

## **European Corporate Governance Network**

### **A Survey on Bulgarian Corporate Governance Rules, Statistics and Institutions<sup>1</sup>**

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## **1. Introduction**

This short survey on the Bulgarian corporate governance issues follows the European Corporate Governance Survey guidelines as well as the structure and layout of the respective survey on Estonian case.

Due to late joining the project it is incomplete. The tables present just the legislative aspect of the problem and the data is still under preparation.

The following are some specifics for Bulgarian Corporate Governance which seem important for its understanding.

### **1.1 Origin of the CG issue**

It won't be wrong to say that the problem as in all other Transition countries originates from the process of privatization since the plan economy was simply ignoring it. Although it will be much correct to say that in Bulgaria it emerged within a night when more than 1000 companies which property was already distributed free to the citizens and privatization funds were accepted for traded on the Stock Exchange.

### **1.2 The intentional CG**

Mass privatization scheme had seen those companies generally having one two biggest shareholders and great number of smaller ones (mostly individual) trading the stock among each other on the Stock Exchange. That's for the policy makers prohibited obtaining blocks higher than 34%, centralized all the trade obligatory through one market and created the Central Depository as a ultimate keeper of the security accounts and also executor of the clearing and settlement of all trade. Further, there was a 6-month ban for transfer of the blocks obtained in the mass privatization after the last auction. This was an attempt to stop the already going process of setting agreements for exchange of the blocks mostly between privatization funds but also with some foreign portfolio investors.

### **1.3 Failure of the good intentions**

Not surprisingly the process failed. As it appeared the weak barriers could not prevent the agreements between the funds. And as it appeared the interest for gathering larger and larger blocks was practically total. Thus the trade in those securities realized mainly as

block trades. The pressure was intensive enough to make government allowing the block trade almost without any obstacles<sup>3</sup> and it is still going. Needless to say that at that time this trade was just a formal registration of the deal at the price wanted (and agreed) outside the floor of the SE. The mechanisms those days and still prevents practically 100 percent the possibility of intervention among the consent parties.

#### **1.4 Reasoning**

One can be equally right blaming as the policy makers for allowing the lobbying groups to obtain desirable decisions as well as the investment society which was short seeing and missed to establish self restricting rules which will make the investing process reliable and trustworthy. Today when most of the investment intermediaries changed their behavior and try to impose more strict trading rules the things have gone so far. Although, both of those blames are not enough elaborated. The actual reason upon me is the process itself:

First, most of the companies simply could not fit any criterion to be public – badly performing, small, outdated technology, shrunk markets etc.

Second, the process was set out with two completely unequal parties – 81 big and aggressive privatization funds and millions of citizens who never new what does it mean to invest in securities plus a week legal protection for the small (minority) investors.

Third, the privatization plus carteling agreements between funds the latter were able to obtain for very cheap a huge and valuable stock.

Given that framework it appeared possible and highly desirable for the ultimate investors to try to concentrate as much shares as possible in most companies, because that allowed them to collect all the margin to the market price. Moreover, for many of those shareholders that was the only goal to have.

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<sup>3</sup> Except a short period suspension in 1997.

## 1.5 The Results

Definitely the immediate result of such a behavior was a large concentration of the ownership. The following table shows the concentration of the ownership right after the mass privatization.

### **Ownership and Corporate Control in Mass Privatized Companies**

	<b>Exclusive Majority Control</b>	<b>Shared Majority Control</b>	<b>Exclusive Minority Control</b>	<b>Shared Minority Control</b>	<b>Limited Minority Control</b>	<b>Control by Constellation of Interests</b>	<b>Control Undefined by Mass Privatis.</b>
Companies							
- number	267	143	159	131	27	48	264
- % from the all	26	13.75	15	12,6	2.6	4.6	25
Capital ('000'BGL)							
- total in the group	19,574,018	21,509,043	11,448,649	22,467,420	2,788,176	830,798	153,610,012
- average per co	73,311	150,413	72,004.08	171,507	103,266	17,308	581,856
- median of the group	43,764	65,296	37,319	95,400	51,897	10,157	-
Average final privatised stack of a company (%)	78.05	70.57	73.55	60.10	69.67	82.44	19.94
Avr stake in a company %	59.00	52.32	41.36	N/A*	NA*	0.02**	-
- of the "couple"	33.48	32.94	31.22	29.41	14.51		8.14
- only of the leading PF	25.53	19.38	8.58	10.99	9.23		1.33
- only of the second PF							
- of the 3 <sup>rd</sup> PF	3.54	5.12	1.57	5.86	5.55		
- sum of 3 <sup>rd</sup> ,4 <sup>th</sup> and 5 <sup>th</sup> PF	3.87	6.00	1.84	7.36	9.46		
- sum of all citizens' stacks	15.18	12.25	31.91	12.30	36.15	82.42	10.00

\* not applicable

\*\* all institutional investors

**Source: Centre for Mass Privatisation**

As it may be seen easily more than fifthly percent of the companies are majority (or close 41.36 average controlling block for the third group) controlled. The process is rather underestimated since in many cases there were more than three funds participating in the agreement and also not all of the "funds couples" were not detected.

Later the process speeded up and the following table is quite persuasive of that.

## Concentration in the Public Companies mid 1999

STACKES OF THE BIGGEST SHAREHOLDER	No of companies
more than 66.7% of the capital	257
between 50% and 66.7%	357
between 33.3 and 66.7%	298
less than 33.3%	230
including those with biggest holding less than 10%; “constellation of interests	51

Source: Central Depository Cit. by S. Petranov (2000)

The second result, much more comprehensive and far going was the complete collapse of the Bulgarian Stock Exchange. Even the few foreign portfolio investors operating for some time in Bulgaria withdrew. Bulgarian investors, and not only the individuals, after some unsuccessful attempts gave up to risk their money on the market.

Mass practice became the abuse of the minority shareholders by number of means, conditional rises of companies' capital, closure and official withdrawal of the companies from the market (after that became possible in 2000). Today the bourse index SOFIX, which actually was re-started in 2000, is at the level of 70% and the turnover is insignificant.

### **1.6 Measures Targeted on Improvement of the Situation**

A number of actions were taken out to stop the deterioration of the situation. First of all legal changes some of which having a CG aspect. The Law on securities was completely replaced which is rather rare practice in this country; the new one having a number of clauses ensuring a better protection of the minority shareholders. The cases of conditional increase of the capital were dramatically limited, the 5% threshold for rising a motion, including court appeal for managers' misconduct, was introduced.

Another aspect was improving the trading rules on the floor of the Exchange. Several times were changed the rules for price corridors, efforts were done for preventing some types of deals including package sales, but block trading remained. A lot of rules for a better disclosure policies were made, including participating interests, large holding directives etc, which are treated in more detail later on.

Although, there are no serious improvements on the market. This actually was one of the strongest points for political attack in the economic program of the former Bulgarian king, which definitely helped him to win decisively the recent elections.

## 2. LEGAL FORMS

### 2.1. COMPANY TYPES AND GROUPS

#### 2.1.A. LEGAL FORMS

Legal Forms	LIMITED LIABILITY PARTNERSHIP	JOINT STOCK COMPANY	PUBLIC COMPANY	SOLE PROPRIETOR	GENERAL PARTNERSHIP	HYBRID COMPANIES	
						LIMITED PARTNERSHIP***	PARTNERSHIP LIMITED BY SHARES***
Names of the legal forms:	Druzhestvo s ogranichena otgovornost OOD	Akzionerno druzhestvo AD	Publichno druzhestvo	Ednolichen Targovetz ET	Subiratelno druzhestvo SD	Komanditno druzhestvo KD	Komanditno druzhestvo s akcii KDA
Main features: Limited versus unlimited liability	Limited liability	Limited liability	Limited liability	Unlimited liability	Unlimited liability	General partner-unlimited liability; limited partner-liability limited to his contribution	General partner-unlimited liability; limited partner-liability limited to his contribution
Minimum Capital	5000 BGN*	50 000 BGN	200 000	None	No minimum. The amount of the contributions is agreed upon in the partnership agreement	No minimum. The amount of the contributions is agreed upon in the memorandum of association	No minimum. The amount of the contributions is agreed upon in the memorandum of association
Smallest Number of Owners	One or more persons	One or more persons	50		Two or more partners	Two or more persons at least one is general partner	At least three limited partners
Smallest Number of Managers	Managing Board less than 9 Supervisory Board 3-7**	Managing Board less than 9 Supervisory Board 3-7**	Managing Board less than 9 Supervisory Board 3-7**		Min one (general partner)	One or more persons Limited liability partners are excluded from managing board	Managing board encompasses exclusively unlimited partners

\* 1BGN=1DM

\*\* If the management is 1-tier Supervisory board should encompass 3-9 persons.

\*\*\*These are the official translations – Bulgarian names are translations from Komandit Gesellschaft and Kommandit Gesellschaft auf Aktien

## 2.1.B. GROUPS

**The Law on Accountancy and the rules on drawing up consolidated accounts** determine the *economic group* as a totality of the parental company with all of its subsidiaries. The couple parent-subsidiary emerges where the first has the control over the latter. And the control is present where the parental company has:

- (1) more than 50% of the shares or parts in the capital of any other undertaking or
- (2) more than 50% of the voting rights in the managing bodies or
- (3) even with less share has the power:
  - over more than 50% of the voting rights pursuant to an agreement with other investors
  - to manage the company pursuant to a provision in its memorandum or articles of association
  - to appoint or remove more than 50% of the members of the managing body
  - to control more than 50% of the voting rights in the managing body.<sup>4</sup>

**Commercial Code** provides a definition of the *holding* – a limited liability company which keeps at least 25% of its capital as a participating interest in subsidiary(es). A subsidiary is such, when at least 25% of its capital is controlled directly or indirectly by the holding or more than 50% of the members of its Management board are appointed directly by the holding.

**The Law on Protection of Competition** uses the broad concept of *concentration*, which emerges from mergers and acquisitions or when one or more persons controlling one or more undertakings acquire by any means direct or indirect control over another undertaking; control is assumed always where a person(s) has a decisive influence over an undertaking obtained through acquiring of property rights over the undertaking or other, including contractual rights over its managing bodies or their decisions.<sup>5</sup>

**The Law on Banking** regulates a bank's exposition toward a group of *connected persons (legal and physical)*, a concept which treats vast number of cases but is not clear about the legal persons member of a an economic group. It also provides a definition for *banking group*, each case where bank's subsidiary is a bank, non-banking financial institution or both, and for *financial holding* a case where an undertaking (industrial) has a bank for its subsidiary.

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<sup>4</sup> The definition is dispersed between the law and its appendices and it is not fully persistent and clear which make it difficult to apply

<sup>5</sup> There are a lot of exceptions one of which is for financial holdings, i.e. it is used the Commercial Code Definition.



### 3.1.B. ACCOUNTING RULES

Ownership Information that companies must enclose in the annex of their annual reports

Yes, for the public ones. The law on Securities requires disclosure of the stacks above 10 percent in an undertaking.

According to Accounting Law consolidated accounts are drawn where a company has more than 50% participating interest and in those cases the relevant ownership information is disclosed. Participating interests between 25 and 50% are accumulated.

Which national laws have transposed the accounting standards directives (4<sup>th</sup> Directive 78/660/EEC and 7<sup>th</sup> Directive 83/349/EEC)?

The Law on Accounting and the National Accounting Standards follow both directives though, not in all details.

Has the Accession State imposed additional requirements via its national accounting standards?

No. According to the accounting standards, the threshold for 'significant interest', which apparently corresponds to the participating interest from 78/660 EEC is higher 25%.

Is the information from this source only available on paper (the printed annual report) or in the computer readable form?

The information of the annual reports on public companies is available also in electronic form through the Commission on Securities.

### 3.1.C. COMPETITION RULES

Are there any competition (anti-trust) rules on ownership stake notifications that apply to companies?

According to the Law on Protection of Competition all cases of concentration (see 2.1.B.) including mergers, acquisitions, purchasing of stock etc. should be reported if the accumulated market share exceeds 20% or the aggregate turnover for the preceding year of the merging parties exceeds 15 million BGN.

To whom do the companies have to notify and where the data is published?

To the Commission for Protection of Competition which takes decision within a month of notification. If the Commission decides that the case threatens the competition it starts inquiry. The decision for the latter is published in the Official Gazette.

### 3.1.D. TRANSPARENCY DIRECTIVE

The large holdings directive` is in essence rather stringent on what should be considered a indirect holding, in Article 2 is for example declared that "[f]or the purposes of Directive, 'acquiring a holding' shall mean not only purchasing a holding, but also acquisition by *any other means whatsoever*, including acquisition in one of the situations referred to in Article 7."<sup>6</sup> The latter paragraph, in turn, gives a rather comprehensive list of what kind of instances that should be considered an acquisition. Bulgaria has indeed implemented most of the provisions which are expressly noted in the directive. In addition there is in the Bulgarian transposition also a direct mentioning of the fact that share held by spouses and minors should be included (except when the person in question is unable to influence the exercising of the voting rights).

When was the Transparency Directive transposed, and in what

With the new Law on Public Offering of Securities (adopted on 15 December

<sup>6</sup> 88/627/EEC, Article 2, emphasis added.

law/regulation?	1999/published on 30 December 1999)(this law meant that the Law for Securities, Stock Exchanges and Investment Companies from July 1995 was repealed) and the consecutive decree 244 of 24 November 2000 on the adoption of an Ordinance on the Disclosure of Major Holdings in Public and Investment Companies
When did the legislation become effective? (or, when is it estimated to become effective?)	November 2000
If there was a delay, what was the reason?	N/A.
Which are the "competent authorities or authorities" referred to in Article 13?	The Bulgarian National Securities Commission ( <a href="http://www.ssec.bg">http://www.ssec.bg</a> ) – in addition reporting by the blockholder on purchases/sales should be made to “the regulated securities market on which the companies shares are listed” (Art. 2), e.g. the Bulgarian Stock Exchange ( <a href="http://www.bse-sofia.bg">http://www.bse-sofia.bg</a> )
The Transparency Directive left the Member States a considerable degree of freedom in implementing the individual articles (see text of directive in Appendix). Indeed, Article 3 allows the Member States to tighten up the transposition at will, converting the provisions of the directive into common minimum standards – has this been done?	They are tighter in some respects, e.g.: (i) the rules apply to all public companies; (ii) the data is made public on a website; and (iii) in the case of an increase in the block it is mandatory to declare whether the aim is to control the company (Art. 6, para. 2, item 3d).  At the same time, however, some minor provisions in the directive are not covered (see table above).
Is the first time notification threshold referred to in Article 5 10% or lower?	There is no explicit first time notification in the Bulgarian rules. However, indirectly such notification is catered for in Art. 2 which states that notification is mandatory for all persons “whose voting rights has <i>reached</i> , exceeded or fallen below...” [emphasis added].  The minimum threshold applied is 5 per cent for companies on the official market on a stock exchange (i.e. tiers A, B and C on the Bulgarian Stock Exchange) and 10 per cent for companies whose shares are listed on a regulated securities market other than the stock exchange.
Do natural persons or legal entities have to notify why they notified (i.e. which of the possibilities in Article 7 apply)?	Art. 6, para. 2, item 3b and 3c may be interpreted in this way. In practice, however, the notification forms in question are still not prepared by the SSEC and the notification is made as before in a non-standardised way.
Do natural persons or legal entities have to notify how they control an undertaking (a, b or c in Article 8)?	Yes, art 8 requires the form of control to be disclosed if different from control through direct ownership of voting rights shares; in practice this seems to mean the cases 5 to 8 of Art 2 para 2. Again, however, there is no practice, since there is no form.

#### 4. Inside supervision 4.1.Boards 4.1.A. Legal and institutional description

##### 4.1.A.1. BOARD STRUCTURE

Legally available board structure (one- or two-tier board)?

Yes, Commercial code determines one and two-tier board structure of the companies – either Board of Directors (BD) or Management Board (MB) and Supervisory Board (SB)

Are they the same for all legal forms?

Limited liability partnerships are managed by Manager and Controller.

Shares companies, including the public ones, could have either one-tier or two-tier.

Are there different categories of directors and/or managers?	Under one-tier system the smaller part (or just one) are Executive Directors.
What are their titles (in the original language)?	In case of one-tier – Savet na Directorite (BD) In case of two-tier Upravitelem Savet (MB) and Nadzoren Savet (SB)
What are their functions?	Supervisory board- gives orders and supervise the management board, exclusively beyond the scope of everyday economic activities, the functions can be limited or extended by the statutes within the limits of the law. Management board- represents and directs the company, follows the orders of and reports to the supervisory board, organise the accounting.
What are their powers?	One-tier The whole BD appoints the Executives and they run the company Two-tier The Supervisory board- hire and fire the members of the management board.*
Does the chairman of the board of directors have a veto power or a “golden vote”?	No. Commercial Code states exclusively that the members of all boards have equal rights and obligations regardless of their internal division of functions.
By whom are directors/managers nominated, appointed (and for how long), re-appointed, promoted, removed, remunerated?	Board of Directors or Supervisory board- elected, and removed by the general meeting. Term of five years, or shorter time by the statutes. The first boards for no more than 3 years. Remuneration determined by the resolution of the general meeting. Management board- elected and removed by the supervisory board. Term not exclusively determined. Remuneration determined by SB.
How are these decisions taken (majority voting, unanimity)?	Simple majority voting.
Does anybody have veto power?	No.
Are the nomination and appointment rules set out in company law, the company statute, imposed by the stock exchange?	Commercial codes impose few requirements for the members of the boards but leaves space for the company statutes, to impose restrictions if needed.
Is it possible to obtain a list with the names of persons who sit on the board and in the various committees for each company?	The list and all the changes are reported to the Commercial Register. And especially for the public companies they should be reported in the Annual Reports.
Is it possible to find out how much the individual directors and managers earn (pay, bonuses, stock options)?	For the public companies, according to the rules for disclosing of information of the Law on securities the annual report should contains the information about their remuneration received against their services in the boards.
Do directors have to declare how many shares in their own company they posses and when they buy and sell?	For the public companies, according to the rules for disclosing of information of the Law on securities the annual report should contains the information about the directly and indirectly owned voting shares, their percent in the GM votes and to report when they exceed or fall between 5 (or rounded to 5) percent for the listed and 10,25,33,50,66 or 75% for the registered companies.
Is it possible for a shareholder/member of the public to obtain a copy of the managers employment contract/the directors employment contracts?	No.

\*The Commercial Code is quite abstract in setting out the rights and obligations of the Board. Such issues should be defined more precisely in the statutes of the company as well as the employment contracts signed with the board members. Thus, if there is a majority shareholder whose votes will determine either directly

or indirectly the content and approval of the statutes as well as the members of the supervisory board, then the law does not leave too much ground for the protection of minor shareholders' interest.

#### **4.1. B. Manager Independence**

For which business decision must the managers seek approval by the shareholder meeting and/or the board and/or worker representatives?

Transformations, and termination of the company, increase and reduction of share capital, issue of convertible bonds- resolved by the general meeting; the GM may have more rights if stated in the statutes.

Termination or sale of the enterprises or their essential parts, significant changes in the business activities of the company, essential organisational changes, establishing or termination of long-lasting partnership, opening of a branch – needed approval by the Supervisory Board or unanimous decision of the Board of Directors.

Although the Commercial code provides an opportunity GM to entrust the decision of rising capital with the MD or BD in some cases.

In particular, do these decisions include financing decisions (IPOs, new equity issues, bond issues, bank loans, use of derivative products)?

Yes, new equity issues are among the restricted decisions.

Is approval granted by the majority voting?

By qualified majority of the votes present at the GM.

Is the catalogue of decisions that the managers cannot take independently set out in the company statute, laid down by the company law, stock exchange or other regulation?

Some requirements are set out in the company law, however, the company can extend their decision-making rights by the statutes.

Are managers allowed to buy shares in the company in the name of the company?

In general not allowed. If the company acquire own shares it is in specific temporary case and the rights are suspended.

Is the management allowed to vote these shares?

No.

### 4.3. Shareholders

Who has the right to attend the shareholder meeting?	All shareholders with voting rights or their representatives (with proxy voting right), members of the managing boards (they do not have voting rights if they are not shareholders).
Is it possible to delegate (or transfer) voting rights to third parties?	Yes, through proxy voting
What majority is required to change the company statute?	At least 2/3 of the votes represented at the general meeting, or a different threshold if set out in the statute.
Can this required majority be increased or decreased in the company statute?	Commercial code allows for the company statute to state a different majority?
Is it possible to obtain a copy of the attendance list of the shareholder meeting as a shareholder/as a member of the public?	Yes, as a shareholder.
Is it possible to obtain the minutes of the annual meeting with the results of the votes for each item on the agenda?	Yes, as a shareholder.
What other information do the minutes contain?	Place and time of the GM, names of the chairman and secretary and counters of votes, presence of the boards' members as well as outsiders (non-shareholders), raised motions, votes and taken decisions, the objections (dissenting opinions). The list of the attendees and the preliminary documents are appended to the minutes.
Can shareholder ask the management to disclose whether the company holds stakes in other companies?	Yes, for the public companies. For the others the issue is not treated so they can ask, but the management has no obligation to disclose such information, especially if that might cause damage to the interests of the company.
How many shares (voting rights) does the shareholder need to own to make such a request?	irrelevant

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