Management agreements of capital companies in insolvency proceedings as per Bulgarian case law

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This article analyses the treatment of the management agreements of capital companies in insolvency proceedings in Bulgaria. The article focuses on the applicable Bulgarian legal provisions and examines relevant judicial practice to justify a conclusion that such management agreements are not to be treated as commercial transactions, which may entitle managers or directors of capital companies to lodge applications for insolvency.

The legal relationships between Bulgarian capital companies (limited liability company, joint-stock company or partnership limited by shares) with the members of their management bodies (managing directors, board of directors or management board) are subject to management agreements.

In accordance with Article 141, paragraph 7 of the Bulgarian Commerce Act (the 'Commerce Act'), the relationship between a limited liability company and its managing director is governed by a management agreement. This is to be executed in written form on behalf of the company by an explicitly authorised person or by the single shareholder.

By virtue of Article 241, paragraph 6 of the Commerce Act, the relationship between the company and a member of the management board (under the two-tier management system, consisting of management board and supervisory board) is to be regulated by a management agreement in writing. This is to be executed between the relevant board member and on behalf of the company by the chair of the supervisory board or by a person explicitly authorised.

On the legal grounds of Article 242, paragraph 6 of the Commerce Act, the relationship between the company and a member of the supervisory board is subject to an agreement in writing executed by the respective board member and on behalf of the company by a person authorised by the general shareholders meeting or by the single shareholder.

As per Article 244, paragraph 7 of the Commerce Act, the relationship between an executive member of a board of directors (under the one-tier management system) are subject to a management agreement, executed in written form by the chair of the board of directors on behalf of the company. The relationship between the company and the other members of the board of directors may be subject to agreement, which is to be executed on behalf of the company by a person explicitly authorised.

In accordance with Article 256 of the Commerce Act, the management bodies of a partnership limited by shares are the management bodies of a joint-stock company under the one-tier management system, such as the board of directors.

The management agreement can be defined as an agreement between a capital company and a managing person, under which the latter undertakes to effectively manage the company, and the company undertakes to create and maintain favourable conditions for management and pay periodically the remuneration provided for in the agreement. Under the management agreement, a complex civil legal relationship arises, which incorporates a system of two interdependent and functionally related legal relationships:

- corporate legal relationship, which contains the right of the management body to manage and represent the company and its obligation to comply with confidentiality and non-compliance of competitive activity; and
- a mandate legal relationship, which arises from the management agreement and contains as its essential element the obligation to perform the managerial

and representative powers.

There is no dispute on the nature of the management agreements as mandate agreements in terms of Articles 280–292 of the Bulgarian Obligations and Contracts Act. This conclusion is also supported by the provision of Article 4, paragraph 1, item 7 of the Bulgarian Social Insurance Code, where the managing directors and procurators (commercial managers) of companies, sole traders, their branches and branches of foreign legal entities, the members of the boards of directors, management and supervisory boards are listed as persons who are to be insured mandatorily against common disease and maternity, disability due to a common disease, old age or death, industrial incidents and occupational diseases, and unemployment, separately from the persons who are employees under contracts of employment (listed in Article 4, paragraph 1, item 1 of the Social Insurance Code).

While there is no dispute on the nature of the management agreements as mandate agreements and not contracts of employment, in some agreements the parties agree on penalties, which are to be paid upon termination of the relevant management agreement. This is because a question arises whether the management agreement may be treated as a commercial transaction in terms of the Commerce Act and, if so, whether a person to whom the management of a company is assigned pursuant to such management agreement shall be entitled to lodge an application for insolvency proceedings against the respective company, claiming that there are liabilities of the company which are due and payable as penalties under a management agreement.

In accordance with Article 625 of the Commerce Act, insolvency proceedings shall be initiated upon written application lodged with the court by:

- the debtor;
- the liquidator;
- a creditor of the debtor under a commercial transaction;
- the National Revenue Agency for a public law obligation to the state;
- municipalities related to the debtor's business or an obligation under a private state receivable; or
- the General Labour Inspectorate Executive Agency in the event of wages due to at least one-third of the workers and employees of the merchant, which are payable but are not discharged for more than two months.

Under Bulgarian law, commercial transactions are absolute commercial transactions, as defined in Article 1, paragraph 1 of the Commerce Act as follows:

- purchasing goods or other things for the purpose of reselling them in their original, processed or finished form;
- sale of one's own manufactured goods;
- purchasing negotiable securities for the purpose of reselling them;
- commercial agency and brokerage;
- commission, forwarding and transportation transactions;
- insurance transactions;
- banking and foreign exchange transactions;
- bills of exchange, promissory notes and cheques;
- warehousing transactions;
- licence transactions;
- supervision of goods;
- transactions in intellectual property;
- hotel operation, tourist, advertising, information, entertainment, impresario and other services;
- purchase, construction or furnishing of real property for the purpose of sale; or
- leasing.

They can also be presumptive commercial transactions in terms of Article 286, paragraph 1 of the Commerce Act, which reads as follows: 'any transaction concluded by a merchant in relation to their business shall be a commercial transaction'.

The provisions of Article 286, paragraph 1 of the Commerce Act and its misinterpretation created reasons for the managing directors and/or board members of Bulgarian capital companies to see a basis for lodging applications for insolvency of the relevant company, claiming sums payable under management agreements purportedly treating them as commercial transactions.

However, the Bulgarian case law is clear in its terms that the management agreements are not to be treated as commercial transactions, but as pure mandate agreements, which are subject to the Bulgarian civil and commercial law.

In light of the above, the following judgment of the Sofia City Court must be taken into account. Judgment No. 22 of 31 January 2017, under commercial case No. 4066/ 2016 of Sofia City Court, reads as follows:

'There is a management agreement between the debtor and the applicant. As per the mandatory case law (judicial practice of the Supreme Court of Cassation) ruled in accordance with Article 290 of the Civil Procedure Code, where this case law is formed on the basis of Judgment No. 88 of 22 June 2010 under commercial case No. 911/ 2009 of the Supreme Court of Cassation, Commercial Collegium, I Commercial Department under commercial case No. 911/ 2009; Judgement No. 306 of 25 June 2012 of the Supreme Court of Cassation, IV Civil Department under civil case No. 1387/ 2011; Judgement No. 204

of 24 July 2014 of the Supreme Court of Cassation under civil case No 983/ 2014; Judgment No. 150 of 28 May 2015 of the Supreme Court of Cassation, Civil Collegium, IV Civil Department; Judgment No. 150 under commercial case No. 3471/ 2014, Commercial Collegium, I Commercial department, the legal relationship, which occurs pursuant to an agreement for assigning the management of a company is not a contract of employment, but it has the nature of a mandate and it is to be regulated by the provisions of the civil and commercial law. The relationship between the managing directors, respectively the members of the Board of Directors and the members of the Supervisory Board, on the one hand, and the company on the other hand, are governed by an agreement for assigning the management, which is a mandate agreement, hence the person to whom the management does not have the capacity of an employee in terms of the Labour Code. The remuneration owed by the company is remuneration under civil contract and it is not relevant how it is named and how it is accounted, and what deductions and calculations are made. In accordance with Judgment No 16 of 22 November 2010 under commercial case of the Supreme Court of Cassation, Commercial Collegium, II Commercial Department, as per its legal nature, the agreement for assigning the management is a type of a mandate agreement, where the powers and liabilities of the managing director to represent the company arises directly out of the resolution of the owner of the capital / its appointment as a managing director. The same [mandate agreement] is a secondary obligational legal relationship, which establishes rights and obligations between the principal of the company and the managing director. However, the nature of a commercial transaction – absolute in terms of Article 1, paragraph 1 of the Commerce Act, or presumptive as per Article 286, paragraph 1 of the Commerce Act, is not present. Therefore, non-performance of duties under a management agreement does not fall into the scope of the receivables on the grounds of which it may be permissible to lodge an application for initiation of insolvency proceedings due to insolvency – Article 608, paragraph 1, item 1 of the Commerce Act, respectively due to overindebtedness.'

In conclusion, management agreements (as mandate agreements) are not to be treated as commercial transactions, hence no insolvency proceedings are to be initiated pursuant to applications lodged by managers alleging claims on the legal grounds of claims due and payable under such agreements.

About the author

Yavor Kambourov is the Founding Partner of Kambourov & Partners Attorneys at Law and the head of the firm's Banking & Finance and Insolvency & Creditors' Rights practice groups. Kambourov has more than 33 years of experience as legal advisor and litigator, defending creditors' rights in insolvency proceedings and complex restructurings in all business areas, with a special focus on bank insolvency. Kambourov is an insolvency trustee registered with the Bulgarian National Bank.