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The International Comparative Legal Guide to:
Corporate Governance 2011

A practical cross-border insight to corporate governance

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Global Legal Group Ltd.
59 Tanner Street
London SE1 3PL, UK
Tel: +44 20 7367 0720
Fax: +44 20 7407 5255
Email: info@glgroup.co.uk
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Georgiev, Todorov & Co.

Alexander Katzarsky

1 Setting the Scene - Sources and Overview

1.1 What are the main corporate entities to be discussed?

The main corporate entities discussed in this overview are Private Joint-Stock Companies and Public (Stock-Exchange Listed) Joint-Stock Companies.

1.2 What are the main legislative, regulatory and other corporate governance sources?

The sources of corporate governance in Bulgaria can be classified into two categories:

I. Regulatory Sources:

1. The Commercial Act

   The Commercial Act applies to any Bulgarian company, whether privately held or listed on the stock exchange. This act regulates all general issues regarding the company, e.g., the relations shareholders *vis-a-vis* the company, the company *vis-a-vis* the board and the shareholders *vis-a-vis* the board. It also governs the power of the General Meeting and the boards, and the management system specifics - one or two-tier systems of governance, procedures regarding the convention of the annual and extraordinary General Meeting, etc.

   Particularly the following chapters apply:

   Chapter 10 containing general rules applicable for all types of company, among them the most important related to some aspects of the incorporation of a company.

   Chapter 14 named "Stock Company" which contains detailed regulations regarding the Private Join-Stock Company, partially applicable for the Public Joint-Stock Company too, unless there are mandatory provisions in the Public Offering of Securities Act.

2. The Public Offering of Securities Act

   This Act provides specific rules for incorporation, management and corporate governance of the Public Joint-Stock Company.

3. The National Code for Corporate Governance

   The Code is, by its nature, a standard for good practice. It provides companies with a framework for corporate management and control. The Code applies to Bulgarian public joint-stock companies according to the "comply or explain" principle. This principle is espoused by all corporate governance codes adopted by EU Member-States. It means that companies should comply with the Code, and if they do not, the company or its corporate board must explain and disclose the reasons for non-compliance.

   Following the principles of the Code is one of the requirements for admission to trading on the official market of securities. The requirement is set as a criterion for the level of the corporate governance and culture of the companies that are admitted to trading to the highest tiers of the Bulgarian Stock Exchange-Sofia.

   Moreover, unlisted companies are also advised to comply with the Code.

II. Non-regulatory Sources:

1. By-laws of the company (Statute)

   These contain provisions regarding the scope of business activity of the company, the amount of capital, the types of shares and specific rights for particular class of shares, if any, the system of corporate governance etc. It is published in the Company Register.

2. Rules and Procedures/Charter of the Board of the company

   This act is not compulsory but, if adopted, it regulates the special requirements regarding convention of the Management Board, Board of Directors and the Supervisory Board, such as invitations, absences, restriction of the power of the board for particular transactions above certain value etc.

1.3 What are the current topical issues, developments and trends in corporate governance?

As far as the implementation of the EU Law has been successfully completed recently, there are no pressing tasks for the development of the legislation. In practice, attempts for the application of the National Code for Corporate Governance by Private Joint-Stock Companies are implemented.

2 Shareholders

2.1 What rights and powers do shareholders have in the operation and management of the corporate entity/entities?

The main characteristic of the Joint-Stock Company is the limited power of the General Meeting concerning the management of the company. Apart from that principle, there are such categories of decision and actions which are of vital importance to the company and could be taken by the management only after special resolution of the General Meeting, usually with majority of more than 50% (art. 221 of the Commercial Act). This constitutes specific shareholder rights, which are classified as non-pecuniary rights. The non-pecuniary rights consist of several groups of rights,

divided by the legal doctrine as follows:

Management rights

Each shareholder has the following rights:

- to participate at the General Meeting, to express his opinion and to demand answers to his questions by the members of the boards;
- to vote at the General Meeting. The principle is that each share has one vote, unless otherwise agreed in the Statute. In particular cases when conflict of interest arises, this right is restricted (art. 229 of the Commercial Act); and
- to vote and to be elected as a member of the boards.

Control rights

They concern mainly the right of information about the status and the activity of the company. This category consists of, but is not limited to, the shareholders' rights described below:

- to be provided with access to or to receive at least 30 days before the date of the General Meeting the materials subject to discussions, according to the agenda (art. 224 of the Commercial Act);
- to receive a copy of the minutes of the General Meeting (art. 232, par. 5 of the Commercial Act); and
- to ask questions at a General Meeting of shareholders (not necessarily related to the agenda) to the board members regarding the economic and financial situation of the company and its commercial activity, the members being obliged to answer correctly, and exhaustively unless for issues considered inside information (art. 115, par. 11 of the Public Offering of Securities Act).

Minority shareholders' rights

These rights belong to a shareholder/group of shareholders who own at least 5% of the capital of the company since a date not later than 3 months before the date of the General Meeting:

- to convene a General Meeting (art. 223, par. 2 of the Commercial Act);
- to enlist questions to the agenda of the General Meeting (art. 223a of the Commercial Act);
- right of a shareholder/group of shareholders who own at least 10% of the capital of the company (5% for a Public Joint-Stock Company) to bring an action against member/s of the board for damage caused to the company by them ("action *pro socio*" or "derivative suit") – art. 240a of the Commercial Act; art. 118, par. 2, item 1 of the Public Offering of Securities Act; and
- right of a shareholder/group of shareholders who own at least 10% of the capital of the company (5% for a Public Joint-Stock Company) to ask the boards or the court to appoint an auditor for revision of the Annual Financial Report of the company (art. 251a of the Commercial Act and art. 118, par. 2, point 1 of the Public Offering of Securities Act).

2.2 Can shareholders be liable for acts or omissions of the corporate entity/entities?

Generally, shareholders cannot be liable for acts or omissions of the company. The "Piercing the Corporate Veil" doctrine is not adopted by the Bulgarian legislation.

However, as regards a Public Joint-Stock Company, in art. 118a of the Public Offering of Securities Act it is provided that liability for damage caused to the company by person/s or company/ies who controls the Public Joint-Stock Company, or every other entity which by its influence on the Public Company caused an act or omission by the members of the board, if this decision/act/omission is not in the interest of the company. In this case, the person or entity is jointly liable with the member of the board who took the action or failed to do so.

2.3 Can shareholders be disenfranchised?

In principle it is not possible. A shareholder is not entitled to vote in one case provided in the Public Offering of Securities Act.

Transactions with interested or related parties at a value more than 2% of the company's assets are subject to preliminary authorisation by the General Meeting pursuant to art. 114, par. 1, letter "b" of the Public Offering of Securities Act, the respective shareholder being disenfranchised.

2.4 Can shareholders seek enforcement action against members of the management body?

Yes, the "derivative suit" is provided for such purpose, both for shareholders in Private and in Public Joint-Stock Companies. This issue is governed by the provisions of art. 240a of the Commercial Act (for Private Joint-Stock Companies) and of art. 118, par. 2, point 1 of the Law for Public Offering of Securities (for Public Joint-Stock Companies), see question 2.1 for more details.

The main peculiarity of this suit is that by bringing the action, shareholders act not on their own behalf, but on behalf of the company and the aim of the claim is all damages to be paid to the company.

2.5 Are there any limitations on, and disclosures required, in relation to interests in securities held by shareholders in the corporate entity/entities?

Regarding shareholders in Private Joint-Stock Companies there is an obligation for shareholders with registered shares to be registered in the company book (art. 179 of the Commercial Act). No limitations concerning acquisition of shares are established.

As regards a Public Joint-Stock Company - provisions of the Public Offering of Securities Act apply (art. 145) and anticipate disclosure of circumstances such as:

- Acquisition or disposal of shares by shareholders when the total amount of these shares represents 5% of the voting rights at the General Meeting, either more than 5%, or the amount is divisible by 5. In this hypothesis the shareholder is obliged to inform both the company and the Financial Supervision Commission.
- Transactions with interested or related parties at a value less than 2% of the company's assets are subject to preliminary authorisation by the board of the company, according to art. 114, par. 2 of the Public Offering of Securities Act.
- Transactions with interested or related parties at a value more than 2% of the company's assets are subject to preliminary authorisation by the General Meeting pursuant to art. 114, par. 1, letter "b" of the Public Offering of Securities Act, the respective shareholder being disenfranchised.

2.6 What shareholder meetings are commonly held and what rights do shareholders have as regards them?

There are two types of General Meetings – annual General Meeting and special (extraordinary) General Meeting. The annual General Meeting must be held during the first six months of the calendar year at the headquarters of the company, according to art. 222 of the Commercial Act and art.115 of the Public Offering of Securities Act (unless otherwise agreed for Private Joint-Stock Companies but on

the territory of Republic of Bulgaria, pursuant to art. 222 of the Commercial Act).

The special (extraordinary) General Meeting takes place when special circumstances occur (e.g. art. 222, par. 3 of the Commercial Act) or when it is convened by authorised persons at their own discretion (art. 223 of the Commercial Act).

The rights of the shareholders are described in question 2.1.

3 Management Body and Management

3.1 Who manages the corporate entity/entities and how?

There are two systems of corporate management and the incorporators of the company could choose one of the following in the Statute:

- One-tier system (Board of Directors)

Where the company is represented and managed entirely by the Board of Directors.

- Two-tier system (Management Board and Supervisory Board)

Where the company is represented and managed by the Management Board but the actions and resolutions of the Management Board are controlled by the Supervisory Board.

At least one-third of the members of the Board of Directors/Management Board of Public joint-stock company should be independent members (art. 116a, par. 2 of the Law for Public Offering of Securities provides a definition of the term "independent member"). In addition, a director for communication with the investors should be appointed.

3.2 How are members of the management body appointed and removed?

The members of the Board of Directors (3 to 9 members) are appointed and removed by the General Meeting. They elect among them a chairman, a vice-chairman, and one or more executive members.

The members of Management Board (3 to 9 members) are appointed and removed by the Supervisory Board whose members (3 to 7) are appointed and removed by the General Meeting. The legal relations between the members of the Management Board and the company are governed by management contract and signed by the chairman of the Supervisory Board on behalf of the company. The rights and obligations of the members of the Supervisory Board are settled in contract.

3.3 What are the main legislative, regulatory and other sources impacting on contracts and remuneration of members of the management body?

The Obligations and Contracts Act is the main source of provisions regarding the contracts executed between the company and the members of the boards.

There are also certain relevant rules in the Commercial Act and the Public Offering of Securities Act.

3.4 What are the limitations on, and what disclosure is required in relation to, interests in securities held by members of the management body in the corporate entity/entities?

Disclosures:

The members of the boards of both the Private and the Public Joint-Stock Companies are required to declare before their appointment the ownership of more than 25% of the capital of other companies. When shares above this limit are acquired during the tenure of the member, an immediate written notification to the company is required.

The members of the boards of the Public Joint-Stock Company are obliged in addition to the described above to declare in front of the company and the Financial Supervision Commission circumstances described in art. 114b of the Public Offering of Securities Act such as current or forthcoming transactions in which they could be interested parties (art. 114b, point 3). Other obligations of the members are required in the subordinate legislation acted by the Financial Supervision Commission.

Limitations:

As regards Public Joint-Stock Company, the limitations described in question 2.5 apply when the members of the boards are shareholders. The general rule, set forth in art. 238, par. 4 of the Commercial Act and applicable for Private and Public Joint-Stock Companies, provides that the members of the board are obliged to notify the chairman of the board in written form not later than the beginning of the board meeting regarding the fact that they or a third party related to them is interested in the resolution subject to discussion in the agenda. Such members do not participate in the decision-making process in question.

The members of the board are also obliged to notify in written form the boards when they or a third party related to them form a contract with the company and its subject-matter is beyond the scope of the ordinary business activity of the company (art. 240b of the Commercial Act). These contracts are formed following a resolution of the Board of Directors or the Management Board. This transaction is binding and valid even if a special resolution was not taken, but the board member who knew or ought to have concluded about it is liable for damage caused to the company.

3.5 What is the process for meetings of members of the management body?

The process for board meetings is governed by The Commercial Act (art. 238 and 239) and by the Statute of the company and its Rules and Procedures. The requirement for quorum in the provision of art. 238 provides that at least half of the board members should attend or should be represented by another member of the board. The resolutions are taken with "ordinary majority" (more than half of the members) unless otherwise agreed in the company's statute. A decision *in absentia* may be taken unanimously in writing.

3.6 What are the principal general legal duties and liabilities of members of the management body?

The members of the Management Board and the Supervisory Board are obliged to conduct any and all business activities of the company. They have to apply due diligence of a proper and diligent manager in this capacity as board members. The board members are jointly and severally liable for damage caused to the company. Furthermore, specific duties of the members of the boards are set forth in art. 116b of the Public Offering of Securities Act and in the

Commercial Act such as:

- to notify the board regarding particular circumstances (art. 237, par. 3 CA);
- to restrain from exercising competition activity unless otherwise agreed in the Statute (art. 237, par. 4 CA);
- non-disclosure of inside information regarding the company (art. 237, par. 5 CA; art. 116b, par. 1, item 2, letter "c"); and
- to be loyal to the company (art. 116b, par. 1, item 2 of the Public Offering of Securities Act).

3.7 What are the main specific corporate governance responsibilities/functions of members of the management body?

The corporate governance responsibilities of the members of the board are divided into three categories:

- **Organisation matters**

Which include preparation of the annual and the special (extraordinary) General Meeting, incorporation of all committees and bodies of the company, appointment and dismissal of employees, business transactions, accountability etc.

- **Management issues**

Concerning all activities for planning and enforcement of the company's strategy and course of business.

- **Control issues**

Where mechanisms for internal control are provided in order to supervise the company's activity and its compliance with the strategy of the company.

The Board of Directors and the Management Board are entitled to act on behalf of the company and these actions must be taken collectively by all of the board members or by executive members, according to the rules of the company's statute.

3.8 What public disclosures concerning management body practices are require

An Annual Report on the Activity of the Management Board/Board of Directors and Annual Financial Report should be drafted by 31st of March each year. The Annual Financial Report is disclosed to the appointed by the General Meeting auditors of the Company (art. 245 of the Commercial Act). Once it is examined by the auditors, it should be accepted by the General Meeting and published in the Company Register.

The annual report on the activity of the board should provide information regarding remuneration of the board members, the amount of securities from the company owned by them, their shares in other companies with more than 25% of the capital etc. It should also be accepted by the General Meeting and published in the Company Register.

3.9 Are indemnities, or insurance, permitted in relation to members of the management body and others?

The members of the boards are obliged to secure a guarantee for their governance in an amount determined by the General Meeting but not less than three times the amount of their monthly remuneration (art. 240 of the Commercial Act; art. 116c of the Public Offering of Securities Act).

4 Corporate Social Responsibility

4.1 What, if any, is the law, regulation and practice concerning corporate social responsibility?

There are no relevant legislative sources on this matter.

4.2 What, if any, is the role of employees in corporate governance?

Pursuant to art. 220, par. 3 of the Commercial Act, if the number of employees of the company is higher than 50, then one employee can attend the General Meeting as their agent. He/she has right to information access (as in art. 224), but has no voting right (he has "consultative vote").

5 Transparency

5.1 Who is responsible for disclosure and transparency?

The board members are responsible for disclosure and obliged to declare relevant circumstances, acts and important issues related to the Company's activity. They should announce this fact in the Company Register and notify the Financial Supervision Commission as well as the regulated market (where its shares and other securities are listed) if it concerns a Public Joint-Stock Company.

5.2 What corporate governance related disclosures are required?

The names of all board members and agents of the Company should be published in the Company Register, their specimen, declaration for compliance, the deadline of their tenure if any, and limitations of the agency powers.

5.3 What is the role of audit and auditors in such disclosures?

The auditors' report on the Annual Financial Report examines whether the provisions of the Accountancy Act and the Statute of the Company are implemented. The statement of the auditors regarding the Annual Financial Report (AFR) is required in order the AFR to be presented to the General Meeting and approved by the shareholders. The board members are liable for omissions or discrepancy regarding the AFR.

5.4 What corporate governance information should be published on websites?

Pursuant to art. 13 of the Commercial Act the website of the company should contain information regarding the name of the company, its headquarters and registered office, the unified identification number and bank account of the Private Joint-Stock Company. In the Commercial Act there are no particular obligations for disclosure of corporate governance information. However, in the Company Register all information about the company described above is published and updated.

The Public Joint-Stock Companies should publish on their websites information regarding forthcoming General Meetings, their agenda and supporting materials, and also the Minutes of General Meeting within three days after the date when it was held (art. 117 of the

Law for Public Offering of Securities).

Art. 115b par. 4 of the Public Offering of Securities Act allows the Statute of a Public Joint-Stock Company to provide the necessary technical facilities for distant voting including via e-mail and/or via website.

Alexander Katzarsky

Georgiev, Todorov & Co. Law Offices
27 Parchevich Street
Sofia
Bulgaria

Tel: *+359 2 937 65 00*
Fax: *+359 2 937 65 25*
Email: *a.katzarski@georg-tod.com*
URL: *www.georg-tod.com*

Alexander Katzarsky has been a partner in Georgiev, Todorov & Co. since 2001. He graduated from Sofia University faculty of law in 1990 and become a barrister at the Sofia Bar in 1996. In 1997 he studied European company and commercial law at the University of Limerick, Ireland and the following year he studied the third and sixth EEC Company Law Directives in TMC Asser Institute in The Hague, The Netherlands. During the period 2001-2002 he conducted research on the transformation of commercial companies at the Max Plank Institute for Comparative and International Private Law - Hamburg, Germany.
He is also an arbitrator practising in the court of Arbitration with the Bulgarian Chamber of Commerce and Industry since 1994. In 2002 he became a member of the Consultative Council on Legislation for the chairman of the National Assembly, and a member of the working group drafting amendments for the Commercial Act. In 2002 he was an expert at the World Bank financed project on the improvement of corporate governance legislation.

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The firm has worked for about 10 years on complex international projects and, as a result, has developed considerable expertise. Lawyers of Georgiev, Todorov & Co. have been involved in various assignments in the field of energy, telecoms, M&A and banking, acting for clients such as: the consortium of Mitsui & Co. Ltd., Toshiba Corp. and the Japanese Bank of International Cooperation with respect to the rehabilitation of six units of Maritza Iztok 2 thermal power plant, Bulgarian Telecommunication Company, Raiffeisen Zentralbank Osterreich AG, Alpha Airport Services and others.

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