty during this period invalidate an otherwise valid transfer, assuming the substitute assets are of no greater value than the assets they are replacing? Is the transfer of additional collateral pursuant to the mark-to-market provisions of the EFET Credit Support Annex during the suspect period subject to avoidance, either because it was considered to relate to an antecedent or pre-existing obligation or for some other reason?

7.1. As discussed, there is no legal limit in the Commerce Act how long backward in time the court may fix the date of the commencement of the debtor's inability to pay its debts (from which the 'suspect period' starts). That is why in February 2013 rules were introduced into the Commerce Act that limited the date back in time until which certain transactions can be challenged as null and void (so called 'claw back actions') (for more details see item 1.1.1**(ii)** of Annex 1.1).

In particular, in the list of challengeable transactions falls the '*establishing a pledge or a mortgage for the securing of a debt that has not been secured so far (made within 1 year prior to the lodging of the request for opening of the insolvency proceedings)*' (article 646(2), item 2 of the Commerce Act).

As evident, this rule applies only if the collateral is provided in the form of pledge or mortgage; this is a difference from the legal regime applicable until February 2013 which included in the list of challengeable transactions '*and other security'*. If the collateral is Cash or Letter of Credit, as per the CSA, the rule shall not apply[46].

7.2. It should be of course kept in mind that a Letter of Credit (e.g. a bank guarantee) is usually issued by the banks against a security (e.g. a pledge or a mortgage) established

[46] Until February 2013 the insolvency receiver, respectively any insolvency creditor had also the right to submit a claim for declaring null and void by the court with respect to the insolvency creditors of acts for mortgaging, pledging **or establishment of another security** in favour of a claim that had not been secured so far, effected within 1 year prior to the institution of the insolvency proceedings (article 647, item 5 of the Commerce Act). After the amendments made in February 2013, this rule applies only with regard to the securing of <u>third party's debts</u>, i.e. it is not applicable to the case at hand either.

in favour of the bank by the debtor (Party A in this case). If this security has been established within the above-mentioned suspect period, it would fall under the cases referred to in the cited article 646(2), item 2 of the Commerce Act and can be thus challenged as null and void. If this is the case, this could undermine the enforceability of the Letter of Credit – e.g. the bank may refuse to pay (depending on the agreement of Party A with the bank and on the wording of the Letter of Credit itself).

7.3. As regards the providing of Cash, as mentioned above it may be challenged on the grounds of the cited provision of article 152 of the OCA as null and void.

7.4. The substitution of a collateral during the suspect period (if the initial collateral was provided before the suspect period) would lead to a situation in which the collateral will be deemed provided as of the date of the substitute collateral (due to the lack of explicit legal provision to the contrary), i.e. within the suspect period, i.e. the above cited rules shall apply (see also item 4.3 above).

7.5. The collateral provided cannot be challenged if the Parties enter into a financial collateral arrangement within the meaning of the FCAA (a title transfer or pledge financial collateral arrangement) - see item 1.1.6(iv) of Annex No 1.1 - in which case the beneficial treatment in case of insolvency proceedings would apply (see item 1.1.6(iii) of Annex No 1.1). However, a necessary pre-condition for the application of the provisions of the FCAA is parties to the arrangement to be entities/ institutions under item 1.1.6(i), sub-items (a) to (p) of Annex No 1.1, or a trader and an entity / institution under sub-items (a) to (p). Therefore, taking into account the current stage of development of the Bulgarian energy market, we consider the application of the FCAA in regard to the relations regulated by the General Agreement limited.

8. Is the EFET Credit Support Annex in an appropriate form to create the intended outright transfer of ownership in the collateral to Party B? Are there any other requirements to be observed in Bulgaria in order to ensure validity of such transfer in each type of Eligible Credit Support created by Party A under the EFET Credit Support Annex? For example, are there any other requirements such as those mentioned under (3) above?

Please see items **C.III.**3.1, 3.2 and 3.3 above.

9. Parent Company Guarantee

The questions below concern the enforceability of a Credit Support Document (as defined in the General Agreement), which is a Parent Company Guarantee (**PCG**):

9.1. Are there any specific statutory formalities that should be (or recommendable as good practice for the benefit of the Beneficiary) complied with in order to create a valid guarantee document?

9.1.1. The PCG could be regarded as a form of personal guarantee in the case of which the Guarantor is liable with all its assets for the debts of the main debtor, the Principal Obligor. It resembles the guarantee agreement (*Bürgschaftsvertrag* in German) (Art. 138 - 148 OCA) but is being provided (issued) as a unilateral statement.

However, in contrast to the guarantee agreement, the PCG is not explicitly regulated by Bulgarian law. According to Art. 44 OCA (in conjunction with Art. 288 of the Commerce Act), the rules regarding contracts shall accordingly apply also to unilateral statements [only] in the cases in which according to the law such statements create, amend or terminate rights and obligations (this is the reverse principle to the cited principle of contractual freedom, Art. 9 OCA). This could give the basis for the conclusion that, since the unilateral statement PCG is not explicitly envisaged in Bulgarian law, it is not valid and not enforceable under Bulgarian law.

It is to be noted that this is just a possible interpretation, there is no explicit and binding case law on that issue. PCG's are a popular instrument in Bulgaria which is used as a security *inter alia* in transactions with electricity and gas. However, this interpretation should be kept in mind and it is recommendable measures to be undertaken in advance in order to mitigate the related risks.

9.1.2. Such measures are for example:

(i) As applicable law in the PCG to be explicitly mentioned the laws of a State (and not Bulgarian laws) in which the PCG's are explicitly regulated as a legal instrument and in which State the PCG's are enforceable (see also the above item **C.III.**1.2.1 regarding the law applicable to unilateral statements). In particular, a PCG issued by a Bulgarian company under a law which is not Bulgarian law should be enforceable against this company under Bulgarian law (but the creditor will have to prove before Bulgarian courts the respective non-Bulgarian law and that the PCG is valid under it).

(ii) The PCG to be countersigned by an authorised representative of the Beneficiary as well (and not only by the Guarantor) - thus it could be argued that this is not an unilateral statement (a PCG) but a contract (a guarantee agreement *or* an entering into debt agreement - see the above item **C.I.**1.3.8(c)(ii)) and that the rules of OCA (Art. 138 - 148, respectively Art. 101) should be applicable to it. This is the minimum recommended by us. Also a text could be added at the end of the PCG (before the Beneficiary's signature) that the Beneficiary accepts the guarantorship / entering into debt, etc.

In addition, if the Guarantor's and the Beneficiary's signatures are verified by a Notary Public, it could be tried to use the PCG as a ground for obtaining an order for immediate enforcement and a writ of execution (Art. 417, item 3 and Art. 418 of the Civil Proceedings Code). Therefore, such a notary verification is recommendable (it is not a precondition for the validity of a guarantee agreement, simple written form is in principle sufficient - Art. 138(1) OCA).

The notary verification of the signatures under the PCG is also recommendable in order to eliminate the risk the Guarantor to contest his signature at a later stage, when enforcement of the PCG is sought by the Beneficiary.

Please note that we have not fully tested yet at court the above recommendations (i.e. it cannot be predicted whether Bulgarian courts would accept that the countersigned PCG is a guarantee agreement, etc.). In a recent case the judge accepted that a countersigned PCG was an entering into debt agreement under Art. 101 OCA (of course, other judges may come to different conclusions).

(iii) The Guarantor and the Beneficiary to enter into an explicit guarantee agreement within the meaning of Art. 138 - 148 OCA *or* into an entering into debt agreement within the meaning of Art. 101 OCA (this proposal is to have a separate agreement instead of the PCG; the approach where countersigning and further markings are made on the PCG is the approach under the previous item (ii)).

9.2. Are there any specific statutory provisions that should be expressly set-aside, varied or referred to, or any specific statement/wording based on any such statutory provisions that should be expressly included, in the document of the guarantee in order to increase the chances of an effective enforcement of the guarantee as may be expected by the Beneficiary based on the assumptions?

See all our comments above. Also, a text could be added to the document that this is a guarantee agreement within the meaning of Art. 138 - 148 OCA *or* an entering into debt agreement within the meaning of Art. 101 OCA (in addition to the above recommendations).

Important note: Art. 147 of OCA provides that the obligation of the guarantor remains valid after the maturity of the obligation of the Principal Obligor only if the creditor (the Beneficiary) institutes proceedings (files a claim) against the debtor within 6 (six) months from maturity.

This could be seen as an advantage of the entering into debt compared to the guarantee agreement.

10. Do you have other specific recommendations on the subject of collateral that you would like the EFET members to consider?

Our general recommendation is legal advice to be sought in each case where Eligible Credit Support / Performance Assurances are going to be agreed and posted between the Parties, in order the compatibility with Bulgarian law of the concrete collateral, as well as its practical weight to be assessed.

IV. General Enforceability

Is the EFET General Agreement and any of the above Annexes (including the EFET Credit Support Annex) enforceable under the laws of Bulgaria in accordance with its own terms? We would like you to specifically discuss the provisions on <u>(i)</u> non-performance due to Force Majeure (§ 7 of the EFET General Agreement), <u>(ii)</u> remedies for non-performance (§ 8 of the EFET General Agreement) and <u>(iii)</u> limitation of liability (§ 12 of the EFET General Agreement) and any other provisions which need to be commented on according to the law of Bulgaria, including whether these provisions could be further expanded or strengthened under the laws of your jurisdiction. We are especially interested in provisions that you may believe infringe upon the *ordre public* in Bulgaria and that may be challenged by the courts in Bulgaria irrespective of the law that governs the EFET General Agreement.

1. Non-performance due to Force Majeure (§ 7 of the General Agreement)

1.1. Force majeure as a ground for suspending, respectively releasing the Parties from their obligations under a contract different from default-related grounds (the so called 'objective impossibility for performance' which exempts parties from their liability for damages) is regulated by article 306 of the Commerce Act. Pursuant to the legal definition, a force majeure shall be an unforeseen or unavoidable event of an extraordinary nature which has occurred after the conclusion of the contract (subsequent impossibility).

A debtor in a commercial transaction shall not be liable for failure to perform due to force majeure. Where the debtor was already in default, he may not invoke force majeure.

The party who cannot perform due to force majeure shall notify the other party in writing within a reasonable time about the nature of the force majeure, and its potential consequences for the contract. In case of failure to notify, compensation shall be due for the damages resulting from such failure.

The performance of obligations and the related counter-obligations shall be suspended for the duration of the force majeure.

Should the duration of the force majeure be such that the creditor loses his interest in the performance, he shall be entitled to terminate the contract. The debtor shall also have the same right.

It should be further noted that in Bulgarian commercial relations it is common practice force majeure to be evidenced by the party pleading force majeure by a certificate issued by the Bulgarian Chamber of Commerce and Industry (the **BCCI**). This is not a mandatory legal requirement, but it could be assumed that if the parties to a contract expressly agree in the contract that such certificates issued by the BCCI shall be regarded as sufficient evidence for the occurrence of force majeure circumstances the parties should not dispute these circumstances.

We believe that the parties to a contract are in principle free to determine in the contract the concrete events which will be regarded as force majeure. Some of the events are standard (such as war, strike, etc.) and should be regarded as indisputable events of force majeure. Of course, the concrete events have to be assessed in the light of the reasonable commercial practice (e.g. insolvency of one of the parties' sub-contractors should not be recognized in our view as force majeure event). We are of the opinion that the events mentioned in § 7.1 of the General Agreements may be considered as force majeure events.

With a view to all the above we could confirm that § 7 of the General Agreements (incl. as amended by the Allowances Appendices) would be enforceable under Bulgarian law. Although it is not explicitly mentioned in § 7 that the notification of force majeure shall be in writing (this is the explicit requirement of article 306(3) of the Commerce Act), this requirement is implied by § 23.2 of the General Agreement.

1.2. Article 89 of the OCA regulates the general principle of termination of contracts in case of subsequent objective impossibility for performance (the above cited article 306 of the Commerce Act develops further this principle on commercial law plain). This principle is different from the regulation of force majeure in the Commerce Act as cited above. Under the OCA, in case of a bilateral contract, if the obligation of one of the parties is extinguished due to impossibility for performance, the contract shall be cancelled automatically, by virtue of law (*ipso jure*). Where the said impossibility is only partial, the other party may claim a respective reduction of its obligation or cancellation of the contract through the court, if it does not have sufficient interest in seeking partial performance.

1.2.1. Bulgarian civil law, legal doctrine and court practice distinguish two main reasons for subsequent objective impossibility – casual event (*casus fortuitis*) where the accent is put on its unpredictability (unforseeability), and force majeure (*vis major*) where the accent is put on its unavoidability (irresistibility). The definition of force majeure given by article 306(2) of the Commerce Act is criticized as being eclectic and abolishing the difference between the casual event and the force majeure.

In our opinion this discussion has more theoretical (than practical) importance (especially with a view to the fact that there is a legal definition of force majeure). Important is in each particular case to be proven by the party pleading force majeure and objective impossibility to perform that the concrete event has been beyond its reasonable control, that this event has been unavoidable, that it has occurred after the concluding of the contract but before the party to be in default, and there must be causation relation between the event and the impossibility to perform.

1.2.2. Subsequent impossibility to perform should be distinguished from the initial impossibility (i.e. impossibility existing as of the moment of entering by the parties into the contract). Initial impossibility is one of the grounds ('impossible subject of the contract') a contract to be declared null and void by the court (article 26(2) of the OCA).

1.2.3. Impossibility to perform should be further distinguished from the so called 'economical unbearability (hardship)' regulated by article 307 of the Commerce Act. The affected party may request <u>from the court</u> to modify or terminate the contract entirely or partially in the event of occurrence of such circumstances which the parties could not and were not obliged to foresee, and should the preservation of the contract be contrary to fairness and good faith. In contrast to force majeure, here performance is still possible but due to certain circumstances occurred after entering into the contract (usually amended economic situation, etc.) it is economically too unfavorable for one of the parties and puts this party in an economically too unequal position which contradicts to common understanding of fairness and good faith. In order to avoid intervention by the court and to simplify their relations, parties usually agree clauses giving them the right to amend or terminate the contract in case of occurrence of such circumstances (*clausula rebus sic stantibus*).

2. Remedies for non-performance (§ 8 of the General Agreement)

§§ 8.1 and 8.2: The following clarification should be made in the light of Bulgarian law in respect of the 'compensation for damages' mentioned in the said clauses:

(i) If in the text it is really meant a 'compensation' for suffered damages (*Schadenersatz* in German), then these damages have to be proven (including their ground (the failure of the Party to perform its obligation), their amount, etc.). If this is the case, then one might be tempted to argue that the words '*or would be able…*' are to be interpreted in a sense that the damages have not occurred yet and that there are no damages to be compensated.

(ii) The other possible interpretation is that in § 8 a kind of liquidated damages (penalty; *неустойка* in Bulgarian, *Vertragsstrafe* in German) is meant. The liquidated damages under Bulgarian law are a compensation for damages whose amount is preliminary determined (or at least determinable) and agreed between the parties (e.g. a lump sum or a percentage of the non-performed amount, etc.). In case liquidated damages are agreed, the non-defaulting party is not required to prove the damages suffered, but merely the fact of non-performance of the other party's obligation. If the amount of the damages suffered is higher than the liquidated damages agreed, the non-defaulting party has the right to claim compensation for these damages by following the common way (see the previous sub-item (i)). Pursuant to article 309 of the Commercial Act in the relations between merchants the liquidated damages may not be decreased on the ground that they are excessive (but a penalty clause may be declared null and void by the court if it finds that the amount of the penalty is exorbitant – i.e., disproportionally higher than the potential damages).

(iii) Last but not least, this way of determining compensation, although not very common, is not unfamiliar in Bulgarian law. Article 323 of the Commerce Act regulating the rescinding of sale contracts stipulates that should the sale be rescinded and within an appropriate period of time after the rescinding the buyer purchases replacement goods, or the seller re-sells the goods (i.e., under the Commerce Act a replacement transaction is required), the party seeking compensation may receive the difference between the sale price and the price of the replacement transaction, as well as compensation.

To sum up: in our opinion the remedies under § 8 are intended as compensation for damages, as discussed in the previous sub-item (i), i.e. such a compensation shall be due only in case such damages have been incurred and the damages' amount has to be proven, but no replacement transaction is required to be entered into by the non-defaulting Party.

3. Limitation of Liability under Bulgarian law (§ 12 of the General Agreement)

3.1. General Enforceability of Exclusion of Liability (§ 12.2)

3.1.1. There is no explicit definition of exclusion clauses (i.e. of clauses agreed by the parties to a contract by which they preliminary[47] limit or exclude their liability for damages caused by the one party to the other party) in Bulgarian law. However, there are many legal provisions regulating what limitations of liability are inadmissible, therefore exclusion clauses are indirectly recognized by Bulgarian law. There is abundant court practice on these matters; the legal doctrine has not remained silent either.[48]

With a view to that and on the grounds of the principle of contractual freedom (article 9 OCA) it can be accepted as undisputable that exclusion clauses are generally permissible under Bulgarian law. In each particular case, however, it should be carefully checked whether Bulgarian law contains any restrictions on the contractual freedom concerning the exclusion clauses. Such restrictions (i.e. prohibitions for limitation or exclusion of liability) are provided for by various laws and in respect of various contracts (e.g. in case of sale of a commodity with defects the seller shall be liable even if he did not know about the defects, an agreement for exclusion of his liability shall be considered null and void

[47] We review the issue only in the light of preliminary limitation / excluding of liability. If the damages have been already suffered and the affected party refuses to claim compensation, this is remittance of debt and not an exclusion clause.

[48] See for instance *'Exclusion clauses in the contracts under Bulgarian civil law'* by Krassimir Mitev (2005).

(article 193(3) OCA); null and void shall be in principle clauses for exclusion of the carrier's liability (article 373(3) of the Commerce Act); numerous prohibitions for exclusion of liability are contained in the Consumers Protection Act, etc.).

3.1.2. The most important provision in this regard, however, is provided for by article 94 of the OCA. Pursuant to it, clauses by which the debtor's liability for intentional (*Vorsatz* in German) or gross negligent (*grobe Fahrlässigkeit* in German) acts is preliminary excluded or limited shall be null and void. This provision gives the general mandatory legal framework of the exclusion clauses under Bulgarian law and has to be considered in any case when exclusion clauses are agreed.

Therefore, in order to be valid and enforceable under Bulgarian law, § 12.4 of the General Agreement should be supplemented and gross negligence should be explicitly pointed out therein too.

We further tend to believe that Bulgarian courts would consider article 94 OCA as part of Bulgarian *ordre public*.

3.1.3. Where it is undisputable that exclusion clauses may be agreed in order to limit / exclude the parties' liability under a contract (their contractual liability), it is disputable in legal doctrine whether the liability resulting of tort (*Delikthaftung* in German) may be limited by exclusion clauses. We tend to agree that exclusion clauses are permissible only in respect of the contractual liability (which is the prevailing opinion) but some credible arguments supporting the other opinion should not be underestimated.

3.1.4. Subject to the above we believe that § 12.2 should be generally enforceable in Bulgarian courts.

However, the following distinctions should be made:

3.1.4.1. § 12.2 regulates not only the exclusion / limitation of liability of the counterparties resulting from breaches of the General Agreement (contractual liability), but also of the liability of the Parties' employees and officers. The liability for damages caused by officers or employees of a person (company) is regulated by the rules for liability resulting of tort (*Delikthaftung*). According to article 49 of the OCA, if a person has assigned to another person work, the assigning person shall be liable for the damages caused to third parties in the course or in respect of the performance of this job (compare with § 831 BGB (German Civil Code) – *Haftung für den Verrichtungsgehilfen*). Despite of the various interpretations in the legal doctrine and court practice, it can be concluded that this liability is objective (i.e. no fault of the assignor is necessary), the employee's or officer's fault is important (acting intentionally or negligently) but it is not necessary to be proven which particular employee or officer has caused the damages in the course or in respect of the performance of the job assigned. Besides, it is disputable whether the third party has a direct claim against the employee / officer or the liability of his employer under article 49 of the OCA excludes the employee's / officer's liability towards the third party.

Since this liability is liability for tort, our comments under the above item 3.1.3 should be taken into consideration.

3.1.4.2. Our further understanding is that apart from the contractual liability of the counterparties and the liability for acts of the Parties' employees and officers, § 12.2 regulates also the exclusion / limitation of the liability of the Parties' (sub)contractors. This issue is not popular in Bulgarian court practice but has been addressed in the legal doctrine. Such clauses are considered on the basis of the contract in favour of third parties (compare with § 328 BGB – *Vertrag zugunsten Dritter*) and are considered as permissible in principle. It could be summarized that generally the liability of the sub-contractors towards the assignor of the main contractor is liability for tort (*Delikthaftung*), unless something different has been explicitly agreed (e.g. there might be entering into debt between the main contractor and his subcontractor). With a view to that, our comments under the above item 3.1.3 should be taken into consideration as well.

Another relevant issue on this plane is whether the assignor may have a direct claim against the sub-contractors if he has a claim against the main contractor based on his contractual liability. Where there are arguments in favour of the opinion that the assignor has the right to choose against whom to direct his claim – against the main contractor on contractual basis or against the sub-contractor on the basis of his liability for tort, it seems that the prevailing opinion in the court practice is that that the contractual liability of the main contractor excludes the possibility the creditor to file a claim for liability for tort of the sub-contractor.

3.1.5. Note also in regard to (12) of the Allowances Appendix that the part of the clause saying that '*each Party waives the right to contest those payments as an unreasonable penalty'* could be regarded null and void under Bulgarian law.

3.2. Enforceability of Limitation of Consequential Damages and similar types of liabilities (§ 12.3, § 12.4)

3.2.1. According to article 82 of the OCA, regulating the scope of the compensation in case of contractual liability, the compensation encompasses the losses incurred (*erlittener Verlust* in German) and the loss of profit (*entgangener Gewinn* in German), provided that they are a direct and immediate consequence of the non-performance and could have been foreseen as of the time of occurrence of the [non-performed] obligation (i.e. at the time of entering into the respective contract).

If, however, the debtor has acted in bad faith (i.e., he has acted with gross negligence or with intentional default), he shall indemnify the other party for all direct and immediate damages, i.e., also for the unforeseeable damages.

Therefore, it can be concluded that under Bulgarian law consequential damages are not covered by the duty to indemnify the damages caused. It is also confirmed by Bulgarian legal doctrine and court practice that consequential damages are an antonym of direct damages and that thus consequential damages shall not be compensated.

Hence, § 12.3 of the General Agreement should be generally enforceable under Bulgarian law (please note our comments under 3.2.2 and 3.2.3 below).

3.2.2. The following clarification should be made in respect of § 12.3 because as shown above, under Bulgarian law, the loss of profit is classed as part of the damages together with the losses incurred. The division of the damages to direct and indirect (consequential) is on a different plane. Subject to compensation are only the direct damages. The limitation / exclusion of liability for loss of profit shall be assessed on the grounds of article 94 of the

OCA (see the previous item 3.1.2). Therefore, liability for loss of profit may be generally excluded / limited, except in cases of intentional default or gross negligence.

3.2.3. As mentioned above (see item 3.1.2), in order for § 12.4 of the General Agreement to be valid and enforceable under Bulgarian law, it should be supplemented and gross negligence should be explicitly pointed out therein too.

3.3. **Enforceability of Duty to Mitigate (§ 12.5)**

Under Bulgarian law (article 83, para 1 OCA), if the non-performance is due to circumstances for which also the creditor (i.e., the person which has suffered damages as result of the breach of contract) is liable, the court may reduce the compensation amount or exempt the debtor from liability. The necessary pre-condition for this is creditor's behaviour to be non-compliant with the respective due diligence (in this case 'co-causing' of damages (by the debtor and the creditor) is meant).

Article 83, para 2 stipulates further that the debtor shall not be liable for the damages which the creditor could have avoided [or mitigated] with due diligence (here the inactivity of the creditor is meant). No contractual liability occurs at all and the court should not have the discretion (in contrast to the case under the preceding paragraph) to assess whether to reduce or exclude the debtor's liability.

Therefore, § 12.5 of the General Agreement should be considered valid and enforceable under Bulgarian law.

3.4. **Could the limitations and exclusions under § 12 of the General Agreement be further expanded or strengthened under Bulgarian law?**

In our opinion, the exclusion clauses under § 12 of the General Agreement could not be further expanded or strengthened under Bulgarian law. On the contrary – as already advised, in order for § 12.4 of the General Agreement to be valid and enforceable under Bulgarian law, it should be supplemented and gross negligence should be explicitly pointed out therein.

4. Is there a risk that a notice, declaration or other communication given in accordance with the E-Notice Agreement may not be recognized as valid? Could the deemed receipt of a notice be challenged? Who bears the burden of proof that the document attached to the e-mail is not falsified?

4.1. First, it is to be noted that, to the best of our knowledge, the use in Bulgaria of such document ratification systems/platforms is highly unusual. Therefore, it cannot be predicted what stance a Bulgarian judge would take if the exchange of documents and the achieving of agreements via such a platform is to be considered in the light of Bulgarian law.

4.2. Apart, it is our opinion that, if the conditions described in the E-Notice Agreement are met, the respective changes should be deemed validly agreed between the parties. We quote the following paragraph from the E-Notice Agreement (German law/English law) because in our view it contains the essence of this exercise: '*As between ourselves and the corresponding Ratifying Party, the agreement to make the amendments stated in the*

*Amendments to any Covered Principal Agreements will take effect as of the date the European Federation of Energy Traders ("**EFET**"), as agent, first publishes on the EDRS website at https://edrs.efet.org (the "**Website**") a list of parties who have ratified the Amendments that lists both Ratifying Parties as having ratified the Amendments for any Covered Principal Agreements and uploads on the Website the Ratification Letters from both such Ratifying Parties to ratify the Amendments (such date, as stated on the Website, being with respect to the relevant Ratifying Parties, the "**Ratification Date**")*'. Or, in other words, the Ratification Date is the date on which the parties' statements meet, i.e., the respective agreement is reached.

4.3. Respectively, if the E-Notice Agreement has become effective between two parties to the General Agreement, we believe that the communication between them in line with the E-Notice Agreement (incl. regarding contract change or termination) should be deemed valid under Bulgarian law.

4.4. Note in this regard also the provisions of articles 3(2) and 13(4) of the Electronic Document and Electronic Trust Services Act, as discussed below in **C.V.**2.3.3.

4.5. We note that under the E-Notice Agreement it is not sufficient to provide a notice or communication solely in an e-mail itself but that such notice or communication shall be attached in a PDF format to such e- mail. I.e., if the attached PDF document is signed in handwriting (and afterwards scanned), or with a qualified electronic signature, there should be no issue as to the form of the attached document, and the matters around the E-Notice Agreement shall be rather related to the topic 'serving of documents via e-mail' – which, as mentioned, should be valid under Bulgarian law (if agreed by and between the parties).

4.6. Regarding the burden of proof, the main rules are contained in article 193(3) of the Civil Proceedings Code: '*The burden of proving the falsity of the document shall be upon the party contesting the said document. Where the truthfulness of a private document, which does not bear the signature of the contesting party, is contested, the burden of proving the truthfulness shall be upon the party who presented the said document*'.

5. Please indicate any recommendations you have and which you are of the opinion EFET and its members need to be made aware of regarding the general enforceability, from a legal stand point, of the EFET General Agreement and its Credit Support Annex.

In addition to all our above opinions and recommendations we would like to make the following comments (these comments serve most of all to clarification purposes and does not mean that the commented clauses necessarily need a revision in order for them to be enforceable in Bulgaria; in particular, we do not deem that these provisions infringe Bulgarian *ordre public*):

§ 4 and § 8: Due to the specifics of the commodity 'electricity' and of the business with electricity we would recommend a definition of 'delivery' and 'acceptance' to be included in Annex 1 to the General Agreement, explaining in reasonable detail what exactly 'delivery' and 'acceptance' for the purposes of the General Agreement means. Achieving maximum clarity on that matter is of crucial importance for the Parties and thus eventual discussions and interpretations in this regard in case of a legal dispute could be avoided.

The issue is important also with a view to the sanctions to be paid under § 8 in case of failure to deliver or to accept.

§ 6.7: It is our understanding that the responsibilities of the Parties should be reciprocal, that is why we do not see the reason for excluding the Buyer's responsibility for Scheduling.

§ 13.5: Please note that it has been disputable in Bulgarian court practice whether the parties to a contract may agree interest rate which is different from the default interest (*Verzugszins* in German) determined by the Council of Ministers of Bulgaria. For your information, the annual amount of the default interest determined by the Council of Ministers is in the amount of the basic interest rate of the Bulgarian National Bank in force as from 1 January, respectively as from 1 July of the current year, plus 10 percent p.a.

The daily amount of the default interest is equal to 1/360 of the annual amount determined as described above.

The more recent practice of the courts is more flexible in this respect, i.e. pursuant to it the parties have the right to agree default interest rates deviating (i.e. higher or lower interest rate) from the rates determined by the Council of Ministers. With a view to that we share the opinion that the Parties to the General Agreement may freely agree on the amount of the default interest rate in the Election Sheet.

§ 19: Bulgarian law does not use the term 'assignment of obligations'. As mentioned above, articles 101 and 102 of OCA regulate two different forms of assumption of obligations - entering into debt and debt substitution. Our understanding is that here debt substitution is meant (i.e., the substituted debtor shall be freed from liability towards the creditor). We believe that the necessary creditor's consent for the debt substitution could be regarded as given in § 19.2 of the General Agreement (although given in advance), therefore, § 19 could be regarded as valid and enforceable under Bulgarian law. However, in order for maximum clarity to be achieved, we would recommend in the Election Sheet to be explicitly pointed out that 'assignment of obligations' means 'debt (obligation) substitution' (within the meaning of article 102 of the Obligations and Contracts Act).

§ 21(l): If Bulgarian law shall be applicable in the relations between the Parties to the General Agreement, the respective terms and definitions (supplier, end user, etc.) should be unified with the terms and definitions stated in the Bulgarian Energy Act (as mentioned (see the above item **B.II.**3), the market participants are the electricity generators, electricity traders, customers, suppliers of last resort, etc.).

§ 23.2: Bulgarian law follows the receipt theory meaning a contract is deemed concluded at the moment the acceptance of the offer is received by the offering party (article 14(1) of the OCA). With a view to that we deem that § 23.2(b) could be regarded as legally not very precise. The documents listed therein (written notices, declarations and invoices) shall be effective on the day of their actual (and not presumed) receipt. Nevertheless, we believe that it could be grounded that article 14 of the OCA is not a mandatory legal provision and that the parties to a contract could agree something different. Therefore, the receipt fictions under § 23.2 should be regarded as admissible under Bulgarian law and as merely changing the burden of proof.

6. General enforceability of the General Agreement

Subject to our comments, assumptions and reservations set out in this Opinion, it can be concluded that the General Agreement would be legal, valid and binding under Bulgarian laws.

The provision of article 26(4) of the OCA should be also kept in mind stating that if certain clauses of an agreement are null and void, this does not make the entire agreement null and void, provided that (a) these clauses are replaced by virtue of law by relevant mandatory legal rules or (b) when it can be assumed that the parties would have entered into the agreement also without the null and void clauses.

It should be further noted that from our discussions with power trading companies in Bulgaria within last years we are aware that some of these companies regard the EFET General Agreement as too heavy, complicated and inappropriate for Bulgarian market conditions and practices and prefer to use their own contract templates, at least as regards the power trading in Bulgaria (but often they use the main principles of the EFET General Agreement as a basis for their contracts, i.e. their contracts are a simplified form of the EFET General Agreement).

7. General enforceability of the Credit Support Annex

7.1. Subject to our comments in Section III above, it can be concluded that the Credit Support Annex would be legal, valid and binding under Bulgarian laws as regards Eligible Credit Support provided in the form of Letter of Credit.

7.2. As regards the transfer of ownership in the Cash, as mentioned above, it may be considered null and void as contradicting the mandatory rule of article 152 of the OCA (<u>outside the scope of the FCAA</u>). With a view to the abundant court practice on the application of this provision (although on a bit different plane), we tend to believe that Bulgarian courts would consider article 152 OCA as part of Bulgarian *ordre public*.

V. Confirmation Practices

Additional assumptions:

- As far as the Confirmation Practice is concerned, when entering into an Individual Contract, the counterparties in each case (i) make oral reference to the EFET General Agreement when concluding the relevant Individual Contract over the phone or (ii) refer to the EFET General Agreement when subsequently exchanging confirmations or similar electronic, written or non-verbal means of entering into or confirming Individual Contracts (in whichever form, including telex, fax, SWIFT, electronic confirmation or position matching service or other means of electronic transmission).

- Parties may or may not (i) use the EFET Electronic Confirmation Matching System (EFET eCM) to electronically match and exchange Confirmations or (ii) enter into the EFET Electronic Confirmation Agreement.

- **<u>Note that the legal requirements regarding the form of agreements for sale and purchase of electricity, on the one hand, and of natural gas, on the other, are different</u>**

under Bulgarian law. This leads to different conclusions on some of the below discussed questions. Where relevant, we have explicitly specified which conclusions refer to ELECTRICITY, and which – to NATURAL GAS.

1. Binding Individual Contract

1.1. **Does the formation of a legally binding and enforceable Individual Contract require any formal act (e.g., execution in writing, signature, registration or notarization) under the laws of Bulgaria?**

1.1.1. The main legal principle regulating the form of commercial transactions under Bulgarian law (article 293(1) of the Commerce Act) is that for the validity of a commercial transaction written (or any other special) form is required only in the cases explicitly envisaged in the legislation in force (see also item 1.1.2 below).

ELECTRICITY

No specific requirements are contained in Bulgarian energy legislation regarding the form of contracts for sale and purchase of electricity (in contrast to the transactions in natural gas for which written form is required by the law, as discussed below).

Therefore, it can be concluded that no written agreement is required in order for the Individual Contracts under the General Agreement to be valid and legally binding.

However, the provision of article 164, para 1, item (c) of the Civil Proceedings Code should be always kept in mind, stating that for proving of contracts with a value exceeding BGN 5000 (approx. EUR 2500) no witnesses' testimonies shall be admissible (see item **C.V.2** below for more details).

NATURAL GAS

Pursuant to article 173(1) of the Energy Act, the transactions in natural gas shall be effected on the grounds of **written contracts** and/or on an organized natural gas exchange market[49], in compliance with the provisions of the Energy Act and the Natural Gas Trade Rules.

Therefore, it can be concluded that there is a legal requirement a written agreement to be concluded in order for the Individual Contracts under the General Agreement to be valid and legally binding.

Non-compliance with the written form requirement is a condition a contract to be declared null and void by the courts on the grounds of article 26(2) of the OCA.

With a view to the above our categorical recommendation is **all Individual Contracts to be concluded always only in writing** and this requirement to be explicitly stated in the Election Sheet.

ELECTRICITY

[49] The natural gas exchanges usually use their own standardized contracts.

1.1.2. Further to the above principle, the parties to an agreement may also agree that written form is mandatory in their relations based on the agreement. According to article 293(2) of the Commerce Act, '*a statement on execution, performance or termination of a commercial transaction shall be null and void if not made in the form established by a law **or by the parties***'. Therefore, if the parties fail to comply with the written form agreed between them (even if such a form is not required by law), the respective statements shall be null and void.

According to § 23(2) of the General Agreement, '*Except as otherwise provided herein or agreed with respect to an Individual Contract, all notices, declarations or invoices sent by one Party to the other shall be in writing and shall be delivered by letter (overnight mail or courier, postage prepaid) or facsimile as provided in the Election Sheet*'. Such 'otherwise' is provided by § 3(1) of the General Agreement regarding the concluding and confirmation of Individual Contracts: '*Unless otherwise agreed between the Parties, Individual Contracts may be concluded in any form of communication (whether orally or otherwise) and shall be legally binding and enforceable from the time the terms of such Individual Contract are concluded*'.

Therefore, the General Agreement does not provide for the written form as a precondition for the validity of the Individual Contracts either.

1.1.3. The provision of article 293(3) of the Commerce Act should be mentioned for the sake of completeness as well, stating that '*A party may not refer to nullity should its behaviour imply that it has not contested the validity of the statement* [of its counterparty]'.

1.1.4. The signature requirement is inseparably related to the written form issues. As seen above, no written form, respectively no signature is required in order for the Individual Contracts under the Electricity General Agreement to be valid and legally binding. On the other hand, written form, respectively **signature is highly recommendable for evidence purposes**. The principle in civil law is that in order for the written form to be regarded as complied with, the respective document has to be signed by its author.

1.1.5. As regards the requirements of the Electricity Trade Rules for registration of the delivery schedules for trade in electricity by the Electricity System Operator (ESO), they should not be regarded as requirements for the validity of the Individual Contracts but as a legally prescribed mechanism for carrying out of the trade in electricity under Bulgarian law, the non-compliance with which would lead to impossibility the (validly) concluded Individual Contracts to be performed.

NATURAL GAS

1.1.6. As far as the Natural Gas General Agreement is concerned, as seen above, written form, respectively signature is required in order for the Individual Contracts under the Natural Gas General Agreement to be valid and legally binding. The quoted principle in civil law is that in order for the written form to be regarded as complied with, the respective document has to be signed by its author. In commercial law there are some deviations from this principle, e.g. according to article 293(4) of the Commerce Act the parties shall be deemed compliant with the written form requirement if their statements have been technically recorded in a way allowing their subsequent transcribing (see also **C.V.**2.2.2

below), or article 3(2) of the Electronic Document and Electronic Trust Services Act, pursuant to which the requirements for written form shall be deemed complied with if an electronic document under the EDESA containing an electronic statement has been issued (see **C.V.**2.3 below).

1.2. **At what point in time does an Individual Contract agreed upon orally become legally binding or enforceable under the laws of Bulgaria?**

Under Bulgarian law, a contract shall be deemed concluded/legally binding as from the moment of receipt of the acceptance (confirmation) by the party who has made the offer (article 14(1) OCA).

ELECTRICITY

Subject to the lack of written form requirement for validity in respect of contracts for sale and purchase of electricity, it can be concluded that if an Individual Contract is agreed upon orally and is later confirmed in writing, this Individual Contract became legally enforceable at the time of the oral agreement between the Parties. Of course, the content of the oral agreement and of the subsequent written confirmation must coincide.

NATURAL GAS

Subject to the written form requirement for validity in respect of contracts for sale and purchase of natural gas, it can be concluded that if an Individual Contract is agreed upon only orally it does **not** become legally binding and enforceable. However, the cited rule of article 293(3) of the Commerce Act should be taken into consideration as well (‘*A party may not refer to nullity should its behaviour imply that it has not contested the validity of the statement’*), i.e. if the Individual Contract is performed by both Parties, it could be argued that the Parties have not contested its validity and that therefore they may not claim that the contract is null and void.

If an Individual Contract is agreed upon orally and is later confirmed in writing, the confirmation (if signed by only one of the Parties) shall be regarded merely as an offer for entering into the Individual Contract. Therefore, this ‘confirmation’ (offer) is subject to further confirmation (acceptance) by the other Party. The Individual Contract shall thus become legally enforceable at the time of the acceptance of the offer (which must also be done in writing). If the confirmation of the preliminary arrangements is effected by a document bearing the signatures of both Parties (i.e. by a written agreement), the Individual Contract shall become legally enforceable at the time of this written agreement. In the written agreement the Parties may agree that their relations in the past shall be governed by the conditions stipulated by the written agreement.

1.3. **Does failure to object to incorrect terms in a received Confirmation (as provided for in § 3.3) constitute “acceptance” of those terms under the laws of Bulgaria? If so, is there a relevant time period under the laws of Bulgaria that could potentially override the governing law of the EFET General Agreement, and permit the parties to object still?**

In contrast to civil law, the principle in Bulgarian commercial law is that if a trader with whom the party sending an offer is in long-term commercial relations does not immediately object to the offer, this trader is deemed to have agreed with the offer (article 292(1) of the Commerce Act).

With a view to that and subject to the above conditions (long-term commercial relations, etc.) we tend to believe that failure to promptly object to incorrect terms in a received Confirmation as provided for in § 3.3 of the General Agreement should be considered as acceptance of those terms.

There is no concrete relevant time period in the Commerce Act. The cited article 292(1) says that objection is to be done 'immediately', but, of course, this issue has to be assessed in each particular case taking into consideration all relevant circumstances and reasonable commercial practice. A recommendation could be made in respect of the terms 'promptly' and 'without delay' (§ 3.3 of the General Agreement) these terms to be explicitly defined in business days in order for various interpretations to be avoided.

NATURAL GAS

In addition, the cited written form requirement under article 173(1) of the Energy Act should always be kept in mind when transactions in natural gas are concerned. With a view to it, one can reasonably object that, if no explicit written confirmation of the offer (i.e., of the Confirmation) has been made, no valid contract has been concluded by the Parties.

Therefore, the conclusion is that failure to object to incorrect terms in a received Confirmation (as provided for in § 3.3 of the Natural Gas General Agreement) does **not** constitute acceptance of those terms. In our view every Confirmation (which, as mentioned above, would have the legal nature of an offer) needs to be confirmed (accepted) in writing by the other Party – only thus the written form requirement would be satisfied. Respectively, if the receiving Party objects to the terms in the 'Confirmation', this would constitute a counter offer to the other Party.

1.4. **Is the reference to the relevant EFET General Agreement made in the relevant written confirmation exchanged (post trade) between the parties sufficient for the inclusion of the Individual Contract in the EFET General Agreement?**

The General Agreement has the legal nature of a master (framework) agreement. There is no legal definition of master agreement in Bulgarian law (except for the purposes of public procurement law), but such a definition could be made on the basis of the intrinsic features of the master agreement: this is a contract by which the parties standardize their future business relations and set out a legal framework of all important general terms and conditions connected with the separate contracts which are going to be entered into between them on the basis of the master agreement. This legal framework shall be applicable in respect of all separate contracts, unless something different has been explicitly agreed between the parties in such a separate contract. In the separate contracts are in principle agreed merely the concrete details of each transaction – amount, price, delivery schedule/period, etc.

§ 1.1 of the General Agreement stipulates that the General Agreement shall govern **all** transactions the Parties will enter into for the purchase, sale, delivery and acceptance of electricity/natural gas and that the provisions of the General Agreement constitute an integral part of each Individual Contract.

ELECTRICITY

With a view to the above, it can be confirmed that if the Parties enter into an Individual Contract orally, such as over the telephone, or otherwise, e.g., through an electronic trading or matching system, or in writing, and make reference to it being an Individual Contract for the purpose of the General Agreement between the Parties, such Individual Contract should be considered validly included in the General Agreement and governed by its provisions. Of course, all our comments and recommendations regarding the necessity of written form for evidence purposes should be taken into consideration as well.

NATURAL GAS

As underlined above, Bulgarian Energy Act requires written form as a pre-condition for the validity of natural gas purchase agreements. This means that any Individual Contracts entered into orally or otherwise, if thus the written form requirement has not been satisfied, are to be considered null and void because of their non-compliance with the form required by law.

Respectively, if the Parties enter into an Individual Contract in a way satisfying the written form requirement and make reference to it being an Individual Contract for the purpose of the General Agreement between the Parties, such Individual Contract should be considered validly included in the General Agreement and governed by its provisions.

2. Means of Evidence

Assumed there is a dispute with respect to the existence or the terms or conditions of an Individual Contract, would any or all of the following be eligible for rendering or otherwise properly introducing evidence of the agreed terms of the Individual Contract in front of a Bulgarian court: (i) taped recording; (ii) witness' statement; (iii) e-mail or other electronic message or transaction entry system; and/or (iv) facsimile? Are there any local requirements or other considerations that are relevant to each form of evidence?

2.1. As mentioned, the provision of article 164, para 1, item (c) of the Civil Proceedings Code states that for proving of contracts with a value exceeding BGN 5000 (approx. EUR 2500) no witnesses' testimonies shall be admissible.

ELECTRICITY

Therefore, even if written form is not a pre-condition for the validity of the Electricity Individual Contracts, it is a necessary pre-condition for proving the existence and the terms of such Contracts. With a view to that **our categorical recommendation is all Electricity Individual Contracts to be concluded only in writing**.

NATURAL GAS

Therefore, written form is not only a pre-condition for the validity of the Natural Gas Individual Contracts, but also a necessary pre-condition for proving the existence and the terms of such Contracts. With a view to that **we reiterate our recommendation all Natural Gas Individual Contracts to be concluded only in writing**.

Hereunder we discuss what means of entering into or confirming Individual Contracts may be regarded as compliant with the written form requirement under Bulgarian procedural law and thus accepted by Bulgarian courts as valid evidence.

2.2. The legal nature of the **taped agreements** deserves particular attention. It has become common practice (incl. in Bulgaria) companies operating in different markets to tape the agreements they enter into, but in general this way of concluding transactions is not very popular in Bulgaria.

2.2.1. In our opinion telephone recordings without the consent of the parties to such recordings are illegal and not permissible. Such recordings will be in breach of the Constitution of Bulgaria and of article 32(2) in particular, which states that no person shall be followed, photographed, filmed, **recorded**, or subjected to any other similar actions without his/her knowledge or despite his/her express disapproval, save in cases provided for in the law[50].

Therefore, *per argumentum a contrario* if the other party's consent has been preliminary obtained, telephone recordings relating to an Individual Contract should be regarded as legal and permissible. It should be undisputable that the explicit consent of the individual (natural person) recorded and not of his/her employer – party to the General Agreement has to be obtained. We do not deem that the employer may validly give such consent on behalf of that employee. If the employer makes a false representation as to that employee's consent having been given and the recorded employee claims compensation for (immaterial) damages from the other party who has made the recording, then the other party should be able to claim compensation from that employee's employer (who has made the false representation).

Therefore, it is highly recommendable in all cases when telephone recordings relating to Individual Contracts under the General Agreement are to be made, the explicit consent of the other party's representatives (employees / officers) who will be recorded to be preliminary obtained – in writing, or, if not possible, such representatives to be warned before each telephone conversation on entering into the Individual Contract that this conversation is going to be recorded and that if they do not explicitly object this will be considered as their consent to the recording. If the recorded individual continues the conversation, it can be assumed that his/her consent has been duly obtained.

2.2.2. Apart from the issues related to the other party's consent, this matter needs to be checked from point of view whether tapes are admissible evidence in court at all (for the purposes of this opinion we assume that the other party's consent for the recording has been obtained in compliance with all applicable rules and regulations). The court practice is not unambiguous. Most judges are sceptic about such evidence (records (tapes) proving the entering into an agreement). There is, however, a provision in the Commerce Act (article 293(4)) stating that the parties shall be deemed compliant with the written form requirement if their statements have been technically recorded in a way allowing their subsequent transcribing. We believe that on the basis of this provision one could try to

[50] Such cases are envisaged for instance in the Special Investigation Means Act (published in State Gazette 95/21.10.1997, last amendments published in State Gazette 6/20.01.2023).

ground that agreements taped in compliance with the law in force actually meet the requirements for written form and could therefore be used as valid evidence in court also for proving of contracts with a value exceeding BGN 5000. However, this is merely a possible interpretation of article 293(4) of the Commerce Act which should not be relied upon when entering into Individual Contracts. Other more secure approaches to evidence the concluded Individual Contracts and their content should be sought.

2.3. The issue whether **electronically transmitted correspondence** (hereunder referred to as 'e-mails') may be regarded as written form of a transaction and as valid evidence at all (in case of eventual court proceedings) is still disputable in Bulgarian court practice and legal circles (although it can be confirmed that more and more often standard e-mails are accepted as evidence by the judges also for proving of contracts with a value exceeding BGN 5000).

2.3.1. First, a couple of terminological notes under the Electronic Document and Electronic Trust Services Act (published in State Gazette 34/06.04.2001, last amendments published in State Gazette 58/23.07.2019) (the **EDETSA**) are necessary in order for the discussed issues to be better understood (note that for many of the definitions the EDETSA refers to Regulation (EU) No 910/2014 of 23 July 2014 on electronic identification and trust services for electronic transactions in the internal market (**Regulation No 910/2014**)):

- 'electronic document' means any content stored in electronic form, in particular text or sound, visual or audiovisual recording;
- 'electronic statement' means a verbal statement, represented in digital form through a commonly accepted standard for transformation, reading and presentation of information;
- 'electronic signature' means data in electronic form which is attached to or logically associated with other data in electronic form and which is used by the signatory to sign;
- 'advanced electronic signature' means an electronic signature meeting the following requirements: (a) it is uniquely linked to the signatory; (b) it is capable of identifying the signatory; (c) it is created using electronic signature creation data that the signatory can, with a high level of confidence, use under his sole control; and (d) it is linked to the data signed therewith in such a way that any subsequent change in the data is detectable;
- 'qualified electronic signature' means an advanced electronic signature that is created by a qualified electronic signature creation device, and which is based on a qualified certificate for electronic signatures. Qualified electronic signatures shall be issued by trusted service providers licensed either in Bulgaria or in another Member State.

2.3.2. It is our understanding that:

- Ordinary/standard (i.e., not signed by an advanced or qualified electronic signature) e-mails qualify as electronic documents; usually they have the necessary information to qualify as having a (simple) electronic signature (for example, '*Best regards, Stefan Ivanov*' and/or the e-mail signature/footer). We comment below (2.3.3-2.3.5) namely the ordinary standard e-mails (and we understand that the questions in the EFET instruction letter refer namely to such e-mails).

- Documents signed with a qualified electronic signature usually do not raise any issues since a qualified electronic signature shall have the equivalent legal effect of a handwritten signature (Art. 25(2) of Regulation No 910/2014).

2.3.3. Pursuant to article 3(2) of the EDETSA, the requirements for written form shall be deemed complied with if an electronic document containing an electronic statement under the EDETSA has been issued; the EDETSA is not applicable in respect of transactions for which the law requires a special written form (e.g. notarized signatures).

The provision of article 13(4) of the EDETSA should be particularly noted, according to which '*An electronic signature and an advanced electronic signature shall have the equivalent legal effect of a handwritten signature where this has been agreed by and between the parties.*'

Therefore, if there are exchanged standard e-mails containing the necessary information to qualify as having a simple or an advanced electronic signature (as discussed above), and the parties have agreed that such e-mails will be considered as being done in written form (i.e., that the way they are signed will have the equivalent legal effect of a handwritten signature), they should be regarded by the courts as meeting the written form requirement and as sufficient evidence for the concluded Individual Contracts and their terms.

This conclusion can be supported also with arguments derived from the Civil Proceedings Code (article 184) which explicitly mentions the 'signed electronic document' in the section dealing with the written evidence. An electronic document may be presented reproduced on a paper-based data medium in the form of a duplicate copy authenticated by the party. Upon request, the party shall be obligated to present the document on an electronic data medium. If the court does not have at its disposal technical means and experts making it possible to reproduce the electronic document and to duly verify the electronic signature in the courtroom in the presence of the persons who appeared, electronic copies of the document shall furthermore be presented to each of the parties to the case. In such case, the truthfulness of the electronic document may be contested during the next succeeding court hearing.

Note also that according to Art. 25(1) of Regulation No 910/2014, an electronic signature shall not be denied legal effect and admissibility as evidence in legal proceedings solely on the grounds that it is in an electronic form or that it does not meet the requirements for qualified electronic signatures.

2.3.4. One of the main arguments against acceptance of e-mails as valid evidence is that the author of the e-mail cannot be checked, respectively proven. In principle everybody can send an e-mail from another person's computer and e-mail address. Besides, there is no guarantee that the content of the e-mail has not been subsequently amended / modified. For such reasons in the past judges were generally reluctant to accept e-mails as evidence in court.

That is why, one may argue that only electronic messages/documents signed with a qualified electronic signature may be regarded as meeting the written form requirement and that hence no standard e-mails are admissible as evidence for contracts with a value exceeding BGN 5000.

There are, however, more and more judges who are willing to accept e-mails for proving of certain circumstances (including of contracts with a value exceeding BGN 5000, i.e. such judges regard e-mails as written evidence). E-mails have, of course, to be presented in the due form to the court (e.g. if they are not in Bulgarian language, they have to be translated by a sworn translator, etc.).

There is no clear legal regulation of the above issues in Bulgarian legislation and case law, which, of course, contributes to the uncertainty and the variety of controversial opinions. It should be, however, noted that, in addition to the above quoted provisions from the EDETSA, the Electronic Commerce Act (published in State Gazette 51/23.06.2006, last amendments published in State Gazette 53/08.07.2022) indirectly recognizes the concluding of contracts via e-mails. In its article 12(2) the Electronic Commerce Act says that some specific rules of the Act do not apply towards contracts concluded exclusively via e-mail or any other equivalent means for exchange of individual statements. Article 293(4) of the Commerce Act should be quoted once again, stating that the parties shall be deemed compliant with the written form requirement if their statements have been technically recorded in a way allowing their subsequent transcribing.

2.3.5. With a view of all the above it could be concluded that the legal ground for recognition of e-mails as valid evidence by Bulgarian courts is still not fully stable. Due to that and to the related uncertainty we would recommend all Confirmations of Transactions under the General Agreements to be done also in 'standard' written form (i.e., with a handwritten signature by an authorized person, or at least with a qualified electronic signature).

In any case we believe that if the parties to an agreement explicitly agree in the agreement that e-mails shall be regarded as valid communication means in their relations, and that for the purpose of this agreement the written form shall be deemed complied with if an e-mail has been sent, this would increase the chance for recognition of such e-mails as valid evidence by the courts (see for example clause 3 of the EFET Electronic Confirmation Agreement, as well as the quoted rule of article 13(4) of the EDETSA).

2.3.6. There is no explicit legal regulation in Bulgarian law of the **electronic confirmation matching systems** (such as the EFET Confirmation Matching System). Therefore, we deem that the above considerations regarding electronic documents, ordinary e-mails and the different types of electronic signatures are relevant in respect of such systems as well, in particular, if the electronic messages exchanged between the Parties qualify as electronic documents having a simple or an advanced electronic signature, and the Parties have agreed that such messages will be considered as being done in written form, they should be regarded by Bulgarian courts as written evidence. On the contrary, if these conditions are not met, it is highly probable that Bulgarian courts would not accept them as written evidence.

2.4. As regards the **fax/facsimile transmissions**, there is an explicit rule in the Commerce Act (article 293(5)), stating that in the event of statements made by telefax or telex, the written form shall be deemed met if the books and documents documenting the operation of these facilities exclude incorrect reproduction of the statement. Based on this provision, Bulgarian courts in principle accept documents sent/received by fax as valid written evidence. Of course, the sent document (e.g. a Confirmation of an Individual Contract) must be duly signed by a representative of the sender in order to be accepted by the court as such evidence.

VI. Core Provisions

Please base your opinion on the additional assumptions outlined under Part C.I.1, C.1.2 and C.II and discuss in detail the following issues:

1. Would any of the elections contemplated by the EFET General Agreement or any of the mentioned Annexes (including the EFET Credit Support Annex) and Appendices change the substance of your conclusions reached under Part C.I or C.II (Enforceability of Close-out Netting) above? As far as the EFET Credit Support Annex is concerned, you should in particular discuss the effect of electing to allow substitution with or without consent.

1.1. Subject to our comments and recommendations (e.g., Automatic Termination to apply in case of an insolvency-based Material Reason) made in this Opinion, in our view the elections contemplated by the General Agreement or the Annexes thereto (including the EFET Credit Support Annex) should not change the substance of our conclusions reached under Sections **C.I** and **C.II** above.

1.2. As regards the effect of electing to allow substitution with or without consent, we would refer to our comments in item **C.III.**4 above.

2. Considering your conclusions reached under Part C.I or C.II (Enforceability of Close-out Netting) above, what are the provisions of the EFET General Agreement that you regard as so essential that a <u>material</u> alteration thereof could affect the conclusions reached in that Part C.I or C.II (each such provision a "Core Provision")? We believe that the following provisions are Core Provisions: § 1, § 10.3(a), the second sentence of § 10.3(b), § 10.3(d), § 10.5(c)(iv), § 11 and the related definitions contained in Annex 1 to the EFET General Agreement.

We deem that following provisions of the General Agreement may be regarded as Core Provisions as regards the enforceability of close-out netting: § 1.1, § 10.3, § 10.4, § 10.5(c)(iv) and §11, and, of course, the related Defined Terms contained in Annex 1 to the General Agreement.

3. Would the inclusion of the General Agreement in the EFET Cross Product Payment Netting Agreement, the Master Netting Agreement or in the Cross-Product Master Agreement (as amended by the EFET/IECA Commodities Schedule to the Cross-Product Master Agreement (the "CPMA")) change the substance of your conclusions reached under Part C.I or C.II?

The inclusion of the General Agreement in the EFET Cross Product Payment Netting Agreement, the Master Netting Agreement or in the Cross-Product Master Agreement (as amended by the EFET/IECA Commodities Schedule to the CPMA) should not change the substance of our conclusions reached under Sections **C.I** and **C.II** above.

VII. Governing Law, Arbitration and Jurisdiction

Additional assumptions:

- The relevant EFET General Agreement is governed by the laws of a jurisdiction other than Bulgaria (including English or German law).

1. Would the Parties' agreement on the governing law, submission to arbitration or jurisdiction (§ 22 of the EFET General Agreement) be upheld in Bulgaria, and what would be the consequence if it were not?

1.1. Choice of law (§ 22.1 of the General Agreement)

Following provisions of Bulgarian legislation and international/EU legal acts should be taken into consideration when the possibility is being assessed, the parties to a contract to choose the law governing this contract:

A. The Private International Law Code

The provisions of the Private International Law Code (published in State Gazette No 42/17.05.2005, last amendments published in State Gazette No 100/21.12.2010) (the **PILC**) shall be applicable in the relations between a Bulgarian Party to the General Agreement and a Party which has its seat (registered office)/place of real management in a country which is not an EU Member State. Of particular importance are the following provisions of the PILC:

- Part III of the PILC regulating the applicable law in respect of private legal relations with an international element, and in particular Chapter IV 'General Provisions' and Chapter X 'Contractual Relations'[51].

- Article 93(1) of the PILC which prescribes that the contracts are governed by the law chosen by the parties (*lex voluntatis*). The legislator has transposed also the rule of article 3(3) of the Rome Convention 1980 in article 93(5) of the PILC – if all elements of a contract at the time of the choice are connected with one country only, the choice of foreign law shall not prejudice the application of rules of the law of that country which cannot be derogated from by contract (i.e. by the principle of contractual freedom), i.e. the ordinary mandatory rules. Therefore, even if all elements of the General Agreement are connected with Bulgaria (incl. both Parties have their registered seat in Bulgaria), the Parties should be able to agree foreign (i.e. non-Bulgarian) law to govern their relations under the General Agreement, but only as regards matters which **(a)** are not explicitly regulated by Bulgarian law or **(b)** are regulated but by non-mandatory rules.

[51] Chapter X of the PILC has been drafted by the Bulgarian legislator in a way compliant with the provisions of the Convention on the law applicable to contractual obligations opened for signature in Rome on 19 June 1980 (80/934/EEC) (the **Rome Convention 1980**).

The choice of applicable law shall be explicit or to follow unambiguous from the contract's provisions or from the circumstances related to the contractual relationship. The parties may choose applicable law in respect of the whole contract or only in respect of part of it.

- The choice of applicable law is not unrestricted. Articles 45 and 46 of the PILC contain some rules regulating the confines of this choice. A provision of a foreign law determined as applicable by the PILC shall not apply if the consequences of such application are manifestly incompatible with Bulgarian public policy (*ordre public*). Incompatibility shall be evaluated while taking account of the extent of connection of the relationship with Bulgarian public policy and the significance of the consequences of application of the foreign law. Where such an incompatibility is ascertained, another appropriate provision of the same foreign law shall be applied. In the absence of such a provision, a provision of Bulgarian law shall apply, if necessary for settlement of the relationship.

  The provisions of the PILC shall not affect the application of the mandatory rules of Bulgarian law which, considering their subject matter and purpose, must be applied notwithstanding the referral to a foreign law (the so called 'special mandatory rules').

- Article 43 of the PILC regulates the rules for establishment of the content of the foreign law. The court applying the chosen law shall in principle of its own motion (*ex officio*) establish the content of the foreign law. The court may resort to the methods provided for in international treaties, may request information from the Ministry of Justice or from another body, as well as request opinions from experts and specialized institutions. The parties may present documents establishing the content of the provisions of foreign law on which they base their petitions or objections, or otherwise assist the court. The court applying the chosen law may order the parties to assist it in the establishment of the content of the said law.

B. The Rome Convention 1980

The Rome Convention 1980 entered into force for Bulgaria on 15 January 2008. As from this date (and until 17 December 2009, see next item; the Rome Convention continues to apply to Denmark), the Rome Convention was applicable in the relations between a Bulgarian Party to the General Agreement and a Party which had its seat (registered office)/place of real management in another EU Member State. Following provisions of the Rome Convention 1980 deserved particular attention:

- Article 3 stating the general rule that the parties to a contract have freedom of choice over the applicable law – '*A contract shall be governed by the law chosen by the parties*'. The law applicable to a contract shall govern in particular '*the various ways of extinguishing obligations*' (e.g. set-off) (article 10(1)(d)).

- Articles 7 and 16 providing the main limitations of the choice of law – the special mandatory rules and the *ordre public*.

C. Regulation Rome I

The Rome Convention 1980 was applicable until 17 December 2009 from which date Regulation (EC) No 593/2008 on the law applicable to contractual obligations (**Regulation Rome I**) shall apply in relations between Parties from two EU Member States (with the exception of Denmark; the Danish government planned to join the Regulation if a referendum on 3 December 2015 approved converting its opt-out into an opt-in, but the proposal was rejected). Of particular importance are the following provisions of Regulation Rome I:

- The freedom to choose the applicable law (article 3).
- The limits of the choice of law (article 3(3); article 3(4) introducing a new principle compared to the Rome Convention 1980 protecting the mandatory provisions of EU law[52]; article 9 regarding the special mandatory rules (for the first time there was a definition of these rules, called 'overriding mandatory rules'[53]); article 21 regarding the public policy (*ordre public*)).
- For the first time there was an explicit provision dealing with the choice of law to the set-off (article 17): '*Where the right to set-off is not agreed by the parties, set-off shall be governed by the law applicable to the claim against which the right to set-off is asserted*' (i.e. the passive claim – this approach is compliant with the approach followed in the EU Insolvency Regulation).

To sum up, reviewing all the three above documents, it can be concluded that they generally follow the same rules and principles on the matters of particular interest. With a view to that, if the Parties to the General Agreement have explicitly agreed in § 22.1 that their relations under the General Agreement shall be governed by the laws of a jurisdiction other than Bulgaria (e.g. by German or English law), and Bulgarian courts are competent to examine a dispute under the General Agreement, Bulgarian courts would apply German or English law.

Bulgarian courts would not apply foreign law if its provisions are manifestly incompatible with Bulgarian public policy and/or contradict to overriding mandatory rules of Bulgarian law. Assessment whether there is such incompatibility / contradiction shall be made in each particular case taking account of all concrete circumstances.

If all the elements of the General Agreement and the Individual Contracts are connected with Bulgaria only (e.g. both Parties have their seats (registered offices)/places of real management in Bulgaria), the choice of foreign law shall not prejudice the application of

[52] article 3(4): '*Where all other elements relevant to the situation at the time of the choice are located in one or more Member States, the parties' choice of applicable law* ***other than that of a Member State*** *shall not prejudice the application of provisions of Community law, where appropriate as implemented in the Member State of the forum, which cannot be derogated from by agreement'*.

[53] article 9(1): '*Overriding mandatory provisions are provisions the respect for which is regarded as crucial by a country for safeguarding its public interests, such as its political, social or economic organisation, to such an extent that they are applicable to any situation falling within their scope, irrespective of the law otherwise applicable to the contract under this Regulation.'*

Bulgarian mandatory rules[54] (with a view to that, for the sake of legal clarity, it could be recommended in such scenarios Bulgarian law to be chosen as applicable in the Election Sheet).

1.2. Choice of jurisdiction / arbitration (§ 22.2 of the General Agreement)

1.2.1. Choice of jurisdiction

The following provisions of Bulgarian legislation and international/EU legal acts should be taken into consideration when the possibility is being assessed, the parties to a contract to choose the jurisdiction, respectively the arbitration – see 1.2.2 below - competent to examine and adjudicate on their disputes under this contract:

A. The Private International Law Code

The provisions of the PILC shall be applicable in the relations between a Bulgarian Party to the General Agreement and a Party which has its seat (registered office)/place of real management in a country which is not an EU Member State. Of particular importance are the following provisions of the PILC:

- Article 23 of the PILC governs the conditions under which the parties to a contract may agree to submit their disputes to a foreign jurisdiction, respectively to Bulgarian courts. Where subject of the lawsuit is a property right (i.e. a right evaluable in money) and the dispute does not fall within the exclusive jurisdiction of Bulgarian courts, any such dispute may be submitted to a foreign court by an agreement in writing between the parties. Although not explicitly mentioned in article 23 of the PILC, we deem that another pre-condition for the valid submission of the dispute to a foreign court is the parties to have their seats (registered offices)/places of real management in two different jurisdictions.

  Where a Bulgarian court has been seized while such an agreement is in place, the defendant must raise his/her objection not later than the term for reply to the claim.

  Under the same terms as described above a case cognizable in a foreign court may be submitted to Bulgarian courts.

- Articles 4 and 15 of the PILC regulate the international jurisdiction of Bulgarian laws, in particular in matters relating to rights arising out of contractual relationships. Bulgarian courts shall have international jurisdiction where:

  (i) the defendant has a habitual residence (domicile), seat (registered office) or place of the actual management of his business in Bulgaria;

  (ii) the claimant is a Bulgarian national or is a legal entity registered in Bulgaria.

[54] See '*The Regulation Rome I*', Chapter '*The choice of applicable law according to article 3*', N. Bandakov, page 67-68, Ciela, 2009.

Claims against a legal entity, where the dispute has arisen out of direct relationships with its branch, may be brought before Bulgarian courts if the branch is registered in Bulgaria.

Bulgarian courts shall have jurisdiction over claims on contractual relationships also where the place of performance of the obligation is within Bulgaria or where the defendant has a principal place of business in Bulgaria.

B. Regulation Brussels I

Since as from 1 January 2007 Bulgaria became EU Member State, Council Regulation (EC) No 44/2001 of 22 December 2000 on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters (**Regulation Brussels I**) became directly applicable in Bulgaria as well and its provisions should also have been respectively taken into consideration when the admissibility of choice of jurisdiction was being assessed (*see item C below on the recast Brussels Regulation*). Regulation Brussels I was applicable until 9 January 2015 in the relations between a Bulgarian Party to the General Agreement and a Party domiciled[55] in another EU Member State (other than Denmark), but also with a Party which was not domiciled in a EU Member State[56] (article 23(1)). Following provisions of Regulation Brussels I deserved particular attention:

- Article 22 regulating the exclusive jurisdiction. We do not deem that the relations under the General Agreement and the Individual Contracts fall within any of the cases of exclusive jurisdiction, neither under any of the cases of protective jurisdiction (articles 13, 17 and 21).

- Article 23 dealing with the prorogation (derogation) of jurisdiction – '*If the parties, **one or more of whom is domiciled in a Member State**, have agreed that a court or the courts of a Member State are to have jurisdiction to settle any disputes which have arisen or which may arise in connection with a particular legal relationship, that court or those courts shall have jurisdiction. Such jurisdiction shall be exclusive unless the parties have agreed otherwise*'. Where such an agreement is concluded by parties, none of whom is domiciled in a Member State, the courts of other Member States shall have no jurisdiction over their disputes unless the court or courts chosen have declined jurisdiction (Art. 23(3)).

- As regards purely internal cases, it is widely accepted that in such cases article 23 is not applicable[57].

C. The 2012 recast Regulation Brussels I

[55] Article 60: '*For the purposes of this Regulation, a company or other legal person or association of natural or legal persons is domiciled at the place where it has its: (a) statutory seat, or (b) central administration, or (c) principal place of business*'.

[56] The jurisdiction agreement applies independently of the later procedural roles of the parties – '*Brussels I Regulation*', edited by Ulrich Magnus and Peter Mankowski, 2007, page 389, note 48.

[57] See '*Brussels I Regulation*', Magnus/Mankowski, page 386, note 40.

In 2012, the EU institutions adopted a recast Brussels I Regulation (Regulation (EU) No 1215/2012) which replaced the 2001 Regulation and applies as from 10 January 2015[58]. One of the most significant changes to the recast Regulation is the abolition of exequatur proceedings when enforcing judgments given in other EU Member States.

The recast Regulation kept the rule that the parties to a contract may reach an agreement at the time of contracting as to which court should govern any dispute (jurisdiction agreement) - Art. 25(1): *'If the parties, **regardless of their domicile**, have agreed that a court or the courts of a Member State are to have jurisdiction to settle any disputes which have arisen or which may arise in connection with a particular legal relationship, that court or those courts shall have jurisdiction, **unless the agreement is null and void as to its substantive validity under the law of that Member State**. Such jurisdiction shall be exclusive unless the parties have agreed otherwise.'* There are two main differences compared to the legal regime under the 2001 Regulation (see the above cited Art. 23):

- The domicile requirement for parties to an Art. 25 jurisdiction agreement has been dropped, so a jurisdiction clause will fall within the scope of Art. 25 even if none of the parties are domiciled in an EU Member State. '*This change has significantly expanded the scope of those jurisdiction agreements captured by the Brussels regime. This amendment has the beneficial consequence of removing the need for a detailed (and potentially costly) enquiry as to the domicile of the parties to any contract*' (Sarah Garvey, Allen & Overy, 'Brussels Regulation (recast): Are you ready?', *http://www.allenovery.com/publications/en-gb/Pages/BRUSSELS-REGULATION-(RECAST)-ARE-YOU-READY.aspx*).

- There is a new explicit rule concerning the governing law to be applied to consider the validity of the jurisdiction clause - according to Art. 25(1), this question will be determined under the law of the Member State identified in the jurisdiction agreement (see also recital 20).

Recital 3 of the recast Regulation clarifies that the aim of the recast Regulation is to eliminate divergences in civil matters '*having cross-border implications',* i.e. it is clear now that the Regulation does not apply to purely national matters.

Therefore, if the Parties are domiciled in two different jurisdictions (for instance in Bulgaria and Germany), and at least one of them is domiciled in a Member State, and the Parties have explicitly agreed in § 22.2 that their relations under the General Agreement shall be referred for resolution to the court of a Member State, such court should be competent to examine and adjudicate on a dispute under the General Agreement.

On the contrary, if all the elements of the General Agreement and the Individual Contracts are connected with Bulgaria only (purely internal cases), the Parties should not have the right to agree that a foreign court will be competent to resolve their disputes.

It should be further noted that the recast Regulation did not fully eliminate all the concerns that occurred during the time of application of the 2001 Regulation Brussels I. In particular, '*While sweeping away the requirement regarding the domicile of the parties,*

[58] Thus, the recast Regulation applies to legal proceedings instituted, authentic instruments drawn up, and court settlements concluded on or after 10 January 2015 (Art. 66(1)). For proceedings instituted, settlements concluded, or instruments drawn up before this date, the old Regulation continues to apply (Art. 66(2)).

Article 25 remains confined to jurisdiction clauses that designate member state courts. This restriction means that there is still no uniform position across member state courts as to whether or not a jurisdiction clause in favour of a third state (for example, a New York jurisdiction clause) would be respected by them. ... following the CJEU's decision in Owusu v Jackson (Case C-281/02) [2005] EUECJ) there remains an unanswered question as to whether a member state court has discretion to stay proceedings brought before them (perhaps as the place of the defendant's domicile) where those proceedings have been brought in breach of contract because the contract contains a third state jurisdiction clause.' (see the cited article by Sarah Garvey).

1.2.2. Choice of arbitration

- Arbitration is explicitly excluded from the scope of Regulation Brussels I, incl. from the recast version (article 1(2)(d)[59]).

- Article 19(1) of the Civil Proceedings Code (published in State Gazette 59/20.07.2007, last amendments published in State Gazette 11/02.02.2023) (**CPC**) governs the conditions under which the parties to a contract may agree to submit their disputes to arbitration, including to foreign arbitration. The parties to a contract may in principle agree that all property disputes (i.e. disputes for rights evaluable in money) under a contract shall be adjudicated by a court of arbitration. Arbitration is not admissible in respect of disputes involving real estate rights or possession over real estate, alimony or rights under labour relationship, as well as of disputes one of the parties to which is a consumer within the meaning of the Consumers Protection Act (i.e. an individual).

- Article 7(2) of the International Commercial Arbitration Act (published in State Gazette No 60/05.08.1988, last amendments published in State Gazette 8/24.01.2017) (**ICAA**) provides for an additional condition – the arbitration agreement shall be concluded in writing.

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[59] See also recital 12: '*This Regulation should not apply to arbitration. Nothing in this Regulation should prevent the courts of a Member State, when seised of an action in a matter in respect of which the parties have entered into an arbitration agreement, from referring the parties to arbitration, from staying or dismissing the proceedings, or from examining whether the arbitration agreement is null and void, inoperative or incapable of being performed, in accordance with their national law.*

A ruling given by a court of a Member State as to whether or not an arbitration agreement is null and void, inoperative or incapable of being performed should not be subject to the rules of recognition and enforcement laid down in this Regulation, regardless of whether the court decided on this as a principal issue or as an incidental question. On the other hand, where a court of a Member State, exercising jurisdiction under this Regulation or under national law, has determined that an arbitration agreement is null and void, inoperative or incapable of being performed, this should not preclude that court's judgment on the substance of the matter from being recognised or, as the case may be, enforced in accordance with this Regulation. This should be without prejudice to the competence of the courts of the Member States to decide on the recognition and enforcement of arbitral awards in accordance with the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done at New York on 10 June 1958 ('the 1958 New York Convention'), which takes precedence over this Regulation.

This Regulation should not apply to any action or ancillary proceedings relating to, in particular, the establishment of an arbitral tribunal, the powers of arbitrators, the conduct of an arbitration procedure or any other aspects of such a procedure, nor to any action or judgment concerning the annulment, review, appeal, recognition or enforcement of an arbitral award.'

- The choice of the **seat of arbitration** is one of the key issues in drafting an arbitration agreement due at least to the following reasons: **(i)** It may influence which law governs the arbitration and the arbitration agreement; **(ii)** It has bearing on the issue which courts can exercise supervisory and supportive powers in relation to the arbitration; **(iii)** The seat of arbitration determines the nationality of the award which is relevant for the enforcement of the award.

- It is not fully clear whether the choice of a <u>foreign seat of arbitration</u> (i.e. outside Bulgaria) is admissible in case all parties have their registered seat in Bulgaria.

  According to article 1(2) ICAA, the international commercial arbitration shall resolve disputes in case the registered seat of at least one of the parties is not in Bulgaria. On the grounds of article 10 ICAA (referring to arbitration in another State than Bulgaria) and § 3 TFP of ICAA (excluding the application of article 10 in cases where all the parties have their registered seats in Bulgaria) it can be concluded that the ICAA does **not** allow parties having their registered seats in Bulgaria to agree foreign arbitration. This conclusion is confirmed by Bulgarian case law.[60]

  However, according to the relatively new (in force as from 1 March 2008) provision of article 19(2) of the CPC, the arbitration may have its seat abroad if one of the parties has its usual residence, its registered seat according to its incorporation act <u>or the place of its real management</u> abroad[61]. The criterion 'place of real management' is new and the new CPC does not provide for a legal definition of this term.

  In private international law doctrine[62] the term 'place of real management' is delineated as follows: **(i)** 'Real management' is the **effecting of control over a company** (e.g. by owning the share capital of a company); **(ii)** The real management is where the directives, the frameworks for the company's activity are prepared and not where (on the grounds of such directives and frameworks) the company's resolutions are technically taken.

  It cannot be predicted how '*place of the real management*' will be assessed by the relevant courts and other authorities and whether they will not give preference to the clearer old criterion – the registered seat, thus coming to the conclusion that foreign arbitration is inadmissible in case both parties have their seats in Bulgaria, regardless of the fact that one of them is fully controlled from abroad.

[60] Cf. the following case in 1999, under the abolished CPC: two Bulgarian companies agreed arbitration in London; the claimant filed a claim in London and won the lawsuit; the claimant filed a request for recognition of the arbitral award to the Sofia City Court; although the arbitration procedure was completed without any of the parties to object, the Court refused to recognise the arbitral award due to the foreign seat of arbitration with the argument that it contradicted Bulgarian public policy.

[61] The 'place of real management' is even not commented at all in the Comment of the new CPC (R. Ivanova, B. Punev, S. Chernev), Trud i Pravo, 2008 – the authors state incorrectly that '*the provision of Art. 19 is not different from the previous rule (Art. 9 (1) and (2), abolished)*'.

[62] Prof. N. Natov, *'Comment of the Private International Law Code'*, Ciela, 2006.

In our opinion there are solid legal arguments to ground the conclusion that if **(i)** the Parties under the General Agreement have their registered seat in Bulgaria but **(ii)** one of them is controlled from abroad and this can be clearly proven, foreign arbitration should be admissible, but an assessment should be made for every particular case with a view to all concrete circumstances.

Subject to all the above it can be concluded that, if the Parties to the General Agreement have their seats (registered offices) in two different jurisdictions (for instance in Bulgaria and Germany), and the Parties have explicitly agreed in § 22.2 that their relations under the General Agreement shall be referred for resolution to a foreign (i.e. with seat abroad) arbitration, such foreign arbitration should be competent to examine and adjudicate on a dispute under the General Agreement.

If both Parties have their registered seat in Bulgaria but one of the Parties has the place of its real management (as discussed above) in a foreign country, agreeing on foreign arbitration should be permissible as well.

If both Parties to the General Agreement are Bulgarian entities and have the place of their real management in Bulgaria, they may not agree that a foreign arbitration will be competent to resolve their disputes. In such a case the Parties have generally two options:

(i) To agree that competent to resolve their disputes will be Bulgarian courts. The court proceedings in Bulgaria are (in principle) three-instance which makes the ordinary court procedure more time-consuming compared to the arbitration procedure.

(ii) To agree on a Bulgarian arbitration institution. The most popular and used arbitration court in Bulgaria is the Arbitration Court with the Bulgarian Chamber of Commerce and Industry. There is no arbitration court in Bulgaria specialized in resolving energy disputes.

(For your information: The Commission for Energy and Water Regulation has some powers to assist the voluntary settlement of disputes between energy companies, as well as between customers and energy companies.)

1.2.3. Governing language

It is, however, admissible, in case the General Agreement is signed in a bilingual version (e.g. English – Bulgarian) and even if both Parties are Bulgarian entities, the Parties to agree that in case of discrepancies between the English and the Bulgarian version the English version shall prevail. We believe that this approach is more reasonable taking into consideration that the 'original' version of the General Agreement is in English and that thus the risk related to any weak points in the Bulgarian translation could be minimised.

It is therefore recommendable, in the Election Sheet to be explicitly stipulated that in case of discrepancies the English version shall prevail. Of course, Bulgarian courts (if the dispute is pending before them) will use the Bulgarian version of the General Agreement. This means that in case of a dispute regarding the conformity of the Bulgarian with the English version (i.e. in case a Party argues that the English version shall be applied), expert(s) will have to be appointed by the court in order for the correct translation of the English version to be verified.

VIII. Regulatory Regime

Are there any exchange control laws or license requirements (under, e.g., any banking, securities trading or energy law) that may affect the enforceability of the relevant EFET General Agreement or of the Individual Contracts?

1. Currency or Exchange Control Law

1.1. Official currency in Bulgaria is the Bulgarian lev (BGN) (1 lev = 100 stotinki). It has fixed exchange rate towards the Euro which is 1.95583 BGN per 1 Euro.

There is no prohibition in Bulgarian law payments to be agreed, respectively effected in other currency than in BGN (i.e. payments may also be freely agreed / effected in Euro).

1.2. The legal framework of transactions and payments between Bulgarian and non-Bulgarian entities, of cross-border transfers and payments and of currency control is provided for by the Currency Act (published in State Gazette 83/21.09.1999, last amendments published in State Gazette 14/18.02.2020). The Bulgarian National Bank (the **BNB**) has issued also several Ordinances on the implementation of the Currency Act.

The main principle stated in the Currency Act is that the above transactions, payments and transfers may be freely effected unless something different is stipulated by the Currency Act.

1.2.1. Bulgarian banks may effect cross-border transfers and payments only after the ground for these transfers/payments has been declared before them. If the value of the transfer/payment exceeds BGN 30,000 (approx. EUR 15,339), the person effecting the respective transfer/payment has to present to the bank the information and documents listed in Ordinance No 28 of the BNB for each particular case, depending on the ground for the transfer/payment (e.g. a copy of the contract on which the payment is based).

1.3. With a view to the above, it can be concluded that pursuant to Bulgarian currency legislation there are no restrictions in respect of transfers of sums from and to abroad. The legal regime is merely declaratory.

Therefore, we would not say that the Currency Act and the Ordinances of the BNB on its implementation would 'affect' the General Agreement and the Individual Contracts. Of course, the declaratory obligation contained therein has to be complied with (in case the sum transferred exceeds the above threshold).

2. Energy Law

2.1. Licenses for trade in electricity and in natural gas

Pursuant to the Energy Act, trade in electricity is an activity which is subject to licensing (see also the above item **B.II**.3). As from 1 October 2021, a license for natural gas trading is required under Bulgarian law as well (see also the above item **B.II**.4).

The licenses in the energy sector are issued by the Bulgarian regulatory body - the Commission for Energy and Water Regulation (the **CEWR**). The procedure is initiated by a written application filed to the CEWR by the applicant company together with all the required documents, evidencing the company's compliance with the criteria set out in the Energy Act and in the Ordinance on licensing the activities in the energy sector.

An electricity/natural gas trading license is issued to a company registered in Bulgaria or in an EU Member State, which company has the technical and financial capabilities, material and human resources and organizational structure needed to meet the regulatory requirements for performance of the licensed activity.

Under the Energy Act, the SCEWR must issue the respective license or reasonably refuse its issuing within three months as from submission of the application and all the necessary documents thereto. It could be confirmed that the SCEWR acts in conformity with this term.

The term of the license may be in principle from 1 to 35 years. The term of the license may be prolonged for a term not longer than 35 years upon written request of the licensee filed at least one year before expiry of the term of the initial license. Most of the electricity trade licenses issued so far by the SCEWR are for a 10-year term (which has been or is being prolonged for another 10 years).

2.2. Registration on the balancing energy market

In order to become operative and to have the right to conclude contracts on the energy market, the company which has obtained the electricity trading license has to be registered on the balancing energy market. An electricity trader may get registered on the market of balancing energy either as a person who is responsible for its own imbalances (which is usually the case if the trader intends to do only wholesale trading in Bulgaria/on Bulgarian borders), or as a coordinator of a balancing group. The registration as coordinator of a balancing group is obligatory only for electricity traders contracting electricity with end customers. For the purposes of the registration a standard application must be sent to the Electricity System Operator (**ESO**), according to a template published on ESO's web page (https://www.eso.bg/doc?market-documents). Within 15 days as from receipt of the application ESO checks the documents and sends to the electricity trader a notification for acceptance of the application for registration on the market of balancing energy.

After receipt of the notification the electricity trader shall conclude a balancing agreement with ESO. In the past, electricity traders who sold electricity under cross-border schedules ('external schedules') had also to enter also into an electricity transmission contract and a transmission network access contract with ESO (and pay, of course, respective price for transmission and for access, as affirmed by the CEWR). As from 5 June 2020, this requirement of the Electricity Trade Rules was abolished.

After conclusion of the balancing agreement ESO registers the electricity trader with the Register of trade participants (https://www.eso.bg/doc/?mms-registers&mmsType=1).

2.3. Cross-border transactions with electricity under the Energy Act

As mentioned above (see item **B.II**.3), with the EU accession of Bulgaria the monopoly of the public provider of electricity National Electricity Company (**NEC**) to enter into cross-border transactions in electricity was legally restricted. As from 1 January 2007 this restriction was abolished. Currently, electricity generators, electricity traders, the public provider, the end suppliers and the suppliers of last resort, the electricity exchange operator and the customers have the right to enter into transactions in electricity with local entities of EU Member States, provided that the conditions of article 102 of the Energy Act are met, in particular:

(i) electricity generators, traders, the public provider, end suppliers, the electricity exchange operator and customers are granted the right to free trade in electricity under the laws of the other country, and

(ii) under reciprocity conditions, the laws of the other country provide an opportunity for free trade in electricity to customers of that country, and

(iii) provided that the household customers connected to the electricity distribution grid at low voltage are secured with the necessary electricity complying with certain quality criteria and at transparent and reasonable prices (it is still not clear how this condition is checked but in any case it leaves the door open for imposing by the Bulgarian State of restrictions on the export of electricity), and

(iv) they inform the market participants about the transactions concluded at the organised electricity market (exchange).

After a concerting procedure with the SCEWR, ESO adopts and publishes annually on its webpage Auction Rules for the allocation of capacities on the interconnection between the control area of ESO and its neighbouring control areas, which should be compliant with the requirements of Regulation (EU) 2019/943 of the European Parliament and of the Council of 5 June 2019 on the internal market for electricity (https://www.eso.bg/doc?tenders-rules-2021).

2.4. On the regulatory aspects of the Bulgarian gas market, please refer to the above item **B.II.4** (as mentioned, as of 1 October 2021, trade in natural gas is also subject to licensing under Bulgarian law).

3. Allowances Trading

3.1. Legal framework

Bulgaria has transposed in its legislation the provisions of Directive 2003/87/EC of 13 October 2003 establishing a system for greenhouse gas emission allowances trading within the Union, as amended. The main rules were initially stated in the Environmental Protection Act (published in State Gazette 91/25.09.2002, last amendments published in State Gazette 102/23.12.2022) (the **EPA**). The EPA established a scheme for greenhouse gas emission allowances trading. The scheme was open for participation of natural and legal entities from Bulgaria and from other EU Member States, as well as from third countries in compliance with the international treaties to which Bulgaria is a party. The allocation of the greenhouse gas emission allowances (the **Allowances**) for 2008 – 2012 (Phase II) was made in accordance with the National Allocation Plan adopted by the Council of Ministers (and approved by the EU Commission in April 2010). After 2013 (Phase III covered the period from 2013 to 2020) the cap on the allowances is for the entire EU, i.e. there is no more obligation of the EU Member States to adopt National Allocation

Plans.

On 1 June 2012 the Council of Ministers adopted Third National Plan for Actions with regard to Climate Change for the Period 2013 - 2020. On 6 July 2012 the European Commission authorised requests from Bulgaria, the Czech Republic and Romania for a continued free allocation of EU Emissions Trading System Allowances to their power sectors beyond 2012. The Commission had taken these decisions under the provisions of the Directive which allowed certain Member States exemptions from the general rule that, from 2013 onwards, the power sector must buy all its Allowances at auctions or in the market. Number of Allowances to be allocated for free to power plants by Bulgaria and year in the period 2013–2020 were as follows:

	2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**Total**
BG	13.542.000	11.607.428	9.672.857	7.738.286	5.803.714	3.869.143	1.934.571	0	54.167.999

Source: http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/12/530&format=HTML&aged=0&language=EN&guiLanguage=en

In March 2014 the Climate Change Mitigation Act (the **CCMA**, last amendments published in State Gazette No 102/23.12.2022) was published and entered into force. It superseded the respective provisions of the EPA and provided a more detailed regulation of issues like the implementation of the government policy on climate change mitigation, the implementation of the EU Emissions Trading Scheme, the administering of the National Registry for Greenhouse Gas Emission Allowance Trading, etc.

For the construction of new and the operation of existing plants as per an appendix to the CCMA a greenhouse gas emissions permit shall be necessary. The permits are issued by the Executive Director of the Environmental Executive Agency for each installation operated by the operator.

The Executive Director of the Environmental Executive Agency shall maintain the National Registry for Greenhouse Gas Emission Allowance Trading and shall be national administrator within the meaning of Commission Regulation (EU) No 389/2013 of 2 May 2013 establishing a Union Registry, as amended. On 5 September 2014 the Ordinance on the way and order for administering the National Registry for Greenhouse Gas Emission Allowance Trading was published in the State Gazette (the **Ordinance**). The transfer of allowances shall be done in accordance with Regulation (EU) No 389/2013.

Note: By virtue of Article 88 of Commission Delegated Regulation (EU) 2019/1122 of 12 March 2019 supplementing Directive 2003/87/EC of the European Parliament and of the Council as regards the functioning of the Union Registry, Regulation (EU) No 389/2013 was repealed with effect from 1 January 2021 (when Phase IV started, which will last until December 2030). However, Regulation (EU) No 389/2013 shall continue to apply until 1 January 2026 to all operations required in relation to the trading period between 2013 and 2020, to the second commitment period of the Kyoto Protocol and to the compliance period as defined in Article 3(30) of that Regulation. On its turn, Commission Delegated Regulation (EU) 2019/1122 shall apply as from 1 January 2021.

3.2. In principle, there are no specific requirements and/or restrictions in the CCMA regarding the trade in Allowances by persons who are not operators of plants within the meaning of the CCMA (as stated above, operators must obtain greenhouse gas emissions permits for each installation). Therefore, no license or permit is required under Bulgarian law (so far) for trade in Allowances (in contrast to the trade in electricity/natural gas). The scheme for trading in Allowances is open for participation of natural and legal entities from Bulgaria and from other EU Member States, as well as from third countries in compliance with the international treaties to which Bulgaria is a party (Art. 30(2) of the CCMA). The participants in the scheme for trading in Allowances must be registered in the National Registry for Greenhouse Gas Emission Allowance Trading by the national registry administrator (i.e., by the Executive Director of the Environmental Executive Agency) and must have their accounts and authorized representatives in the National Registry (Art. 8-10 of the Ordinance). However, as mentioned, the transfer of allowances shall be done in accordance with Regulation (EU) No 389/2013. This means that in order to purchase, or sell Allowances (and not only to act as intermediaries), participants must be registered in the Union Registry, i.e. they shall have their accounts in the Union Registry, and the transfer is to be registered in the Union Registry.

In addition, the CCMA (Art. 53) provides for some limitations regarding the entities eligible to apply for admission to bid directly in auctions for greenhouse gas emission allowances. Such entities are:

1. an operator of installation or an aircraft operator under Art. 18(1)(a) of Regulation (EU) No. 1031/2010;
2. investment intermediaries, licensed pursuant to Art. 17(1) and MiFIA;
3. banks, licensed pursuant to Art. 2(2), item 9 of the Credit Institutions Act, when bidding for auctioned products;
4. business groupings of operators under item 1 bidding on their own account and acting as an agent on behalf of their members;
5. state-owned entities and administrative bodies exercising control over the operators under item 1 above within the meaning of Art. 3, item 15 of Regulation (EU) No. 1031/2010.

3.3. Legal nature of an Allowances transaction

Our opinion is that Allowances themselves can be considered as financial instruments, in particular as securities, and more particular – as <u>book entry securities</u> ('dematerialized securities').

Additional light on this issue was cast by Regulation (EU) No 389/2013 and in particular by its Art. 40 called 'Nature of allowances and finality of transactions' which read as follows: '*(1) An allowance or Kyoto unit shall be a fungible, dematerialised instrument that is tradable on the market. (2) The dematerialized nature of allowances and Kyoto units shall imply that the record of the Union Registry shall constitute prima facie and sufficient evidence of title over an allowance or Kyoto unit, and of any other matter which is by this Regulation directed or authorised to be recorded in the Union Registry.*' Thus, an official definition of the allowances' legal nature was given by the EU legislator (which definition is close to the interpretation given by us above).

See also Art. 4, item 11 of the MiFIA and Annex I, Section C, item 11 of MiFID II which explicitly include the Allowances (‘*emission allowances consisting of any units recognised for compliance with the requirements of Directive 2003/87/EC (Emissions Trading Scheme)*’) in the list of financial instruments within the meaning of MiFID II.

In this regard, also the following recitals from the above-mentioned Commission Delegated Regulation (EU) 2019/1122 should be pointed:

Recital 9: ‘*Following the classification of emission allowances consisting of any units recognised for compliance with the requirements of Directive 2003/87/EC as ‘financial instruments’ under Directive 2014/65/EU of the European Parliament and of the Council, it is appropriate to adapt the rules regulating the Union Registry to align them with the requirements of the financial market legislation to the extent necessary, in particular by ensuring the provision of relevant information allowing the effective enforcement of Directive 2014/65/EU and Regulation (EU) No 596/2014 of the European Parliament and of the Council*.’

Recital 10: ‘*In accordance with Directive 2014/65/EU and Regulation (EU) No 600/2014 of the European Parliament and of the Council, financial instruments are to be identified by means of International Securities Identification Numbers (ISIN codes) defined in ISO 6166. In order to facilitate the fulfilment of reporting obligations by the account holders, the ISIN codes for emission allowances should be displayed in the Union Registry’*.

4. Trading in green certificates

The definition of ‘Commodity’ under the General Agreement also covers ‘(green) certificates’. With a view to that, we believe that some short explanatory notes regarding the applicable Bulgarian legal framework would be helpful:

We understand that under ‘green certificates’ the renewable energy (**RES**) Guarantees of Origin are meant.

Note that since the Bulgarian certificate issuing body, namely the Sustainable Energy Development Agency (the **SEDA**), has not gained full membership in the Association of Issuing Bodies (the **AIB**) yet, all RES Guarantees of Origin issued by SEDA need to be reviewed in the context of the national certificate scheme. Following the Energy from Renewable Sources Act (the **ERSA**, published in State Gazette 35/03.05.2011, last amendments published in State Gazette 11/02.02.2023) (Art. 33-35), a "Guarantee of Origin" is an electronic document which serves as evidence before an end-user (purchaser for own use) that a certain share or quantity of the energy supplied is produced from RES. Guarantees of Origin shall be issued to producers for produced standard amount of energy of 1 MWh, which shall be valid for a period of 12 months from the production of the respective unit. The use of the guarantees is limited to prove to an end-customer that a certain share of electricity in the overall energy mix of its electricity supplier has been generated from RES, or that a certain quantity of electricity has been generated from RES, in case of the guarantees being transferred independently from the generated electricity (following the amendments to the ERSA of 2018, Guarantees of Origin (incl. of EU origin) can be transferred regardless of the electricity for which they were issued, although only once to an end-customer – Art. 34(7) of the ERSA). The amount of RES-energy corresponding to Guarantees of Origin transferred to a third party by the electricity supplier shall be subtracted from the share of RES-energy its energy mix.

The SEDA has a power under Art. 35 of the ERSA and Art. 20 of Ordinance РД-16-1117/14.10.2011 on terms and conditions for issuance, transfer, abolishment, and recognition of guarantees of origin for RES energy to deny the validity of a certificate issued under the European Energy Certificate System (**EECS**), if any of the conditions under Art. 34(1) of the ERSA has not been met. Bulgarian Guarantees of Origin, issued by the SEDA, are not eligible for transfer by a cancellation statement (as opposed to EECS Certificates), but only by the explicit SEDA registry transfer procedure.

5. MiFIA

Please refer to item **C.I.**1.3.7 above for more information with regard to the MiFIA and the exemptions under it.

IX. Other Provisions

If you have other recommendations that you would like EFET members to consider (for example to fully optimize the EFET General Agreement for a specific purpose such as to support limited trading between two entities both organized and doing business solely in your jurisdiction), then these types of suggestions may, but need not, be appended as an Annex to the end of your final opinion letter. [Not applicable]

This Legal Opinion is as of this date (12 June 2023) and we do not undertake any obligation to update it or to advise of changes hereafter occurring. We express no opinion as to any matters other than those expressly set forth herein.

Sincerely yours,

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Enclosure: Annex No 1.1 (*Short overview of Bulgarian insolvency proceedings, laws and relevant terminology*).

Appendix A – Types of Counterparties.

Appendix B – Transactions under the EFET General Agreement.

ANNEX No 1.1
to

Legal Opinion Regarding the Enforceability of Close-Out Netting and the Validity and Enforceability of the EFET General Agreements Concerning the Delivery and Acceptance of Electricity and of Natural Gas and its Collateral Arrangements
(Bulgaria)

1.1. Short overview of Bulgarian insolvency proceedings, laws and relevant terminology applicable to Party A

1.1.1. General legal framework

The general legal framework of insolvency proceedings in Bulgaria is provided by Part IV of the Commerce Act, called 'Insolvency'[63] (*'Nesustoiatelnost'*). Part IV regulates the whole insolvency procedure – from the necessary conditions for opening of insolvency proceedings against a debtor (commercial undertaking) through the composition procedure until the distribution of the debtor's assets which have been converted into cash and the termination of the insolvency proceedings. In particular:

(i) Opening (institution) of insolvency proceedings

The necessary pre-conditions for the opening of insolvency proceedings against a debtor - commercial undertaking (trader) (referred to hereunder as the 'company' or the 'debtor') are:

(a) The company is unable to pay its debts. This means that a company cannot pay a due monetary debt under a commercial transaction, or a public liability towards the State or the municipalities, related to its business, or a debt under a private state receivable, or an obligation to pay wages to at least one third of the employees, which has not been discharged for more than two months. Inability to pay debts is presumed when the debtor has ceased payments. It shall be presumed that the trader is unable to meet any due obligation, if, prior to filing of the application for institution of the insolvency proceedings, the trader has not applied for announcement in the Commercial Register of its annual financial statements for the past three years.
or
(b) Over-indebtedness of a private limited company, public limited company or a partnership limited by shares. A company is in the situation of over-indebtedness if its assets do not suffice to cover its monetary debts (article 742(1)).

[63] Hereunder 'insolvency' is used as a synonym of 'bankruptcy' (i.e. *Insolvenz, Konkurs* in German). The pre-condition for insolvency is referred to as 'inability to pay debts' (*Zahlungsunfähigkeit* in German).

The insolvency proceedings are opened upon a request in writing submitted to the district court at the seat (registered office) of the debtor[64] by the debtor itself[65] (i.e. by its directors or managers), by its liquidator (if the company is in a liquidation procedure), by a creditor under commercial transaction, by the National Revenue Agency or by the General Labour Inspectorate Executive Agency. The court shall assess on the grounds of the collected evidence whether all the necessary pre-conditions for opening of the insolvency proceedings are available. If the court comes to the conclusion that the debtor is unable to pay its debts or is in over-indebtedness, the court shall pass a judgement by which it[66]:

- declares the debtor's inability to pay its debts, respectively the debtor's over indebtedness, and determines their initial (commencement) date;
- opens the insolvency proceedings;
- appoints a temporary insolvency receiver;
- imposes security measures over the debtor's assets;
- appoints the date for the first creditors' meeting (not later than one month after the judgement's date).

The judgement does not automatically terminate the contracts concluded by the debtor. The insolvency receiver may terminate any contract, unless it has been already performed (article 644 of the Commerce Act; this is part the insolvency receiver's 'cherry-picking rights' under the Bulgarian law).

One of the crucial issues in this stage is the determining of the initial date of the debtor's inability to pay its debts. From this moment starts the so called 'suspect period'. Some transactions concluded and payments made within this period can be challenged by the insolvency receiver, respectively by the creditors of the debtor (see below item (ii)). The lack of a backward limit proved problematic in practice as the court had the discretionary power to date the commencement of the debtor's inability to pay its debts really long time backward – for instance two or three years, which contradicted in our view to the common principle of a secure and stable business life.

That is why in February 2013 rules were introduced into the Commerce Act that limited the date back in time until which certain transactions can be challenged as null and void (for more details see below).

When the insolvency proceedings have been opened, the debtor continues its activity under the supervision of the insolvency receiver. It may enter into new transactions only with the receiver's preliminary consent. If the court comes to the conclusion that with its actions the debtor threatens the creditors' interest, the court may deprive the debtor of the right to manage and dispose of its assets and to render this right to the insolvency receiver.

[64] Pursuant to Article 3(1) of the EU Insolvency Regulation No 848/2015 (which has direct application in Bulgaria) the competent court is determined by the centre of the debtor's main interest. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary. That presumption shall only apply if the registered office has not been moved to another Member State within the 3-month period prior to the request for the opening of insolvency proceedings.

[65] A debtor who becomes unable to pay its debts or falls in over-indebtedness shall submit a request for opening of insolvency proceedings to the competent court within 30 days.

[66] We do not elaborate on the special scenarios envisaged in the Commerce Act in which the court ascertains that the debtor's assets are not sufficient to cover the insolvency proceedings related costs.

Performance of obligations towards the debtor may only be made against the insolvency receiver.

(ii) Complementing the insolvency estate

This section of Part IV of the Commerce Act regulates the different possibilities that the insolvency receiver, respectively the debtor's creditors have in order to challenge transactions entered into and payments made by the debtor prior to and after the date of the judgment on opening of the insolvency proceedings. In particular:

<u>Article 645</u> regulates the admissibility of **set-off** (this provision should be taken into account when the set-off / close-out netting provisions of the General Agreement are assessed in the light of Bulgarian legislation):

<u>Any creditor</u> may set-off his claim to the debtor against his debt to the debtor, in case (a) prior to the date of the judgement for institution of the insolvency proceedings both debts (b) existed and (c) were counter and (d) of the same kind and (e) the creditor's claim was due. In case the claim has become outstanding in the course of insolvency proceedings or as result of the judgement on institution of the insolvency proceedings, and as well as in case both debts have become of the same kind as a result of such a judgement, the creditor may set-off only after the claim becomes outstanding, respectively of the same kind. The statement for set-off shall be sent to the insolvency receiver.

The set-off may be declared null and void with respect to the insolvency creditors, in case (a) the creditor has acquired the claim and the debt to the debtor prior to the date of the judgement for institution of the insolvency proceedings, but (b) he knew <u>as at the time of acquiring the claim or debt</u> that (b1) inability to pay debts, respectively over-indebtedness, has occurred in respect of the debtor or that (b2) a petition for opening of insolvency proceedings has been filed.

A set-off effected <u>by the debtor</u> after the initial date of the inability to pay debts, respectively the over-indebtedness (i.e. within the suspect period) – but not earlier than one year prior to the lodging of the request for opening of the insolvency proceedings – shall be null and void with respect to the insolvency creditors, except for the part that the creditor would acquire after the distribution of assets converted into cash, regardless of the time of occurrence of both counter debts.

<u>Article 646</u> regulates the voidness of certain actions and transactions:

First of all, null and void with respect to the insolvency creditors are certain actions and transactions effected after the date of the judgement for institution of the insolvency proceedings and not in compliance with the procedure established thereby, such as: performance of an obligation that has occurred prior to the date of the judgement for institution of the insolvency proceedings; pledging or mortgaging rights or assets included in the insolvency estate; transactions with rights or assets included in the insolvency estate.

Next, the following actions and transactions carried out by the debtor after the initial date of the inability to pay debts, respectively the over-indebtedness (i.e. within the suspect period) – but not earlier than within certain time periods prior to the lodging of the request for opening of the insolvency proceedings – may be declared null and void with respect to the insolvency creditors:

- performance of a debt that is still not due and payable regardless of the way of performance (made within 1 year prior to the lodging of the request for opening of the insolvency proceedings);
- establishing a pledge or a mortgage for the securing of a debt that has not been secured so far (made within 1 year prior to the lodging of the request for opening of the insolvency proceedings);
- payment of a due and payable debt, regardless of the manner of performance (made within 6 months prior to the lodging of the request for opening of the insolvency proceedings).

If the creditor knew that the debtor was unable to pay its debts or over-indebted, the above time periods shall be respectively two years / two years / one year. The creditor's knowledge shall be assumed where: (a) the debtor and the creditor are related parties, or (b) the creditor was aware or was in a position to become aware of circumstances, based on which a justified assumption could be made of the existence of inability to pay debts or over-indebtedness.

The above rules regarding the payment of debts (first and third bullet) shall **not** apply where the performance falls within the usual operations of the debtor and where: (a) it had been effected in accordance with the agreement between the parties together with the provision of an equivalent good or service to the benefit of the debtor or up to 30 days following the due date of the debt, or (b) following the execution of the payment the creditor has actually provided to the debtor an equivalent good or service.

The above rules regarding the establishing of a pledge or a mortgage (second bullet) shall **not** apply where the pledge or mortgage had been established (a) prior to or at the time of the extending of a loan to the debtor; or (b) to replace another property security, which cannot be declared null and void in accordance with the rules of this section; or (c) to secure a loan extended for the acquisition of the subject of the pledge or mortgage.

The above rules shall not affect the rights acquired by bona fide third parties against consideration prior to the registration of the request for opening of the insolvency proceedings. Unfairness shall be presumed until the contrary is proved, if the third party is a related person of the debtor or the person with whom the debtor negotiated.

Article 647 regulates the annulment claims which may be filed by the insolvency receiver, or, should he fail to do so – by any insolvency creditor within one year following the institution of proceedings. The legal nature of these claims originates from *Actio Pauliana* (article 135 OCA). By these claims various actions and transactions committed by the debtor within certain time periods prior to the lodging of the request for opening of the insolvency proceedings (varying from 1 year to 3 years) and infringing the creditors' interest may be declared null and void by the court with respect to the insolvency creditors. These include economically unequal transactions; transactions which prejudice the creditors, and transactions where a party to which is a person related to the debtor, etc.

In addition, it should be noted that acts detrimental to creditors may also be challenged by virtue of the *Actio Pauliana* (article 135 OCA). A creditor may request from the insolvency court to declare as null and void with respect of him the agreements between his debtor and a third party which are detrimental to him. The necessary pre-conditions for the success of such a claim are:

- both parties (i.e. the debtor and its counterparty) to the agreement[67] must have known at the moment of entering into it that the agreement that it causes a prejudice to the debtor's creditors (if the creditor's claim occurs after the agreement, then both parties must have acted with a fraudulent intent);
- the creditor must have suffered a prejudice (i.e. the creditor's possibility to satisfy its claims from the debtor's assets is reduced/impeded).

(iii) Competent bodies in the insolvency proceedings

The competent bodies in the insolvency proceedings are:

- The insolvency court (the district court at the seat (registered office) of the company[68] at the day of filing the request on opening of the insolvency proceedings);

- The insolvency receiver[69] (which represents the debtor, supervises its activity, finds and ascertains its creditors, finds and ascertains its assets and converts them into cash, etc.);

- The temporary receiver in insolvency (which is appointed by the court's judgement for institution of the insolvency proceedings and (eventually) replaced by the Creditors' Meeting);

- The assistant receiver;

- First Creditors' Meeting (hears the report of the temporary receiver in insolvency, chooses a permanent receiver in insolvency and proposes to the court its appointment, elects Creditors' Committee);

- Creditors' Meeting;

- Creditors' Committee.

(iv) Submission (lodging) of claims

Creditors shall submit their claims in writing before the insolvency court up to one month after the publishing of the judgement on institution of the insolvency proceedings in the

[67] If the agreement is for a consideration (and not gratuitous).
[68] See footnote 64.

[69] The receiver has to be distinguished from the liquidator under Bulgarian law, who is appointed in case of liquidation proceedings, i.e. winding-up of a company which is able to pay its debts but desires to terminate its existence. That is why in this Opinion the term 'receiver' is used for the Bulgarian insolvency officer (the recast EU Insolvency Regulation uses the term 'insolvency practitioner' (and the old version uses the term 'liquidator')).

Commercial Register[70]. The list of the submitted and accepted (admitted) claims is prepared by the insolvency receiver and approved by the court.

It should be mentioned that in the initial phase of the insolvency proceedings (and before the first court hearing is over), in case the proceedings are opened following a petition filed by a creditor, also other creditors may join the proceedings and submit written evidence (article 629(4)).

(v) Composition procedure

A composition plan may be proposed not later than one month from the date of publishing of the ruling of the court for approval of the list of accepted claims in the Commercial Register. The plan is approved by the Creditors' Meeting and confirmed by the insolvency court. If the court confirms the plan, it terminates the insolvency proceedings and appoints the Supervisory Body proposed in the plan or elected by the Creditors' Meeting. If the debtor does not perform its obligations under the plan, the court may upon creditors' or Supervisory Body's request reopen the insolvency proceedings (without new inability to pay debts or over-indebtedness to have to be proven).

(vi) Declaring the insolvency

If no composition plan has been proposed within the legally prescribed term, or if the proposed plan has not been approved or confirmed, or if it is evident that the debtor's activity would prejudice the insolvency estate, or in case of reopening of the insolvency proceedings, the court then will declare the debtor insolvent and will terminate its activity. By the same judgement the court shall order commencement of the conversion of the debtor's assets included in the insolvency estate into cash and the subsequent distribution of this cash.

(vii) Distribution of the debtor's assets converted into cash

The insolvency receiver will prepare an account for the distribution of the available amounts among the creditors with claims according to article 722(1) of the Commerce Act in conformity with the order, the privileges and the securities. The account must be approved by a ruling of the insolvency court. The claims are paid as per the order under the said article 722 and *pari passu* (the creditors of one rank are paid pro rata in accordance with the amount of their claim).

(viii) Termination (closure) of the insolvency proceedings

The insolvency proceedings are terminated by a court's judgement when (a) all the debts have been paid or (b) the insolvency estate has been depleted. By its judgement the court orders deletion of the company from the Commercial Register, unless all the creditors have been satisfied and there are assets left.

(ix) Out-of-court settlement

[70] Bulgarian Commercial Register is on-line based which guarantees high degree of transparency.

In every stage of the insolvency proceedings the debtor can conclude with all creditors with accepted claims an agreement in writing for settlement of the payment of the monetary debts. In this case the insolvency receiver shall not represent the debtor as a party. If the agreement complies with the legal requirements and if there are no claims for the ascertaining of the non-existence of accepted claims, the court may then terminate the insolvency proceedings. Civil law shall apply unless provided otherwise in the agreement or the Commerce Act.

If the debtor does not perform his obligations under the agreement the creditors whose claims represent not less than 15 percent of the aggregate claims amount can request reopening of the insolvency proceedings without proving new inability to pay, respectively over-indebtedness. Composition procedure may not be carried out during the reopened insolvency proceedings.

(x) Reorganisation proceedings

At the end of 2016 an entirely new Part V was introduced in the Commerce Act called 'Merchant reorganisation proceedings'. The purpose of these proceedings is to avoid institution of insolvency proceedings by an agreement reached between the merchant and its creditors on the settlement of the merchant's payables, allowing the merchant's business to continue. Reorganisation proceedings may be initiated for any merchant which is not unable to pay its debts but is in imminent danger of such inability.

For the purposes of Part V of the Commerce Act a merchant (trader) is to be understood a trader in the general meaning of the Commerce Act (i.e. any natural person or legal entity whose business is any of the activities listed in Art. 1(1) of the Commerce Act; traders by definition are also the companies and the cooperations). The reorganisation proceedings shall not be applicable for any public enterprises exercising a State monopoly or created by a special law, as well as for a bank or an insurer (for which the special proceedings provided for in the respective laws shall be applicable /as explained below/).

1.1.2. **Specific rules for insolvency proceedings**

Such specific rules are contained in:

1.1.2.1. The Bank Insolvency Act (the **BIA**) and the Credit Institutions Act

(i) The BIA is applicable in respect of banks having their seat (registered office) in Bulgaria (to the insolvency proceedings of a bank having branches in EU Member States the provisions of Chapter XIII of the Credit Institutions Act shall apply as well, see item (iii) below). A request is submitted to the competent court (the district court at the seat of the bank) by the Central Bank (Bulgarian National Bank) in case of withdrawal of the bank's license under article 36(2)[71] of the Credit Institutions Act. The BIA regulates in detail the whole bank insolvency procedure. Some of the provisions reiterate provisions and principles stated in the Commerce Act, some reflect quite different principles deriving from the specificity of banking activity.

[71] Grounds for such withdrawal are inability to pay debts, negative equity and not meeting the conditions for restructuring under article 51(1) of the Recovery and Resolution of Credit Institutions and Investment Intermediaries Act.

As concerns the ways of complementing the insolvency estate and challenging certain actions and transactions (Art. 22, Art. 58 – 62 BIA), the regulation is similar to the respective regulation under the Commerce Act (see the above item 1.1.1**(ii)**), but the period backward in time in which actions and transactions can be challenged is longer compared to the general rules of the Commerce Act. Of course, there are specific rules as well. For instance, in case of set-off, it shall be deemed that the creditor (who has made the set-off) knew that inability to pay debts by the bank has occurred, provided his receivable or obligation has been acquired after the date of registration of the decision of the Central Bank for withdrawal of the licence for carrying out banking activity (and such knowledge is a condition for declaring the set-off null and void in the insolvency proceedings) (Art. 59(4) BIA). In addition, every set-off, made <u>by a creditor</u> (≠ Art. 645 of the Commerce Act) or by the bank after the initial date of the bank's inability to pay debts, shall be invalid with respect to insolvency creditors, except for the part which each of them may have acquired from distribution of the converted into cash assets, regardless of the time of occurrence of both counter debts (Art. 59(5) BIA). In these cases, the coming into effect of the set-off shall be postponed until the distribution account is credited under article 104 of BIA; when a bank is sold as an enterprise the set-off comes into effect after the transaction is approved by the court (Art. 59(6) BIA).

The distribution of the assets converted into cash among the creditors is to be made according to article 94 of the BIA (and not to article 722 of the Commerce Act).

In 2014 the license of one of the largest Bulgarian banks – Corporate Commercial Bank – was revoked by the Bulgarian National Bank and in April 2015 the bank was declared insolvent by the Sofia City Court. One of the most discussed issues with regard to the bank are transactions made in 2014 (when it was already clear that the bank is in financial troubles) between debtors (having received loans) and creditors (having deposited funds) of the bank where the creditors sold (transferred) their receivables against the bank to the debtors (with a discount) who then set-off their obligations to repay the loans with the acquired receivables (deposits). It is argued that these transactions infringe the other creditors' rights, and circumvent the rules for payments to the creditors, etc. The bank's receivers have challenged them as contradicting to Art. 59 BIA; not all such cases have been finally resolved (court proceedings were additionally delayed because of the below-mentioned retroactive legislative amendments and the temporary stay of the court proceedings until the Constitutional Court issued its decision in this regard). There were court judgements confirming that the set-offs made after the initial date of the bank's inability to pay debts were invalid with respect to insolvency creditors, but there were also court judgements dismissing the bank's receivers' claims. The above cited rules of Art. 59(5) and (6) were modified in November 2014 to better deal with such situations, but the amendments were done *post factum*, i.e. they should not apply in their amended version to the case with Corporate Commercial Bank. That is why, by further legislative amendments to the BIA (promulgated in State Gazette on 13 March 2018 and on 19 April 2019) the insolvency receivers of Corporate Commercial Bank were given additional powers to challenge certain transactions, to reinstate securities in favour of the bank which had been deleted, etc. The amendments had retroactive effect (incl. as regards the set-offs made) which lead to public debates. By its decision No 8 of 27 May 2021 the Constitutional Court declared these amendments (incl. the retroactive effect) anti-constitutional. Recent case law of the Supreme Cassation Court seems unanimous: to the set-offs made (relevant is the date when the set-off statement made by the bank's creditor reached the bank) prior to November 2014 the version of Art. 59(5) BIA applicable at that time must apply;

according to it, it was possible to challenge only set-offs made by the bank (and not by the bank's creditors), therefore, the claims of the bank's receivers' should be dismissed.

(ii) Bank *insolvency* should be distinguished from bank *liquidation* which is regulated in the Credit Institutions Act (voluntary[72] and compulsory[73] bank liquidation).

(iii) A special section (articles 133 to 150) is envisaged in the Credit Institutions Act regarding the cross-border reorganisation measures and winding-up procedures of banks (transposing the provisions and requirements of Directive 2001/24/EC on the reorganisation and winding-up of credit institutions). Competent to pass a judgement / decision on the liquidation or opening of insolvency proceedings of a bank licensed in Bulgaria are Bulgarian courts or administrative authorities. The judgement / decision has effect also in respect of the bank's branches in other EU Member States. In such a case, the general rule is that in regard to the liquidation or insolvency proceedings (incl. as regards the conditions under which set-offs may be invoked) of the bank licensed in Bulgaria, Bulgarian laws shall apply (unless something different is envisaged by the Credit Institutions Act).

The judgement/decision of the competent court or administrative authority on opening of winding-up proceedings of a bank licensed in an EU Member State carrying out activity on the territory of Bulgaria shall be directly and without any formalities recognized in Bulgaria and shall have effect in Bulgaria from the time that it enters into force and becomes effective in the EU Member State of the opening of proceedings. In such a case the general rule is that in regard to the winding-up proceedings of the bank, the laws of the EU Member State where the bank has been licensed shall apply.

Pursuant to article 144 of the Credit Institutions Act, the adoption of reorganisation measures or the opening of a winding-up procedure of a bank shall not affect the right of creditors to demand the set-off of their claims against the claims of the bank, where such a set-off is permitted by the law applicable to the bank's claim. This provision shall not preclude the actions for voidness, voidability or unenforceability of legal acts detrimental to all the creditors as per the applicable law. Therefore, if the claims arising under the General Agreement are governed by a law other than Bulgarian law (and provided that set-off is legal, valid, binding and enforceable under that law), Bulgarian reorganisation measures or winding-up proceedings of a bank should in principle not interfere with the possibility bank's creditors to set-off their claims under the General Agreement.

In case of the adoption of reorganisation measures or the opening of a winding-up procedure of a bank the applicable law in respect of the netting agreements[74] shall be the law applicable under the contract which envisages netting agreements (article 145, it. 2) without prejudice to the provisions of Art. 100 and Art. 103 of the Act on Recovery and Resolution of Credit Institutions and Investment Intermediaries (implementing into Bulgarian law the Bank Recovery and Resolution Directive /Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014/), or the respective provisions of

[72] A resolution on voluntary liquidation may be taken by the General Meetings of the shareholders of the bank after permission of the Central Bank.

[73] Compulsory liquidation of a bank is carried out where the bank's license has been withdrawn on any of the grounds listed under article 36(1) of the Credit Institutions Act (i.e. other than inability to pay debts / negative equity).
[74] No definition of 'netting agreements' is provided for by the Credit Institutions Act.

the legislation of an EU Member State. Therefore, if the General Agreement is governed by a law other than Bulgarian law, Bulgarian reorganisation measures or winding-up proceedings of a bank should in principle not interfere with the effectiveness of the General Agreement.

It could be further concluded that article 145, it. 2 of the Credit Institutions Act dealing with netting agreements is *lex specialis* and prevails over article 144 of the same Act dealing with set-off.

1.1.2.2. The Insurance Code (published in State Gazette 102/29.12.2015, last amendments published in State Gazette 25/29.03.2022)

The Insurance Code (Art. 612 – 634) provides for special regulation of the insolvency of insurers (an insurer shall be: (a) a joint-stock company, a European company, a mutual insurance cooperative or a European cooperative society with a seat of business in Bulgaria, which has obtained a licence under the conditions and in accordance with the procedure laid down in the Insurance Code (local insurer); (b) a person who has obtained a license for insurance in another member state and performing activities on the territory of Bulgaria under the conditions of the right of establishment or of the freedom to provide services (insurer from another member state); (c) a branch of an insurer from a third country, registered under the Commerce Act, which has obtained a license under the conditions and according to the procedure laid down in the Insurance Code).

There are special provisions in the Insurance Code regarding the cross-border liquidation and insolvency proceedings of insurers. An explicit provision (Art. 631(3)) states that the opening of liquidation or insolvency proceedings of an insurer shall not affect the right of its creditors to set-off where such a set-off is permitted by the law applicable to the insurer's claim. This provision shall not limit the rights of the liquidator, the receiver or the creditors in accordance with the Commerce Act and the OCA to invoke voidance or to request declaration of voidability or of invalidation with respect to the creditors of actions and transactions. They shall not have this power in case a third party, who has acquired rights under such actions / transactions, proves that the action or the transaction are regulated by the law of another EU Member State, and that according to this law they are effective and valid (Art. 632(2)).

1.1.2.3. The Energy Act

Pursuant to article 61 of the Energy Act, the relations related to the inability to pay debts and the insolvency of energy companies, which have obtained licenses for electricity or heat or natural gas transmission, for electricity or natural gas distribution, as well as the companies which have obtained a license for activities through objects as per a list of the strategic objects of national importance in the energy sector[75] approved by the Council of Ministers, shall be regulated by a special Act. No such an Act has been adopted yet[76].

[75] The text refers only to those companies included in the list which carry out any of the activities public delivery of electricity or natural gas or public supply of electricity or natural gas. A review of the list approved by the Council of Ministers, however, shows that also large electricity generators are included in it; therefore, in our opinion they have also to be covered by the special legal treatment established by the future Act on the insolvency of energy companies.

[76] According to the court practice (Judgement No 791 of 15 December 2005 of the Supreme Cassation Court in case No 471/2005), '*The lack of a special Act regulating the inability to pay debts and the insolvency of the companies*

It is to be noted that electricity traders do not fall within the scope of this special Act, so, their insolvency proceedings should be governed by the general rules stated in the Commerce Act.

Therefore, from the current participants on the liberalized electricity market in Bulgaria (see item **B.II.**3 of our Opinion) only the electricity generators (those of them which carry out activity through objects included in the said list) should be concerned by the future Act on the insolvency of energy companies. Until the adopting of such an Act, the general rules of Part IV of the Commerce Act (see the above item 1.1.1) regarding the insolvency proceedings shall be applicable in respect of such companies if they become unable to pay their debts and/or over-indebted.

1.1.3. **Council Regulation (EU) No 848/2015 of 20 May 2015 on insolvency proceedings (recast)**

The Bulgarian Commerce Act contains several provisions dealing with applicable law in respect of cross-border insolvency proceedings (a foreign judgement declaring insolvency shall be recognized by Bulgaria under the conditions of reciprocity if it has been passed by the competent authority of the State where the debtor's seat (registered address) is, etc.). As from 1 January 2007 Bulgaria became EU Member State, therefore the EU Regulations are binding for Bulgaria and have direct application. Therefore, Council Regulation (EU) No 848/2015 of 20 May 2015 on insolvency proceedings (recast) (the **EU Insolvency Regulation**), applicable since 26 June 2017, shall be directly applicable in Bulgaria as well and the provisions of the Commerce Act regulating cross-border insolvency proceedings shall be considered not applicable if EU Member States are concerned.

Any judgement opening insolvency proceedings passed by a court of an EU Member State which has jurisdiction pursuant to article 3 of the EU Insolvency Regulation shall be recognized in Bulgaria from the time that it becomes effective in the EU Member State of the opening of proceedings (based on the principle of mutual trust).

If the debtor (Party A) has its centre of main interests (**COMI**) in Bulgaria (i.e. generally if its seat (registered office) is in Bulgaria), Bulgarian courts will be competent to pass a judgement on opening of the <u>main</u> insolvency proceedings and Bulgarian law shall apply in respect of those proceedings (i.e. Bulgarian law shall be *lex concursus*). If the debtor has only an establishment within the territory of Bulgaria (i.e. any place of operations where the debtor carries out a non-transitory economic activity), Bulgarian courts will have the jurisdiction to open <u>secondary</u> insolvency proceedings and apply Bulgarian law, where the effect of those proceedings will be restricted to the assets of the debtor situated on the territory of Bulgaria.

The law applicable to the insolvency proceedings shall regulate also the conditions for set-off in such proceedings (article 7(2)(d)). If Bulgarian law is *lex concursus*, then the above cited article 645 of the Commerce Act shall apply (see the above item 1.1.1**(ii)**). Pursuant to article 9(1) of the EU Insolvency Regulation, the opening of insolvency proceedings shall not affect the rights of creditors to demand the set-off of their claims against the

licensed under the Energy Act does not exclude the applicability of Part IV of the Commerce Act in such cases.' This was confirmed also by more recent case law - Judgement No 977 of 17 June 2015 of the Sofia City Court in case No 1992/2014 (not entered into force yet).

claims of the debtor, where such a set-off is permitted by the law applicable to the insolvent debtor's claim (i.e. the passive claim). On the other hand, this provision shall not preclude actions for voidness, voidability or unenforceability of legal acts detrimental to all the creditors as per the applicable law (article 9(2) of the EU Insolvency Regulation) (such as under articles 645 to 647 of the Commerce Act – see the above item 1.1.1**(ii)**). If, however, the person who benefited from an act detrimental to all the creditors provides proof that:

- the said act (i.e. the set-off) is subject to the law of a Member State other than that of the State of the opening of proceedings (e.g. if insolvency proceedings are opened in Bulgaria in respect of a Bulgarian Party but the counterparties have agreed that German or English law shall regulate their relations under the General Agreement), and
- that law does not allow any means of challenging that act in the relevant case (i.e. German or English law does not allow the set-off under the General Agreement to be challenged in insolvency proceedings),

the rules under *lex concursus* relating to voidness, voidability or unenforceability of the legal act shall not apply (i.e. the set-off should be not challengeable under Bulgarian law) (article 16 of the EU Insolvency Regulation).

On the contrary, if German or English law allows means of challenging the set-off in the insolvency proceedings, then the set-off is in principle challengeable under article 645 of the Commerce Act and the respective conditions for its validity have to be checked.

It should be noted that the EU Insolvency Regulation does not apply to cross-border insolvency proceedings concerning insurance undertakings, credit institutions, investment firms and other firms, institutions and undertakings to the extent that they are covered by Directive 2001/24/EC, or to collective investment undertakings.

The EU Insolvency Regulation does apply in a cross-border insolvency where assets (e.g. claims of the bankrupt Bulgarian Party) are also located in one or more other Member States (other than Denmark) (see also item 1.1.5 below).

1.1.4. Quasi-governmental entities

It should be further noted that insolvency proceedings are opened only in respect of traders (i.e. companies (including 100 % State-owned companies), cooperations, single merchants).

Quasi-governmental entities are not subject to insolvency proceedings (neither to the ordinary forced execution proceedings[77]). No insolvency proceedings shall be opened with respect to 'public undertakings' (see item **B.II.**2.(ii) of our Opinion) which exercise State monopoly or are established by virtue of a special law; the relations related to their inability to pay debts shall be regulated by a separate law (no such a law has been adopted yet).

[77] This rule is applicable to the municipalities only as regards cash on their accounts received as State subsidies; the forced execution over their other assets (unless public municipal property) shall follow the general order.

1.1.5. As evident from the above considerations, two main criteria determine the legal rules applicable to insolvency proceedings – what kind of counterparties have entered into the General Agreement and whether there is a cross-border element. With a view to that following scenarios could be outlined (the list is non-exhaustive) and should be taken into consideration:

(i) Counterparties are two Bulgarian companies (e.g. two electricity traders registered with the Bulgarian Commercial Register and licensed by the (S)CEWR). In this case the general insolvency rules stated in the Commerce Act (Part IV) shall apply (see the above item 1.1.1).

(ii) Counterparties are a Bulgarian company and a Bulgarian bank (i.e. a bank having its seat (registered office) and licensed (authorized) in Bulgaria). Where to the Bulgarian company Part IV of the Commerce Act shall apply, to the bank the Bank Insolvency Act (see the above item 1.1.2.1) shall apply.

(iii) Counterparties are a Bulgarian company (having its COMI in Bulgaria) and a company having its COMI in another EU Member State (other than Denmark). If the Bulgarian Party becomes unable to pay its debts (or over-indebted), Part IV of the Commerce Act shall apply, where in respect of the other counterparty the law of the EU Member State where it has its COMI shall apply (see the above item 1.1.3).

(iv) Counterparties are a Bulgarian company (having its COMI in Bulgaria) and a credit institution authorized in another EU Member State. In respect of the Bulgarian Party Part IV of the Commerce Act shall apply (see the above item 1.1.1), in respect of the credit institution the relevant Act applicable in the State where it is authorised which regulates its winding up shall apply.

(v) Counterparties are a company having its COMI in another EU Member State and a credit institution (a bank) authorized in Bulgaria. In respect of the Bulgarian Party the Bank Insolvency Act shall apply (see the above item 1.1.2.1).

1.1.6. **Financial Collateral Arrangements Act (published in State Gazette 68/22.08.2006, last amendments published in State Gazette 8/25.01.2023)**

On 22 August 2006 the Financial Collateral Arrangements Act (the **FCAA**) was published in the State Gazette. As evident from its name, the FCAA was adopted in order to implement into Bulgarian legislation Directive 2002/47/EC of 6 June 2002 on financial collateral arrangements[78]. The FCAA almost literally transposes the provisions of Directive 2002/47/EC, including as regards definitions of financial collateral arrangements (title transfer or security (pledge) financial collateral arrangements), financial obligations, financial instruments, close-out netting provisions, etc. Although the FCAA does not contain any specific insolvency proceedings rules (except for those cited below, but they are not to be considered as procedural rules), we believe that it is relevant in respect of our

[78] Prior to its amendment by Directive 2009/44/EC of the European Parliament and of the Council; Directive 2009/44/EC was implemented in the FCAA by the amendments published in State Gazette 101/28.12.2010, in force as from 30.06.2011.

task and the scope of this Opinion, that is why we summarize below some of the provisions of the FCAA which are of bigger importance for the issues reviewed herein[79]:

(i) Parties to financial collateral arrangements

Parties to a financial collateral arrangement are the collateral provider and the collateral taker. The collateral provider and collateral taker can be only any of the entities listed in the FCAA, such as:

(a) public authorities, local government authorities;
(b) a central bank;
(c) the European Central Bank, the Bank for International Settlements, the European Investment Bank, the International Monetary Fund, the multilateral development banks;
(d) a credit institution (i.e. a bank, see item **B.II.**1(iii) of our Opinion), incl. within the meaning of Directive 2006/48;
(e) a financial institution (see item **B.II.**1(iii) of our Opinion) , incl. within the meaning of Directive 2006/48;
(f) an insurer;
(g) an investment intermediary;
(h) a management company;
(i) a collective investment scheme or a national investment fund;
(j) a regulated stock market;
(k) a Central Depository;
(l) an additional social security company;
(m) a health insurance company;
(n) a company with special investment purpose;
(o) a central counterparty, settlement agent or clearing house, including similar legal entities acting in the futures, options and other derivatives markets;
(p) a trader (excluding the single merchant) acting on behalf of one or more persons holding bonds or other forms of securitised debt or of any entity / institution as listed above in items (a) to (o);
(q) any entity (excluding the single merchant or a company which is not a legal entity) (see item **B.II.**1(i) of our Opinion) provided that the other party to the financial collateral arrangement is an entity / institution as listed above in items (a) to (p).

A party to a financial collateral arrangement can be also any person having the status of any of the above entities / institutions under its national law.

The general idea of Directive 2002/47/EC is that only professional players on financial markets should benefit from the special treatment under it. Bulgaria has applied a partial opt-out and has not excluded totally the arrangements where one of the parties is a person mentioned in article 1(2)(e) of Directive 2002/47/EC, but has included traders (i.e. companies and cooperations) and excluded natural persons, single merchants and civil partnerships.

[79] For more details on the FCAA see for example*'Financial collateral'*, Prof. Angel Kalaidjiev, Commercial law, issue 4/2007, pages 5-25; '*Contractual law*', Prof. Angel Kalaidjiev, 7th edition, Sibi 2016, pages 745 – 775; the studies by Ivan Mangachev in Commercial and Competition Law, issues 5 (pages 53-60), 10 (pages 34-37) and 11 (pages 26-30) of 2008, as well as the books by Ivan Mangachev '*Financial collateral arrangements*' (Ciela 2009) and '*The new legal regime of the financial collateral arrangements*' (Ciela 2011).

Therefore, if parties to a transaction which qualifies as a financial collateral arrangement under the FCAA (see the discussion in (iv) below for more details) are a 'special' entity / institution under any of the above items (a) to (p) and a company (for instance, an electricity trading company, registered in Bulgaria or in Germany), the special rules under the FCAA shall apply in respect of this transaction, including concerning close-out netting and beneficial treatment in case of insolvency proceedings. If parties to such a transaction are two 'ordinary' companies (i.e. companies which do not fall under any of the definitions under the above items (a) to (p) – for instance two energy trading companies), then the special treatment under the FCAA will **not** apply in respect of this transaction.

(ii) Close-out netting

Under article 10(2) of the FCAA, a close-out netting provision is a provision of a financial collateral arrangement, or, in absence of such provision, any statutory rule[80], by which, in case of non-performance[81]:

- the obligations of the parties become immediately due and transform into obligations to pay an amount representing their estimated current[82] value, or are terminated and replaced by an obligation to pay such an amount; and/or
- the obligations of the parties are redeemed up to the amount of the smaller obligation[83], where the party owing the larger amount remains debtor to the other party for the net sum equal to the balance of the account.

A close-out netting provision shall apply notwithstanding:

- the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider and/or the collateral taker (the definitions of winding-up proceedings or reorganisation measures (article 14) also comply with Directive 2002/47/EC; in the definition of winding-up procedures are explicitly included the insolvency proceedings and the liquidations proceedings (voluntary or compulsory); it is further explicitly stated that the rules apply to all winding-up proceedings or reorganisation measures, regardless of the territory of the state where they are being carried out); and/or
- any purported assignment (transfer) of the financial collateral, other disposition of it or attachment in respect of it.

The legal doctrine underlines that the effect of the close-out netting occurs **automatically** (*ipso iure*), without a statement by any of the Parties to be necessary (in contrast to the set-off under the OCA).

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[80] We are not aware of a statutory rule under Bulgarian law regulating the *ex lege* close-out netting.

[81] 'Non-performance' is the non-performance of a financial obligation or any event as agreed between the parties or stipulated by a law which is made equal to non-performance.

[82] Which value is current is a matter which is decided with a view to each concrete case ('*Contractual law*', Prof. Angel Kalaidjiev, Sibi 2016, page 766).

[83] The wording is taken from the definition of set-off under the OCA.

Therefore, Art.10(2) of the FCAA provides an exemption from the "cherry-picking right" of the insolvency receiver for qualifying transactions (financial collateral arrangements; see also the discussion in (iv) below for more details) between qualifying parties (broadly speaking, one party needs to be a financial institution).

(iii) Insolvency proceedings and financial collateral arrangements

In case of winding-up proceedings in respect of the collateral provider, the collateral taker shall retain the rights to realise the financial collateral.

A financial collateral arrangement, as well as the provision of financial collateral under such arrangement, may not be declared invalid, void or voidable or be reversed or terminated on the sole basis that the financial collateral arrangement has come into existence, or the financial collateral has been provided:

- on the day of the commencement of winding-up proceedings or reorganization measures, but prior to the order or decree making that commencement (derogation of the 'zero hour principle'[84]); or
- in a legally prescribed period prior to, and defined by reference to, the commencement of such winding-up proceedings or reorganization measures or by reference to the making of any order or decree or the taking of any other action or occurrence of any other event in the course of such winding-up proceedings or reorganization measures (i.e. the financial collateral arrangement and the provision of financial collateral may not be challenged only on the ground that they have been entered into / provided within the 'suspect period').

Where a financial collateral arrangement or a relevant financial obligation has come into existence, or financial collateral has been provided on the day of, but **after** the moment of the commencement of, winding-up proceedings or reorganization measures, it shall be legally enforceable and binding on third parties if the collateral taker can prove (i.e. the burden of proof is for the collateral taker) that he was not aware, nor should have been aware, of the commencement of such winding-up proceedings or reorganization measures.

The right of or the obligation for provision of financial collateral, additional financial collateral or substitute or replacement financial collateral shall not be treated as or declared invalid, void or voidable or reversed or terminated on the sole basis of the provisions of the next paragraph, where a financial collateral arrangement contains:

- an obligation to provide financial collateral;
- an obligation to provide additional financial collateral in order to take account of changes in the value of the financial collateral or in the amount of the relevant financial obligations, or
- a right to withdraw financial collateral on providing financial collateral of substantially the same value.

[84] According to article 634a of the Commerce Act, insolvency proceedings shall be deemed instituted as of the date of the judgement on opening of such proceedings and in case certain actions have been performed on this date, they shall be presumed as effected **after** the institution of the insolvency proceedings.

The following shall not be the basis for a financial collateral arrangement to be treated as or declared invalid, void or voidable or reversed or terminated:

- the provision or substitution being made on the day of the commencement of winding-up proceedings or reorganization measures, but prior to the order or judgement making that commencement;
- the provision or substitution being made in a legally prescribed period prior to, and defined by reference to, the commencement of winding-up proceedings or reorganization measures or by reference to the making of any order or decree or the taking of any other action or occurrence of any other event in the course of such winding-up proceedings or reorganization measures (i.e. within the 'suspect period'), or
- the relevant financial obligations being incurred prior to the date of the provision of the financial collateral, additional financial collateral or substitute or replacement financial collateral.

It deserves mentioning that in the last years the financial collateral arrangements have started to be used in Bulgarian commercial practices due to the advantages they offer to the credit and financial institutions as collateral takers compared to other collateral.

(iv) The FCAA and the Credit Support Annex (**CSA**)

A question is posed whether the CSA would qualify as a financial collateral arrangement under the FCAA.

The first precondition, as discussed above, is to have two qualifying parties to the General Agreement and to the CSA (broadly speaking, one party needs to be a financial institution).

Having two qualifying parties, however, is not sufficient, the Eligible Credit Support under the CSA should qualify as financial collateral within the meaning of the FCAA and Directive 2002/47/EC.

Under the FCAA, financial collateral shall be money claims (Directive 2002/47/EC uses 'cash'), financial instruments and credit claims which, under a financial collateral arrangement, are used to secure the performance of certain financial obligations.

Under the CSA, Eligible Credit Support shall be either (a) Cash or a (b) Letter of Credit. The two collaterals are commented consequently below:

(a) Cash

Definition under the CSA: an amount of money in the Base Currency or any Eligible Currency.

Definition under Directive 2002/47/EC: money credited to an account in any currency, or similar claims for the repayment of money, such as money market deposits.

Definition under the FCAA – instead of 'cash', the law uses the term 'money claims': Money claims shall be any money credited to an account in any currency, or similar claims for the repayment of money, such as money market deposits. Money in cash shall not be money claims within the meaning of this Act.

At the first glance, it seems that the Cash under the CSA does not qualify as financial collateral within the meaning of the FCAA.

However, when excluding money in cash from the scope of the Act, the legislator has meant money in cash not in a bank account. Arguments supporting this conclusion can be derived for example from article 5(2) of the FCAA according to which '*Money claims shall be deemed provided as of the moment when the cash collateral has been credited to, or forms a credit in, the designated account with a bank'*.

Therefore, it is rather to be concluded that the Cash under the CSA qualifies as financial collateral within the meaning of the FCAA and that thus the CSA qualifies as a financial collateral arrangement under the FCAA – with regard to the Eligible Credit Support in the form of Cash.

(b) Letter of Credit

Definition under the CSA: a standby letter of credit, bank guarantee or similar document in a format acceptable to the Transferee denominated in the Base Currency or an Eligible Currency issued irrevocably by a leading commercial bank with a credit rating of at least A- from Standard & Poor's Rating Group or A3 by Moody's Investors Services, Inc. which obliges the bank to pay the amount guaranteed therein upon first demand of the Transferee.

Neither Directive 2002/47/EC nor the FCAA refer to a letter of credit, to a bank guarantee or to a similar document. The letter of credit does not qualify as either financial instrument (any materialized or book entry securities) nor as a credit claim (pecuniary claims arising out of an agreement whereby a credit institution grants credit in the form of a loan).

Therefore, the Letter of Credit does **not** qualify as financial collateral within the meaning of the FCAA and the CSA does not qualify as a financial collateral arrangement under the FCAA with regard to the Eligible Credit Support in the form of Letter of Credit.

If additional certainty is sought that the FCAA would apply in the relations between the two qualifying parties, it would be recommendable (aa) to include a specific reference to the FCAA in the CSA (in case of applicable Bulgarian law) and (bb) to exclude the Letter of Credit from the Eligible Credit Support (i.e. to limit the ECS to Cash only).

Of course, any other Eligible Credit Support agreed in any of the forms of financial collateral under the FCAA is permissible and should qualify the CSA as financial collateral arrangement.

Therefore, in a scenario in which a foreign bank enters into a General Agreement plus a CSA with a Bulgarian electricity/gas company, and both exchange cash as collateral, Art. 10(2) of the FCAA would protect the contractually agreed close-out netting. Of course, it has always to be kept in mind that the Bulgarian market is for the time being only at a stage where mainly physical electricity/gas is traded between classical energy companies (and EFET CSAs are not very wide-spread either). The Bulgarian market is still far from developing sophisticated derivatives instruments which banks would require to hedge any physical positions they take.

(v) In August 2015 the FCAA was amended to reflect the implementing into Bulgarian law of the Bank Recovery and Resolution Directive which was done by the Act on Recovery and Resolution of Credit Institutions and Investment Intermediaries. According to Art. 16(2) FCAA, the rules dealing with the close-out netting and the realisation of the financial collateral shall **not** apply to any restriction on the enforcement of financial collateral arrangements or any restriction on the effect of a security financial collateral arrangement, any close-out netting or set-off provision that is imposed by virtue of Chapters XV or XVI of Act on Recovery and Resolution of Credit Institutions and Investment Intermediaries, or to any such restriction that is imposed by virtue of similar powers in the law of an EU Member State to facilitate the orderly resolution of any entity referred to in the above item 1.1.6(i), points (f) and (o) which is subject to safeguards at least equivalent to those set out in Chapter XVII of the Act on Recovery and Resolution of Credit Institutions and Investment Intermediaries (compare with Art.1(6) of Directive 2002/47/EC).

1.1.7. Public Offering of Securities Act (**POSA**) and Markets in Financial Instruments Act (**MiFIA**)

The POSA does not provide for special separate insolvency procedural rules in respect of the entities regulated by it – public companies. Therefore, the general insolvency rules stated in the Commerce Act (Part IV) shall be respectively applied (see the above item 1.1.1), or, if any of the public companies is also a bank – the rules under the Bank Insolvency Act (see the above item 1.1.2.1).

With the adoption of the aforementioned new Act on Recovery and Resolution of Credit Institutions and Investment Intermediaries ('**ARRCIII**', published in State Gazette 62 of 14 August 2015, last amendments published in State Gazette 8/25.01.2023) implementing into Bulgarian law the Bank Recovery and Resolution Directive (Directive 2014/59/EU), some additional safeguard provisions in case of undertaken measures for (i) prevention of insolvency or, (ii) when insolvency occurs, for minimising the negative repercussions by preserving the systemically important functions of credit institutions and investment intermediaries have been provided in Bulgarian legislation. Art. 109 of the ARRCIII implements the safeguard provisions of Art. 77 of Directive 2014/59/EU and stipulates that the respective Bulgarian authority when executing the recovering or resolution measures (i) shall not be authorized to transfer some, but not all, of the rights and liabilities that are protected under a title transfer financial collateral arrangement, a set-off arrangement or a netting arrangement if the parties to the arrangement are entitled to set-off or net those rights and liabilities and (ii) shall not have the right of modification or termination of such rights and liabilities.

With regard to the implementation of the provisions of Directive 2014/59/EU, the Credit Institutions Act was respectively amended and supplemented. Respective provisions were envisaged in the MiFIA (effective as of 16.02.2018) as well. For example, Art. 145 of MiFIA and Art. 144 of the Credit Institutions Act provide that the execution of recovering measures or opening of winding-up procedure for an investment intermediary, respectively for a bank, shall not affect the rights of its creditors to set-off when the law applicable to the investment intermediary's/bank's claim allows the set-off. As per Art. 146 of MiFIA and Art. 145 of Credit Institutions Act, in case of execution of recovering measures or opening of winding-up procedure for an investment intermediary, respectively for a bank, regarding the netting arrangements the applicable law shall be the law applicable to the netting agreement providing such netting arrangements.

1.1.8. **Please clarify whether or not there is a distinction in time with respect to a creditor's rights between:**

(a) the filing of proceedings seeking a judgment of insolvency

(i) As stated in the above item 1.1.1**(i)**, the pre-conditions for opening of insolvency proceedings against a trader are:

(a) inability to pay debts, or

(b) over-indebtedness (in case of a private limited company, public limited company or a partnership limited by shares).

The court shall assess on the grounds of the collected evidence whether the necessary pre-conditions for opening of the insolvency proceedings are available. In contrast to ordinary civil proceedings, the insolvency court has the power to collect evidence on its own motion (*ex officio)*.

(ii) The court shall open a case under the filed petition on the day the petition was filed and shall pass a judgement after **four months** at the latest. This term may be longer (depending on the particular case and its complexity), because it is merely instructive and not binding for the court (from our practical experience we would rather say that this term is approx. 8 months, and in more complicated cases it can be even longer).

(iii) If the court decides that there is no sufficient proof that the debtor is unable to pay his debts or if the debtor's difficulties have temporary nature or if the debtor has sufficient assets to cover his debts without the creditors' interests to be endangered, the court rejects the petition by a judgement.

As from 2003 there is a special provision in the Commerce Act (article 631a) stating that if the judgement on rejection of the creditor's petition on opening of insolvency proceedings has entered into force, the debtor has the right to claim compensation, if the creditor has acted intentionally or with gross negligence. The compensation encompasses all direct material (property) and immaterial (non-property) damages[85]. Immaterial damages are determined by the court in accordance with principles of justice.

The idea of this new provision was to reduce the abuses of creditors' right to request from the competent court opening of insolvency proceedings against their debtors.

Creditors' rights: The petition on opening of insolvency proceedings may be filed *inter alia* by a creditor of the debtor. The petition is not published on the Commercial Register's

[85] This was a revolutionary legislative amendment since according to the court practice legal entities shall not have the right to claim compensation for immaterial (moral) damages. This court practice changed in the last years.

webpage (in contrast to the petition filed by the debtor himself). However, information about the filed petition can be found on the internet site of the respective district court at the debtor's registered office, and also in the online insolvency information system with the Ministry of Justice (https://ispn.mjs.bg/mj/ispn.nsf/indexPublic.xsp?page=searchDeb). If other creditors succeed in obtaining information about the petition, they may file petitions as well and be constituted as parties to the proceedings. They have this right until the first court hearing in the proceedings is over.

At this stage (prior to the judgement regarding the filed petition to be taken by the court, see next item (b)) the debtor is neither unable to pay its debts / over-indebted, nor insolvent, i.e. all the restrictions applicable to the debtor, its activity and its creditors after the court judgement on opening of the insolvency proceedings are not applicable yet.

An exception is provided by the law only in case of imposing by the court of preliminary (i.e. prior to the judgement on opening of the insolvency proceedings) security measures under Art. 629a of the Commerce Act. The purpose of these measures is to preserve the debtor's assets (in general, the court may impose all measures which it finds appropriate for the achievement of the said purpose – e.g. appointment of a temporary receiver still at this stage of the proceedings, freezing of accounts, etc.) and they may be imposed upon request of a creditor or *ex officio* by the court.

(b) a bankruptcy court recognizing the filing of proceedings seeking a judgment of insolvency

(i) Our understanding is that here the judgement on opening of the insolvency proceedings is meant.

If the court comes to the conclusion that the debtor is unable to pay its debts or is over-indebted, the court shall pass a judgement by which it *inter alia* declares the debtor's inability to pay its debts, respectively the debtor's over indebtedness, and determines their initial (commencement) date and opens the insolvency proceedings (see also the above item 1.1.1**(i)**). By the same judgement the court imposes security measures with the purpose to preserve the insolvency estate and appoints a temporary receiver.

The declaring of the debtor insolvent comes in principle at a later stage - if no composition plan has been proposed within the legally prescribed term, or if the proposed plan has not been approved or confirmed, or if it is evident that the debtor's activity would prejudice the insolvency estate, or in case of reopening of the insolvency proceedings (see also the above item 1.1.1**(vi)**).

If, however, it is evident that the continuation of the debtor's activity would prejudice the insolvency estate, the court may upon request of the debtor, the liquidator, the insolvency receiver, a creditor or the National Revenue Agency declare the debtor insolvent and terminate its activity by the same judgement on opening of the insolvency proceedings.

(ii) As mentioned above, the debtor continues its activity under the supervision of the insolvency receiver. It may enter into new transactions only with the receiver's preliminary consent.

If the court comes to the conclusion that with its actions the debtor threatens the creditors' interest, the court may deprive the debtor of the right to manage and dispose of its assets and to render this right to the insolvency receiver.

Performance of obligations towards the debtor may only be made against the insolvency receiver.

(iii) The judgement on opening of insolvency proceedings shall be published in the electronic on-line based Commercial Register and may be appealed within 7 days as from having been published.

Creditors' rights: The insolvency proceedings shall be deemed opened on the date of the judgement on opening of the proceedings; if certain actions (e.g. payment of obligations to the debtor) are committed on this date, they are deemed to be done **after** the institution of the insolvency proceedings.

As from the date of the judgement on opening of the insolvency proceedings all the restrictions to the debtor, its activity and its creditors envisaged by the Commerce Act become applicable. Certain actions committed after this date or within certain term before this date are null and void with respect to the insolvency creditors (e.g. performance of an obligation that has occurred prior to the date of the judgement for institution of the insolvency proceedings and is effected after the date of the judgement and not in compliance with the procedure established thereby; for more details see the above item 1.1.1**(ii)** and in particular the comments on Art. 645 of the Commerce Act regulating the permissibility of the insolvency set-off).

The creditors may submit their claims to the insolvency court within certain term as from the date of the publication of the judgement for institution of the insolvency proceedings (for more details see item (d) below). This is the first act in the insolvency proceedings to be published on the webpage of the Commercial Register (except for the cases of imposed preliminary security measures under Art. 629a of the Commerce Act – see the above item 1.1.8**(a)**(iii), final paragraph).

(c) the date on which a bankruptcy court determines a party first becomes insolvent

Our understanding is that here the initial date is meant when the party became unable to pay its debts (*Zahlungsunfähigkeit* in German), or became over-indebted (*Überschuldung* in German) (and not the court's judgement on declaring the insolvency (bankruptcy, *Insolvenz* in German).

Creditors' rights: As stated above (see item 1.1.1**(i)**), the court has the almost unrestricted right on its own motion (based on the evidence collected, of course) to fix this date by its judgement on opening of the insolvency proceedings. There is no legal limit in the Commerce Act how long backward in time this date may be fixed. This lead to problems and uncertainty in practice with a view to the possibility some transactions concluded and payments made within the 'suspect period' (i.e. after the date determined by the court on which the debtor became unable to pay its debts) to be challenged by the insolvency receiver, respectively by the creditors of the debtor. That is why in February 2013 rules were introduced into the Commerce Act that limited the date back in time until which certain transactions can be challenged as null and void (for more details see above item 1.1.1**(ii)**).

(d) any other stage of the proceedings where a creditor's rights may be affected.

A. Most important with a view to creditor's interests and rights is the procedure for lodging of claims and their admittance by the insolvency receiver and approval by the insolvency court (see also the above item 1.1.1**(iv)**).

(i) Creditors must submit their claims in writing to the insolvency court within one month as from publishing in the electronic on-line based Commercial Register of the judgement for institution of the insolvency proceedings. Creditors have to point out their claims, the claim's ground and amount, the privileges and securities and to provide written evidence thereof. If any creditor fails to comply with the one-month term, he still has the possibility to file his claim, not later, however, than two months after its expiry. After expiry of this additional term claims which have occurred by the date of opening of the insolvency proceedings may not be lodged.

(ii) With the submission of a claim the statutory limitation period (*Verjährung* in German) for this claim is suspended and stops running until the insolvency proceedings last.

(iii) Within 7 days as from expiry of the above one-month term the insolvency receiver prepares the list of the accepted claims and a list of the submitted but not accepted claims. These documents are presented by the receiver at the clerk's office with the insolvency court and published in the Commercial Register.

(iv) Within 7 days as from the publication under the preceding item the debtor or any creditor may challenge any accepted or not accepted claim. The challenge shall be made in writing and filed to the insolvency court with a copy to the receiver. The court examines the challenges in an open hearing. If the court deems that the challenges are justifiable, it adapts the list respectively.

(v) The court approves the list of the accepted claims by a ruling which is published on the webpage of the Commercial Register.

(vi) The creditors who have challenged the acceptance or non-acceptance of a claim, but their challenges have been rejected by the court, still have the possibility to file a claim for ascertaining the existence of a not accepted claim or the non-existence of an accepted claim within 14 days as from the publication of the ruling for approval of the list of the accepted claims in the Commercial Register.

B. The next significant moment with a view to a creditor's rights in the insolvency proceedings is the distribution of the debtor's assets converted into cash (see also the above item 1.1.1**(vii)**).

(i) The distribution of the debtor's assets converted into cash is made by the insolvency receiver. The receiver prepares an account for the distribution of the available amounts among the creditors with claims according to article 722(1) of the Commerce Act in conformity with the order, the privileges and the securities of the claims. The account is to be approved by a ruling of the insolvency court which is published on the webpage of the Commercial Register.

(ii) Under article 722(1) of the Commerce Act the order and priority for satisfaction of the claims are the following:

(a) Claims with special privileges:

- claims secured by a pledge or mortgage, or distraint or attachment registered in pursuance of the procedure under the Special Pledges Act – out of the proceeds of the realized security (e.g. of the sale by the receiver of a mortgaged real estate);
- claims with regard to which retention right is exercised – out of the proceeds of the sale by the receiver of the property over which the retention right is exercised.

(b) Claims with general privileges:

- costs related to the insolvency proceedings (state fees, receiver's remuneration, debtor's employees' remunerations if the company has not ceased its activity, costs related to complementing, management, evaluation and distribution of the insolvency estate);
- claims deriving from employment contracts;
- alimony (maintenance) claims;
- public law claims of the State and the municipalities (such as taxes, customs duties, fees, obligatory social security contributions) which have emerged prior to the date of the judgement on opening of insolvency proceedings;
- claims which have emerged after the date of the judgement on opening of insolvency proceedings and have not been paid when due.

(c) Other claims:

- any remaining unsecured claims that have occurred prior to the date of the judgement on opening of insolvency proceedings;
- claims under article 616(2), items 1 to 4 of the Commerce Act.

(iii) If the cash funds are insufficient to fully satisfy the claims of the creditors under the above items (b) and (c), the claims are satisfied as per the above order where creditors of one rank are paid pro rata in accordance with the amount of their claim.

(iv) If the proceeds of the sale of the mortgaged or pledged assets or the assets over which retention right is exercised are insufficient to fully satisfy the claims of the respective creditors and the interest accrued thereon, these creditors will be treated as unsecured creditors for the rest of their claims (item (c), first dash).

1.1.9. **We would also like to know whether there is publicly available information that would confirm any of the procedural steps mentioned above under (a) through (d) or other solvency related facts (e.g., financial statements, corporate actions, etc.).**

(i) As mentioned, as from 1 January 2008 in Bulgaria functions a new Commercial Register system which is on-line based and guarantees a high degree of transparency (until 1 January 2011 all existing companies registered in the old Commercial Register maintained by the district courts at the seat of these companies had to be re-registered in the new electronic Commercial Register). All important acts of the court (judgements, rulings) in insolvency proceedings are subject to publication in the electronic Commercial Register. The first act in the insolvency proceedings to be published on the webpage of the Commercial Register is the judgement on opening of these proceedings (step 1.1.8**(b)** above).

An exception from this rule occurs on the appointment of a temporary receiver (i.e. after the submission of the petition on institution of insolvency proceedings but before the court's judgement regarding this petition). The appointment of a temporary receiver is one of the preliminary security measures under article 629a of the Commerce Act which may be imposed by the court for safeguarding the debtor's assets and is subject to publication on the webpage of the Commercial Register.

We have commented above where an act of the court is subject to publication in the Commercial Register.

(ii) A possible source of information for the other creditors (different from the creditor who has filed the petition seeking a judgment of insolvency) to receive information about the filed petition at an earlier stage (i.e., after the filing of the petition) is the so called E-Justice Portal and the internet site of the respective district court at the debtor's registered office (which site is part of the said Portal), and also the online insolvency information system with the Ministry of Justice (https://ispn.mjs.bg/mj/ispn.nsf/indexPublic.xsp?page=searchDeb).

(iii) Apart from that, any circumstances which require a registration in the Commercial Register from corporate law viewpoint can be checked by everybody on the webpage of the Commercial Register (there are published not only the mere registered circumstances, but also scanned copies of all underlying documents – such as corporate resolutions, etc.).

(iv) The annual financial statements of the companies for the preceding year must be published in the Commercial Register until 30 September of the current year (there is a sanction provided by the law if they fail to do so).

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Appendix A

Types of Counterparties

Corporations (e.g., limited liability companies or stock corporations)

Partnerships (e.g., general or limited partnerships)

Banks/Credit Institutions

Investment Services Provider/Investment Firms

Insurance Companies

Investment Fund Management Companies

other Financial Institution

Municipalities or Counties

Associations of Local Government

Publicly-owned Corporations

Quasi Governmental Entities.

Appendix B

Transactions under the EFET General Agreement

Commodity Forward. A transaction in which one party agrees to purchase a specified quantity of a Commodity at a future date at an agreed price and the other party agrees to pay a price for the same quantity to be set on a specified date in the future. The payment calculation is based on the quantity of the Commodity and is settled based, among other things, on the difference between the agreed forward price and the prevailing market price at the time of settlement.

Commodity Option. A transaction in which one party grants to the other party (in consideration for a premium payment) the right, but not the obligation, to purchase (in the case of a call) or sell (in the case of a put) a specified quantity of a Commodity at a specified strike price. The option can be settled either by physically delivering the quantity of the Commodity in exchange for the strike price or by cash settling the option, in which case the seller of the option would pay to the buyer the difference between the market price of that quantity of the Commodity on the exercise date and the strike price.

Commodity Swap. A transaction in which one party pays periodic amounts of a given currency based on a fixed price and the other party pays periodic amounts of the same currency based on the price of a Commodity or an exchange-traded futures contract on a Commodity (e.g., the EEX EU Carbon Future); all calculations are based on a notional quantity of the commodity.

Physical Commodity Transaction. A transaction which provides for the purchase of an amount of a Commodity at a fixed or floating price for actual delivery on one or more dates.

“Commodity” means electricity, natural gas, emissions allowances, (green) certificates or capacity rights.