
CORPORATE AND FINANCIAL LAW HANDBOOK



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PREFACE

The subject-matter of the *Corporate and Financial Law Handbook* is complex and multifaceted, proving that there is a need for joint studies, involving both lawyers and economists. The present Handbook is a good example of such a collaboration.

Why this book? The information provided in the Handbook will be useful to students in the Bachelor and Master programmes of the Faculty of Economics and Business Administration (FEBA) at the St. Kliment Ohridski University in the field of Business Administration and Economics. The Handbook is based on the content of different legal, economic and management courses, but its foundation is the accredited course in Corporate and Financial Law which is part of FEBA's Bachelor programme in Accounting, Finance and Digital Applications, taught in English. The programme offers the internationally recognised Certificate in Finance, Accounting and Business (CFAB) of the Institute of Chartered Accountants in England and Wales (ICAEW). The Corporate and Financial Law course is a mandatory module toward obtaining the ICAEW Certificate in Finance, Accounting and Business (ICAEW CFAB). In addition, FEBA has officially received accreditation from the Association of MBAs (AMBA), one of the world's leading authorities on post-graduate business education, demonstrating its continuing commitment to excellence in management education, and the Handbook will be a useful tool for achieving the aims of AMBA's membership. Last but not least, the Handbook will be useful for graduates and will be incorporated in the content of various programmes of the professional school for computer programming and innovations in the city of Burgas, which holds the status of an associated school of the University of Sofia, the first school outside Sofia and the third in the country associated with the University.

The authors of the different chapters of the Handbook are experienced professionals in their field. In their analysis of the various topics, they demonstrate that Bulgaria has its own traditions in the different fields

of legal and economic doctrine but upholds EU values and their legal foundations along its path toward European integration. The contents of the different chapters of the Handbook allow for quick and easy access to important information on the following topics: introduction to legal theory; brief overview of contracts and contract lifecycle; null and voidable contracts under Bulgarian civil and commercial law; the fundamentals of secured obligations; time limits and limitation periods in civil and commercial law; agency in civil and commercial law; types of companies; corporate governance and ESG standards; basics of commercial transactions; Bulgarian property law; Bulgarian competition law; legal foundations of intellectual property; data protection legislation in the European Union and Bulgaria; constitutional principles of economics and finance; contemporary financial law; basic concepts of budget law and budget process in Bulgaria and the European Union; legal foundations of sustainable finance; trends in the field of financial control and audit in the public sector; protection of the financial interests of the European Union; public procurement issues; the Eurozone and Bulgaria; strategic documents in the field of circular economy; shared management of EU-backed financial instruments in Cohesion Policy; penal law; greenwashing in sustainable finance, anti-money laundering and contemporary issues of artificial intelligence. An integral part of the Handbook is a book containing ‘Train Yourself’ questions for students.

The subject matter of the Handbook is interdisciplinary, complex and varied. Hence, an interdisciplinary method is used, with view of the specifics and diversity of the reviewed topics thanks to the scientific editor Assoc. Prof. Savina Mihaylova-Goleminova.

This is a book for lawyers and non-lawyers written by lawyers and economists. Internet content has been used freely, with proper identification of sources. The work is based on Bulgarian and European law valid as of January 2024.

— Jacques Malherbe

The *Corporate and Financial Law Handbook* examines some fundamental topics of private and public law. An innovative interdisciplinary approach has been used. The topics also cover basic aspects concerning public relations arising from the membership of the Republic of Bulgaria in the European Union. The issues are interdisciplinary and topical and are presented through a new and contemporary approach, with the authors drawing on the traditions of generally accepted legal and economic doctrine. Relevant Bulgarian and foreign scientific literature has been used. The individual albeit interrelated themes are presented in 31 chapters and are logically interconnected. The book also includes analyses of legal frameworks, of case law of the Constitutional Court, the Supreme Administrative Court, the Supreme Court of Cassation, the Court of Justice of the European Union, of publications on relevant topics, etc. The content of the book corresponds to its title. The authors make use of modern methods of scientific research, namely: the historical method; documentary analysis; comparative legal analysis; systematic method. The focus is on the use of comparative legal analysis and an interdisciplinary method. The book is intended for the English language programmes of the Faculty of Economics and Business Administration (FEBA) at the University of Sofia and aims to facilitate the preparation of students; the topics draw on the approved curricula of courses taught in the undergraduate and graduate programmes of the Faculty. The content of the accredited course in Corporate and Financial Law, part of FEBA's Bachelor programme in Accounting, Finance and Digital Applications, taught in English, provides the basis of the book's contents. The book is prepared by a team of authors, comprising lecturers at the Faculty of Economics and the Faculty of Law of the St. Kliment Ohridski University of Sofia, as well as reputable expert-lecturers with practical experience. The authors are lawyers and economists, which demonstrates the interesting approach of the compiler of the book in the formation of the team. Each of the authors boasts publications and teaching experience. The chapters analyse legal regulations, relevant case law of the Constitutional Court, the Supreme Administrative Court, the Supreme Court of Cassation, the Court of Justice of the European Union, and of publications on the respective topics. The book will also be useful for lawyers and economists in practice.

— Prof. Dr. Lyuben Karanikolov

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CHAPTER 1:

AN INTRODUCTION TO LEGAL THEORY (FUNDAMENTAL LEGAL NOTIONS AND CONCEPTS)

Dilyan Nachev

ABSTRACT	KEYWORDS
This Chapter's main purpose is to outline and present the basic features of some of the most fundamental legal concepts. It starts by offering a definition of Law and distinguishing it from other similar social phenomena and then attempts to draw up a simple mind map of various legal notions and their theoretical and practical manifestations.	Law, legal concepts, legal theory, jurisprudence.

During the last few years (or even decades) many European universities have opted to abandon courses in Legal Theory and History of Law, considering them impractical for future lawyers. Law is viewed only as a craft and legal practitioners as people simply bound to know what the Law requires but not necessarily capable of understanding the reasons for these requirements, nor of criticizing and changing them. I have spent enough time – both teaching and practising Law, to claim that such approach is unreasonable and risky. It makes it difficult for lawyers to adapt to social and legal changes (that occur almost constantly) and leaves them under the false impression that Law and legislation are synonyms. My understanding is that fundamental legal knowledge is an important tool of any skilful lawyer. Every building needs a strong foundation and legal theory can be regarded as the foundation of all practical legal knowledge.

This chapter focuses on some of the most important basic legal notions and concepts and is addressed mainly to students in majors other than 'Law' who wish to have root understanding of basic legal phenomena and the way the legal system functions. It is obvious that within the page limit, some issues will either have to be overlooked or explained too briefly

but the reader should always keep in mind that Law has been a topic of discussions for thousands of years and it is therefore almost impossible to give definitive answers to most fundamental legal issues.

The first thing that university professors usually ask students concerning Law is to define the concept. What is Law? The question may seem easy but in reality, it is like quicksand – the deeper you go into it, the more difficult it gets. A rather vague definition would be that ‘Law is a set of rules and principles’. Even though accurate, such abstract approach is not sufficient to explain Law as social phenomenon, mainly because this description would fit the definition not only of Law, but also of any other social regulator – such as morality, religion etc. Furthermore, Law can be viewed from different perspectives and depending on that, there would be various understandings of its essence. It would therefore be best to try to give some clarifications on the notion of Law as such, before explaining the aspects in which it differs from other systems of social norms.

Law is most often regarded as somehow related to State. Certain authors even go beyond the simple existence of a link between these two, claiming that Law and State are practically the same thing, seen from a different perspective.¹ Without necessarily going so far, most lawyers tend to focus on various features of Law in order to distinguish it from similar social phenomena. It is often said that Law is mandatory and the non-observance of legal norms leads to the imposition of legal sanctions, backed by public coercion, if needed. However, all of these characteristics of Law can be challenged under certain circumstances.

Let us examine that more closely. My understanding of the idea that Law is mandatory, consists of the following: certain social behaviour is required and due because of a valid legal norm. This behaviour can be active (that is to say, someone is bound to do something) or passive (someone is bound to not do something). Either way, in case of non-compliance, a legal sanction will be imposed and its imposition may be done by force, if necessary, i.e., using public coercion, ensured by state authorities.² Even

¹ **Kelsen, H.** The Pure Theory of Law and Analytical Jurisprudence. // Harvard Law Review, 1941, № 55, pp. 64–65.

² **Начев, Д.** Формална и фактическа юридическа задължителност. – В: Научни четения на тема „Право и принуда“, София, Университетско издателство „Св. Климент Охридски“, 2023, с. 50.

though this paradigm is correct for the vast majority of cases, there are certain exceptions or, at least, certain critics to its applicability in general. Suffice to mention two categories of situations: (i) formal legal obligations without sanctions and (ii) factual legal obligations, i.e., mostly what we call *soft law*,³ as opposed to *hard law*. A simple example of the former, to name one, are legal obligations imposed on governmental bodies. Most of the time, the legislator would not have adopted a legal provision containing a sanction in case of non-compliance, mainly because it is considered that all state authorities act in good faith and therefore perform all their legal obligations without the need for some sort of legal pressure. Sometimes that is true and sometimes it is not, but this does not diminish the legal nature of such obligations. As for *soft law*, this is often perceived as a sort of legal recommendation, i.e., formally speaking, it is not legally mandatory but usually has some factual authority either related to the public image of the rule's addressee or to some moral value. This *soft law* technique is mostly used in situations where hard law is practically impossible – e.g., in order to create some more or less universal standards in an area of law in which this cannot be achieved by ordinary legislation. *Soft law* can be found, for instance, in various Codes of Good Practices and Ethical Behaviour that many national and international organisations have nowadays adopted.

Having said that, it is still worth noting that in most cases formal legal obligations would be mandatory and would have a formal legal sanction. A simple illustration of that would be the legal obligation of tax payers to file a tax declaration within a certain period of time and if they fail to do so, normally they would have to pay a fine, i.e., suffer some negative consequences of their illegal inaction. This is probably the reason why certain authors tend to underline the importance of legal sanctions as a criterion of distinction between law and other social regulators such as morality and religion.⁴ They all tend to govern people's behaviour in a certain way but the nature of their sanctions is quite different. Let's take religious rules as an example (keeping in mind that there are a large number of various religious beliefs which cannot be summarised in a few

³ For more on this distinction, see **Начев, Д.** Пак там, 55–59.

⁴ See, for instance, **Ташев, Р.** *Обща теория на правото: основни правни понятия*. София, Сиби, 2010, 176–192.

sentences). They usually require some sort of conduct in accordance with the said religion and prescribe certain sanctions to those who do not follow them, e.g., going to hell, being reborn as a caterpillar, etc. These are all sanctions that are not under our control, their potential imposition depends on the will of an almighty deity and they usually occur in the ‘afterlife’. Similar things can be said about moral sanctions too. The violation of a moral rule (keeping in mind that morality is always subjective and relative, at least, to some extent) would lead to the imposition of a moral sanction – a sanction which is not organised and not imposed by the State, i.e., by public coercion, but a sanction imposed by the society itself or most of the times by a certain fraction of society which considers the violation of the said moral rule as something particularly offensive/immoral, requiring some sort of public reaction. Legal sanctions, on the other hand, are imposed by the State, in a centralized and public manner, within this life. They usually concern either our personal rights (such as freedom of movement) or our patrimonial rights (e.g., confiscation or paying a fine). It is also worth mentioning that Law can be distinguished from religion and morality based on its purpose. Morality usually tends to say what is good and what is considered evil, while Law does not necessarily claim such things, i.e., legal rules might sometimes be considered unjust, unfair etc., but they do not cease to be legally binding for that reason alone. This is because they serve a different purpose – they exist in order to regulate social interactions and find some balance between all contradicting interests within a society. Nevertheless, Law often attempts to be (or at least, appear so in the eyes of most people) just and reasonable because this is one of the factors having impact on people’s willingness to obey the Law. Some authors claim that Law’s main objective is to pacify, i.e., to give people institutionalized opportunity to resolve potential disputes without resorting to violence.⁵ This shows again that Law’s main *raison d’être* is more practical than what lawyers usually wish to recognize. Similar things can be said about the distinctions between Law and religion. The latter is based on faith, its validity is practically impossible to prove in a rational way, therefore it is mostly focused on certain sacred books claiming to express God’s will,

⁵ Вълчев, Д. Валидност и легитимност в правото. София, Сиела, 2013, 276–277.

while Law does not claim such a profound purpose, it is made by men and for men and can therefore be found within legislation (in the broadest possible sense), that is to say, in legal acts containing general abstract legal norms that we usually call *Sources of Law*.

Sources of Law can be defined as legal acts, legal procedures and social practices, containing legal norms.⁶ They serve, at the very least, two purposes: (i) they are a formal criterion for the validity of legal rules and principles, i.e., serve as a way to identify in an undisputed manner all legal norms that are mandatory and need to be obeyed and applied; but also (ii) they demonstrate the hierarchical organisation of legal norms within a given legal order.

Nevertheless, most modern national legal systems are quite complicated since they are open to legal rules and principles coming from other legal orders such as EU Law, international public and private law. It is therefore sometimes very difficult to place legal norms in a non-contradictory and hierarchically organised way. The Constitution is usually said to be at the top of the pyramid even though such stand can also be criticized, especially from the perspective of EU Law.

Every legal system has its own official and typical sources of law. In Bulgaria, besides the Constitution, such fundamental sources of law are the acts of Parliament (i.e., ordinary legislation, adopted by the Bulgarian National Assembly), sub-legislative acts, mostly adopted by the executive branch, ratified international treaties etc. An important category is also formed by various EU law sources such as EU Treaties (central point of EU primary law), EU Regulations and EU Directives (most important sources of EU secondary law).

Within these sources of law one can find different categories of legal rules and principles, expressed by legal provisions, i.e., formally written and organised written texts of legal nature. The distinction between rules and principles is amongst the most complicated and debatable topics in legal theory. There are many contrasting and divergent concepts. Just as an illustration, I will point out two of them: some authors believe that there

⁶ Гройсман, С. Право и власт: от неограничената държава до постмодерното върховенство на правото. София, Сиела, 2020, с. 320.

are practically no substantial differences between rules and principles and they are simply linguistically expressed in a dissimilar way – principles are expressed more generally and abstractly than rules.⁷ Others claim to have found many formal and substantial criteria of distinction: concerning the way they are created and the way they impact their addressees' behaviour; concerning the manner in which potential conflicts between them are resolved, concerning the way they are integrated into the legal system, etc.⁸ It is important to note that regardless of what sort of distinction is made between them, rules and principles are the two most fundamental legal standards.

It is rather universally acknowledged that legal rules and principles govern people's and state officials' behaviour, i.e., they inform us of our legal rights and obligations as well as of the sort of legal liability one will face in case of non-compliance. In Bulgarian law there are four major categories of legal liability: (i) civil liability (deriving either from contractual non-performance or from tort), (ii) criminal liability (related to the commission of a criminal offense), (iii) administrative liability (concerning administrative offences) and (iv) disciplinary liability (broadly speaking, deriving from the violation by an employee of rules set by his/her employer).

Besides by acting unlawfully, which will eventually lead to one or several of the aforementioned legal liabilities, legal norms' addressees can also generate legal consequences out of their lawful actions, such as signing a contract, getting married or preparing a last will. Actions that have some sort of relevance to Law, i.e., are somehow regulated by Law, will normally have some impact on people's legal rights and/or obligations – either conferring/imposing them, or changing them somehow, or extinguishing them.

But who is entitled to have legal rights and legal obligations? The answer might seem obvious, but in reality, it is neither certain, nor universal. It depends on the legal system. It is basically up to the legal order itself to decide who (or what) can be regarded as a *subject of*

⁷ See **Вълчев, Д.** От апология на правната норма към теория на правния ред. София, УИ „Св. Климент Охридски”, 2003, с. 128.

⁸ See **Стоилов, Ян.** Правните принципи: теория и приложение. София, Сиби, 2018, 55–71.

Law, i.e., is capable of having rights and obligations. What is nowadays undisputedly accepted is that all human beings are entitled to have rights and obligations, as long as they are born alive and capable of living, and for as long as they are living. They are what we normally call *natural persons*. However, this was not always the case. Suffice to mention slaves in Roman times who were not regarded by Law as subjects, but as objects – that is to say, living and breathings things, not much different from cows and oxen. Most legal systems today, if not all, also recognize other categories of subjects of law – generally referred to as ‘legal persons’ or ‘legal entities’.⁹ These are usually groups of people who perform together certain type of activity (commercial or other), to whom the legal order has recognized legal existence, distinct from the existence of the persons themselves, i.e., the legal entity (e.g., company, association etc.) has its own rights and obligations and can be held liable for certain actions, performed by the natural persons, involved in it. These legal persons are often regarded as a sort of legal fiction, that is to say, an imaginary person, whose sole reason for being recognized by Law is to be useful to natural persons – mostly by helping them limit their personal liability or by providing them with a well-organised legal ‘vehicle’ for cooperation.

Having explained, albeit briefly, what legal rights and legal obligations are and who is capable of having them, it is now time to see who and how makes sure these rights and obligations are legally respected. Observance is the general issue of *law application and law enforcement*. As already established, one of Law’s main characteristics is its binding force. Nevertheless, it is easy to notice that not all people obey the Law at all times. Under these circumstances, those affected by a violation of legal norms (a natural person, a legal entity or even the State) need to have a tool, a mechanism at their disposal to protect their legally recognized interests. Most of the time, this would mean that they are entitled to request assistance from some state authority – more often than not – a jurisdiction, i.e., a governmental body, whose main purpose is to resolve legal disputes by applying the Law (in other words, courts). These can be national or

⁹ For more information on the topic, see Chapter 8 *Some Issues of Contemporary Company Law in Bulgaria*.

international; they can be categorised based on various other criteria such as type of legal disputes, place in the hierarchy, etc.

Normally, the courts act only when someone who is entitled to do so, has requested such action. There are usually two parties to every legal dispute (e.g., a plaintiff and a defendant) and therefore there are at least two sides of the truth, two different interpretations of the law. It is up to the judges to assess the foundation of each claim and to determine the legal consequences for each party by applying the relevant legal provisions. This is mainly done in two ways – either by *legal syllogism*, i.e., a logical tool, based on deductive reasoning, which consists of a comparison between the factual circumstances, described within the applicable legal rule, and the proven facts of the case, and by doing so to draw a conclusion regarding the specific case, or by *analogy* (statutory – *analogia legis*; or legal – *analogia iuris*), i.e., by applying a similar rule or legal principles.

Prior to applying the Law however, the courts should interpret the applicable legal provisions in case they are not sufficiently clear. *Legal interpretation* can be generally defined as a rational activity of finding the exact meaning of an incomprehensive legal provision. It is done by following certain methods of interpretation, some examining the linguistic nature of legal provisions, others – their place in the relevant legal act or their purpose, etc. This process needs to be distinguished from the *legal activism* and *legal arbitrariness* of courts. The former may be defined as ‘the activity performed by the highest jurisdictions, in resolving hard cases by completing the legal prescriptions, sticking to their spirit, in order to protect generally accepted values’¹⁰ and is often regarded as something more or less positive and acceptable, while the latter can be regarded as a sort of distortion of legal rules by the courts, therefore a highly regrettable situation.

Law is one of the most complicated social phenomena. It has practically existed almost since the beginning of mankind and will probably continue to exist (even though changing through time) as long as humans need to

¹⁰ **Nachev, D.** Judicial Activism and the Democratic Legitimacy of Courts. – In: *The Role of Courts in Contemporary Legal Orders*, The Netherlands, Eleven International Publishing, 2019, 134–135.

interact with each other. It has been a research topic for thousands of years and has spurred a colossal number of theories and concepts. It is therefore very difficult to present its most important features within a few pages or even within a whole book. I hope that this chapter is sufficiently well written so that those who decide to read it will start searching for more information about the topics discussed and go much further than what can be found here.

CHAPTER 2:

BRIEF OVERVIEW OF THE CONTRACT – FORMATION, CONTENT AND TYPES

Hristina Tancheva

ABSTRACT	KEYWORDS
The contract is the most important source of rights and obligations in the field of civil law. It is a legally binding agreement that may be enforced by law in case of breach. The parties are free to negotiate and conclude a contract that meets their interest as the process of conclusion includes an offer and acceptance. The parties must negotiate in good faith as they are not obliged to accept the offer but once the agreement is concluded it is binding for them and cannot be amended or terminated unilaterally unless the law or the contract provides otherwise. Most of the contracts are informal and can be concluded orally without written document or notary certification. However, in certain cases the law provides for a specific form of the agreement and if it is not met the contract is invalid. We also have real contracts where in addition to the agreement, delivery of an item is required.	freedom of contract, privity of contract, good faith, offer, acceptance, general terms, essential content, conclusion.

I. INTRODUCTION

The contract is the most important source of obligation, as every day we conclude various agreements: we buy coffee, tickets on the bus, products from the store, etc. Most contracts are concluded orally, without any written evidence, and are immediately executed. However, when a dispute arises, we need legal rules to solve the problem. The general rules for contracts are provided in the Obligations and Contracts Act.

The contract is a legally binding agreement imposing rights and obligations in areas of civil law that may be enforced by law. The parties enter into an agreement, freely choosing the type of contract and its content. Yet, not every promise to another party is binding. If a friend promises to bring a snack to a party but forgets, this would not be considered a breach of contract. Even though the friend's promise was made honestly and seriously and intended to be binding, the intention was probably not to form a legal agreement enforceable in court. Moreover, the promise to donate has no effect pursuant to Article 226 of the Obligations and Contracts Act (OCA).¹

The contract is a **bilateral transaction** consisting of two statements – offer and acceptance. However, there are unilateral statements² of will where one person expresses his will and no other person is bound, for example, public promise of reward, powers of attorney, testaments, promissory notes, etc. We also have multilateral agreements – when the parties' will is directed towards a common purpose (e.g., a contract of partnership).³

1. Definition

According to the legal definition: *a contract is an agreement between two or more persons which creates, amends, or terminates a legal relationship between them* (Article 8(1) OCA). Thus, a contract can:

- **create** a relationship – sale and purchase contract, donation, lease contract, etc.;
- **amend** an existing contract – the parties can, by mutual agreement, amend the term, place of execution, quantity, etc.; or
- **terminate** a relationship – e.g., an obligation can be remitted by agreement between the parties or a lease contract, concluded for two years, can be terminated in the first year by the parties' mutual agreement, etc.

¹ Решение № 229 от 06.07.2011 г. по гр. д. № 162/2009 г. на ВКС.

² In the Anglo-Saxon system, one-sided promises are not considered to be binding, it is a problem of morals when people do not fulfil their promises. For example, a public promise of reward is deemed to be an offer which will be accepted to be enforceable.

³ Решение № 506 от 24.03.2011 г. по гр. д. № 731/2010 г. на САС.

A contract usually has **two parties** but one of the ‘parties’ can comprise more than one person. For example, if a husband and spouse sell their house to three brothers, we have one contract with two parties and five persons – two on the side of the seller and three on the side of the buyer (who will become co-owners of the house).

In any event, the contract will have two parties even if they are represented by the same person or if the representative itself is a party to the agreement. For example, one person represents both seller and buyer in a sale agreement or *one person is the buyer of a property and at the same time, represents the seller*. However, in both cases the consent of the represented person(s) is required for the contract to be valid (Article 38 OCA).⁴

2. The main principles of contract law and the fundamental ideas of the institute are:

- *Freedom of contract*. The parties are free to negotiate and determine the content of the contract insofar as it does not contravene the **mandatory provisions** of the law and **good morals** (Article 9 OCA).⁵ This means that the persons voluntarily conclude contracts and are free to decide whether to conclude a contract at all, with whom to negotiate, what kind of contract to conclude, which clauses to include, etc. Furthermore, we can have ***innominate contracts*** – these are contracts that are not provided for in law. For example, a contract for the transfer of property against an obligation to take care and support the other party financially is not regulated by law but can be concluded on the grounds of Article 9 OCA, as the general rules and the rules concerning sale agreements (as it is a similar contract) will apply.
- *Pacta sunt servanda*. Contracts will have the force of law for the parties which have concluded them. This means that contracts are binding on the parties and may be amended or terminated only by their mutual consent or on grounds provided for in the law. Rights

⁴ Определение № 15 от 14.01.2009 г. по гр. д. № 3967/2008 г. на ВКС.

⁵ Решение № 135 от 18.11.2015 г. по т. д. № 2634 / 2014 г. на ВКС.

and obligations assumed by the contract cannot be changed by way of interpretation.⁶ For example: a party cannot terminate a contract unilaterally unless the other party is in default nor can it change the price or place of performance unilaterally. The parties must perform the contract otherwise they can be forced to perform through legal means. No one can be forced to enter into an agreement but if doing so voluntarily, he is obliged to fulfil the contract's terms just as he is obliged to obey the law.

- *Privity of contracts.*⁷ The contract creates rights and obligations for the parties. The contract has effect between them but concerning third parties, the contract will have effect only in cases envisaged in law. For example, Article 22 OCA provides that contracts having a third party as beneficiary can be concluded.⁸ In this case the third party can acquire only rights, not obligations as it can refuse to accept the stipulated rights at its own discretion.⁹
- *Good faith* – when concluding a contract¹⁰ and upon its execution, the parties must act in good faith which means that they have to be fair, sincere and honest.¹¹

⁶ Определение № 2427 от 9.08.2023 г. на ВКС по к. гр. д. № 4348/2022 г.

⁷ **Merkin, R.** Privity of contract. Informa law from Routledge, 2013.

⁸ **Калайджиев, А.** Облигационно право. Обща част. Седмо издание. София, Сиби, 2020, 137–149; **Кожухаров, А.** Облигационно право. Общо учение за облигационното отношение. Нова редакция и допълнения Петко Попов. София, Юриспрес, 2002, 102–108.

⁹ If a contract contains some stipulation in favour of a third person, the latter may demand its fulfilment. The third party need not be in existence or identified at the time the contract is concluded (e.g., it can be stipulated that the contract is in favour of A's children despite the fact that at the time of the conclusion, there were none).

¹⁰ Решение № 17 от 08.03.2013 г. по търг. д. № 829/2012 г. на ВКС.

¹¹ **Jansen, N., Reinhard Zimmerman.** Commentaries on European Contract Laws. Oxford University Press, p. 138 et seq.

II. CONTRACT CONCLUSION

1. Legal capacity

A contract can be validly concluded by a person who has legal capacity to act.

Legal entities express their will through their bodies and are capable of concluding any contract. For example, a Limited Liability Company is represented by its manager; a Joint Stock Company by the Executive Director, etc. However, certain agreements require the passing of a resolution of the General Meeting of Shareholders in advance. This includes the acquisition or alienation of real property and the real rights over such property on behalf of a Limited Liability Company.¹² However, the contract for acquisition or alienation of real estate and real rights over such property concluded by the manager is valid even if no resolution of the General Meeting of Shareholders is passed according to Interpretive Decision 3/2013 of General Assembly of the Civil and Commercial departments of the Supreme Court of Cassation.

Every *natural person* can be the subject of legal relationships but the power to conclude contracts and perform other legal acts is acquired at a certain age. Therefore, every person can have rights and obligations under an agreement, but not every person can acquire rights and assume obligations through his own actions as the law imposes some restrictions. This means that if a child in a playground offers to sell one of his toys, this offer will not be binding.

At the age of *eighteen* people become fully capable of concluding contracts and performing other legal acts (Article 2 of the Persons and Family Act). Persons under the age of fourteen years are infants (Article 4 of the Persons and Family Act) and cannot conclude contracts or perform any legal actions.¹³ They are represented by their parents or guardians who

¹² Русчев, И. Придобиване и отчуждаване на имоти в ООД без решение на общото събрание. // Търговско и конкурентно право, 2011, № 4, 5–17.

¹³ This regulation is problematic because children under the age of 14 years go to school but as they cannot conclude valid contracts, they cannot legally buy something to eat for breakfast. The regime is too old and will be revised.

act on their behalf.¹⁴ Persons from fourteen to eighteen years are minors (Article 3 of the Persons and Family Act) and can perform legal actions, not alone but with the consent of their parents or custodian. This means that when concluding a contract, the minor and the parent (custodian) must be in agreement. However, minors can conclude on their own small value contracts in order to meet their current needs (e.g., they can buy a sandwich on their own) and can also spend what they gained by their own labour (i.e., if they get job¹⁵ and earned some money, they can buy a telephone).

When a person over 18 years of age suffers from insanity or mental illness (either inherited or acquired) due to which he or she cannot take care of his or her own property, such person can be restricted in performing legal actions (including contracts) – Article 5 of the Persons and Family Act.¹⁶ This is an instrument designed to protect the interests of those persons who are unable to take care of their own interests. The restriction can be full if the person is totally unable to take care of his or her property. In that case the person can be placed under *full incapacity* and become incapacitated and will have the status of a child under the age of 14 with his guardians undertaking legal actions on his behalf. A contract where one of the contracting parties is an infant or person placed under full incapacity is invalid.¹⁷

If the condition of the person is not so grave that he is placed under *full incapacity*, at the court's discretion he will be placed under *limited incapacity*.¹⁸ The person will then have the status of a person at the age between 14 and 18 years. Thus, he will have a custodian who gives consent for him to undertake legal activities as the individual cannot act alone.

¹⁴ The parents must manage the child's property in its interest and with due diligence. For example, a parent can conclude a contract for the lease of a child's property. However, concluding contracts for: the disposal of immovable and/or movable property through a formal deal; bank deposits, and securities, possessed by the child is determined by permission of the Regional Court, if the disposal does not contradict the child's interest.

¹⁵ The minimum age for employment is 16 years. By exception, children at the age of 15 can get jobs that are light, not dangerous or harmful to health, or physical, mental and moral development.

¹⁶ Решение № 230 от 18.12.2023 г. на ВКС по к. гр. д. № 340/2023 г.

¹⁷ Павлова, М. Гражданско право. Обща част. София, Софи-Р, 2002, с. 537.

¹⁸ Определение № 1547 от 8.06.2023 г. на ВКС по гр. д. № 433/2023 г., III г. о., ГК.

Some actions cannot be performed by persons under the age of 18 either alone, or when represented and will be invalid (Article 130(4) of the Family Code):

- ◆ donation;
- ◆ waiver of rights;¹⁹
- ◆ lending money;
- ◆ securing someone else's obligation. By exception, securing someone else's obligation through pledge or mortgage may be admitted with the permission of the Regional Court in case of need, evident profit for the child, or in case of outstanding needs of the family.²⁰

2. Process of conclusion

The parties must act in good faith²¹ in conducting negotiations and concluding contracts, otherwise they will be liable for damages (Article 12 OCA). For example: if one of the parties hides important information about assets that will be transferred and the contract is voided, losses/damages (if any) will be indemnified. This also applies if one of the parties discloses confidential information that has been provided by the other party; if it terminates negotiations without good reason; or if it enters into or continues negotiations with no real intention of reaching an agreement with the other party. Therefore, a party is free to negotiate and is not liable for failure to reach an agreement but if the party has negotiated or terminated negotiations contrary to good faith and fair dealing, it is liable for any damages caused to the other party.

¹⁹ Interpretive Decision 1/2021 of General Assembly of the Civil Department of the Supreme Court of Cassation provides that renunciation of inheritance by a person under the age of 18 is invalid as it constitutes a waiver of rights within the meaning of Article 130(4) of the Family Code.

²⁰ Решение № 1844 от 21.03.2017 г. на СГС по в. ч. гр. д. № 1438/2017 г.

²¹ When a party enters into negotiations with the intention of concluding a contract, it should bring to the knowledge of the other party all the circumstances that are important for forming its decision to conclude the contract (Решение № 17 от 8.03.2013 г. на ВКС по т. д. № 829/2012 г., I т. о., ТК).

2.1. In order for a contract to be concluded one of the parties (offeror) must make an **offer**²² to the other party (offeree). The offer is a unilateral proposition that one party makes to the other for the conclusion of the contract. It expresses the willingness to be bound by the contract and must include the essential content of the particular type of contract. Therefore, the offer indicates the **intention of the offeror** (the person who makes the offer) to be bound and the terms under which the offeror is willing to be so.²³ Without a genuine intention for the parties to be legally bound, no legal relation will be created and an agreement will not be legally enforceable. Thus, a study case or a joke, presented as an example of contract conclusion, will not be legally binding.²⁴

The offer is sufficiently determined if it is possible to accept it by simply saying ‘yes’. For example, the offer to conclude a lease contract must include, at least, details of the property and the lease price. However, an invitation by one party to another to make an offer is not an offer in itself but an invitation for negotiation. For example, goods displayed in shops are not considered an offer but an invitation to make such in accordance with the terms indicated. The customer makes an offer by presenting the product to the cashier.

An offer can be:

- express – either verbal or written, or
- implied – the willingness to do or to abstain from doing something, which follows from conduct or circumstances. For example, an offer to sell products can be made by sending them to the offeree without prior arrangement.

The offeror will be bound by the offer until (Article 13(1) OCA):

- ✓ expiration of the time period specified therein.
- ✓ if there is no time period for acceptance:

²² **Charman, M.** Contract law. Fourth edition. Willan publishing, 2007.

²³ **Smits, J.** Contract Law: A Comparative Introduction, Second Edition. Edward Elgar Publishing, 2017.

²⁴ **Калайджиев, А.** Цит. съч., с. 66.

- an offer made to a *person present* will lose its effect if it is not accepted immediately;
- an offer made to a *non-present person* will be effective upon expiration of such a period of time as is normally necessary, according to circumstances, for the acceptance to reach the offeror.

The offer is made personally when the parties are physically at the same place or they are not but communicate in such way that they can be considered as present – talking on telephone, Viber, Skype, etc. Example: if the offer indicates that the offeree has three days to respond, the offeror is bound until the expiration of this period. If a period is not indicated, the offeror will be bound until expiration of, for example, 2 days because the reception of letters through the post usually takes two working days.

The offer can be *addressed to an indefinite number of persons*, including through mass media. It should contain both the total quantity offered and the time limit for accepting the offer (Article 291 of the Commerce Act). In this case the offeror will be bound until the quantity is exhausted within the specified time limit.²⁵ However, catalogues, price-lists, tariffs, as well as advertisements or other statements addressed to an indefinite number of persons, will be deemed to be an invitation to negotiate (Article 290 of the Commerce Act), e.g., to make an offer in accordance with them. If the offer is not accepted without reasonable cause, the author of the invitation will be held liable for damages incurred by the offeror.²⁶

When buying something by inserting a coin in a machine who will make the offer as the machine has no will and cannot negotiate? In such cases the owner of the machine, or the person that exploits it when he installs and prepares it for use, makes the offer which the buyer accepts by using the machine.

The offer may specify the method of acceptance. For example, it can be provided that acceptance will be sent by email or indicated that the offeree will send a text message or a registered letter to accept the offer.

²⁵ Герджиков, О. Търговски сделки. София, Труд и право, 2008, с. 35.

²⁶ Герджиков, О. Цит. съч., 35–36.

The offer can be **withdrawn** only if the withdrawal reaches the offeree before or at the same time as the offer.²⁷

Thus, an offer will be valid until:

- acceptance
- refusal
- subject to counter-offer: a new proposal from the other party;
- expiry of a time limit: either a specific time period set by the offeror or a reasonable time
- withdrawal of the offer.

2.2. In order for the contract to be concluded the offeree must **accept** the offer completely. The acceptance is a statement expressing the person's willingness to be bound by the terms of the offer. If the offeree agrees to some clauses but disagrees with others, the contract is not concluded and negotiations continue. Therefore, acceptance must be unconditional, i.e., it must conform with all the terms and conditions of the offer otherwise it will constitute a new proposal (counter-offer) which means that any modification or variation from the terms and conditions of the original offer prevent conclusion of the agreement. For example: A proposes to B to sell him A's computer for 200. If B agrees to buy but for 180 no agreement is concluded. However, the statement of B can be considered as a counter-offer and if A accepts, the contract can be concluded.

If the offeree does not express its will, whether or not it accepts the offer, the contract will not be concluded, e.g., silence does not constitute acceptance by general rule. However, Article 292(1) of the Commerce Act provides that an offer to a merchant with whom the offerer has lasting commercial relations will be considered accepted if not immediately rejected.²⁸

An acceptance can be made by conduct. For example, the party does not accept the offer in words but pays the other party the price indicated in the offer.

²⁷ Определение № 222 от 07.04.2021 г. по т. д. № 146 / 2020 г. на ВКС, 1-во ТО.

²⁸ Герджиков, О. Цит. съч., 36–37.

Acceptance can be **withdrawn** only if the withdrawal reaches the offeror before or at the same time as the acceptance (Article 13(4) OCA). If it is evident that a delayed acceptance was sent on time, the contract will be deemed concluded unless the offeror notifies the offeree immediately that it considers such acceptance overdue (Article 13(5) OCA).

Therefore, the offer and acceptance are generally irrevocable unless the withdrawal reaches the other party before or at the same time as the offer/acceptance.

2.3. *When is a contract concluded?*

A contract will be deemed concluded from the moment when the acceptance reaches the offeror. For example, if A sent the offer through the post on 01.09.2023 and the other party received the letter on 03.09.2023 and sent the acceptance, also through the post, on 04.09.2023 and A received the letter on 07.09.2023 – this latter date will be the date on which the contract is deemed concluded (07.09.2023). This approach puts the risk of a message being lost before the arrival on the sender and the risk of the message not being read on the recipient.

The moment of conclusion determines:

- ◆ the law applicable to the contract;
- ◆ the ability of the parties to conclude the contract;
- ◆ the transfer of property in certain cases.²⁹

If, after the acceptance has been sent, any of the parties dies or falls into a condition which constitutes grounds for placement under interdiction, the contract will be deemed concluded (Article 14(2) OCA). In some cases, the performance of the contract becomes impossible when the obligation is personal (*intuitu personae*), for example in the case of performance by an

²⁹ Article 24 of the Obligations and Contracts Act provides that, in the case of ownership transfer contracts and contracts for establishing or transferring some other property rights over a specific movable property, the transfer or establishment will occur by virtue of the contract itself and will not require delivery. In contracts for the transfer of ownership of fungibles, ownership will be transferred when the fungibles are specified by agreement of the parties or on delivery thereof.

artist. In the latter case the contract will be deemed concluded but will be terminated by operation of law due to the impossibility of execution. Where execution of the contract is not of a personal nature, as in the case of a sale contract, the agreement will be effective and will bind the successors of the dead person or representatives of the person placed under interdiction.

2.4. *Where is a contract concluded?*

A contract will be considered concluded at the place where the offer was made (Article 14(1) OCA).

2.5. Bulgarian law does not provide a specific form for the offer and acceptance.³⁰ Thus, these are informal statements and may be delivered in written form or verbally.³¹ They can be sent as postal letters, an email or communicated by telephone, but if the law requires a specific form of contract, this form must be observed for the contract to be effective. For example: if A wishes to sell his inheritance to B, he can write him a SMS with the offer and, even if B texts him back that he agrees, it does not mean that the contract is concluded. Article 212 OCA requires the contract for sale of inheritance to be concluded with notarized signatures of the parties. Therefore, the parties must sign the contract before a notary in order for the contract to be valid.

2.6. The written form will be observed if an **electronic document** is drafted, containing an electronic statement.³² This means that if a law requires a document to be drafted in simple written form without notarization, an electronic document can be valid (e.g., an email).³³ For example: a preliminary contract for the sale of real estate which, under Article 19 OCA

³⁰ Решение № 485 от 09.06.2010 г. по ч. гр. д. № 1451/2009 г. на ВКС, ГК, III г. о.

³¹ Решение № 485 от 9.06.2010 г. на ВКС по гр. д. № 1451/2009 г., III г. о., ГК.

³² Article 9, item 1 of Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 provides that Member States must ensure that their legal system allows contracts to be concluded by electronic means. Member States must in particular ensure that the legal requirements applicable to the contractual process neither create obstacles for the use of electronic contracts nor result in such contracts being deprived of legal effectiveness and validity on account of their having been made by electronic means.

³³ Решение № 77 от 17.03.2015 г. по дело № 2040/2014 г., IV г. о., ГК, ВКС; Решение № 303 от 07.10.2013 г. по гр. д. № 3715/2013 г., IV г. о., ВКС.

must be in writing, can be concluded by email. One party can send the other an email containing the offer to conclude such a contract and the second party can send back an email with its confirmation.

The specific features of electronic statements are regulated by the Electronic Document and Electronic Trust Services Act. Article 3(2) provides that the ‘electronic document’ is an electronic document within the meaning of Article 3, item 35 of Regulation (EU) No 910/2014 of the European Parliament and of the Council of 23 July 2014 on electronic identification and trust services for electronic transactions in the internal market and repealing Directive 1999/93/EC (OJ, L 257/73 of 28 August 2014): *electronic document means any content stored in electronic form, in particular text or sound, visual or audiovisual recording.*

A consumer contract between a trader and a consumer can also be concluded **remotely**,³⁴ without the simultaneous physical presence of the parties, using one or more means of distance communication – by telephone, by mail, over the internet, using digital television services, etc. (see Article 45 of the Consumer Protection Act). However, if the two parties to a contract are not dealing with each other face to face, the consumer can be at a disadvantage in not seeing the goods described by the seller. Thus, the specific feature of this contract is the obligation of the seller to inform the consumer of the name and address of the trader, the main characteristics of the goods, the price including VAT, the cost of transport, costs for delivery, etc. In addition, the consumer has the right, unilaterally, to withdraw from this contract within 14 days from its conclusion without the need to give reasons (only the costs of returning the goods will be borne by the consumer) and the seller is obliged to return, in full, the sums paid by the consumer no later than 30 days from the date of withdrawal. The consumer is obliged to preserve the goods and return them.

2.7. The offer may contain **general terms**. General terms are drafted in advance by one of the parties (usually the seller). They are used when

³⁴ Directive 2011/83/EU establishes rules on information to be provided for distance contracts, off-premises contracts and contracts other than distance and off-premises contracts.

one of the parties concludes many contracts of the same type and general terms facilitate the process of conclusion.³⁵ For example, mobile network operators, banks, insurance companies, etc. usually provide general terms to their customers. However, general terms are often unfavourable to the other party and legislation tends to intervene to protect the interests of the weaker party (see below).

If the offer contains general terms, acceptance will be effective provided it confirms acceptance of those general terms **in writing** (Article 16(1) OCA). However, these general conditions will become binding upon the other party if it states in writing its acceptance or is a merchant and has known or should have known them and has failed to reject them immediately (Article 298(1) Commerce Act).³⁶ When concluding a contract under general terms with a consumer, the general terms bind the consumer only if they have been provided to him and he has agreed to them. The consumer's consent to the general terms is certified by his signature – Article 147a of the Consumer Protection Act.

General terms can be amended or supplemented but in the event of a discrepancy between these provisions and the provisions contained in the general terms, the former will prevail even though the latter may not have been removed. For example, if, the general terms of A note that the parties can terminate the contract with three-months' notice and the contract between A and B states that the general terms of A are applicable but also states that the contract will be terminated with one-month notice, the second provision will prevail as it is individually stipulated between the parties and is not part of the general terms.

However, clauses of general terms stipulated in an agreement with a consumer can be unfair and thus void. Article 143 of Consumer Protection Act³⁷ provides that an unfair term in a contract concluded with a consumer is be any clause, to the detriment of the consumer, which is contrary to the requirement of good faith and causes a

³⁵ Русчев, И. Сключване на договори при общи условия – проблеми в доктрината и практиката. // Търговско и конкурентно право, 2010, № 9.

³⁶ Определение № 29 от 13.01.2014 г. по търг. д. № 1617/2013 г. на ВКС.

³⁷ These regulations were passed following the European Directive on Unfair Terms in Consumer Contracts (93/13/EEC).

significant imbalance in the rights and obligations of the trader and the consumer.³⁸ For example:

- a clause excluding or limiting the statutory liability of a producer, trader or supplier in the event of the death, or personal injury to a consumer resulting from an act or omission of the said trader or supplier;
- a clause making the fulfilment of contractual obligations by the trader subject to a condition the realisation of which depends only on his own will;
- a clause requiring any consumer who fails to fulfil the obligation thereof to pay a disproportionately high amount in compensation, etc.

III. CONTENT OF THE CONTRACT

The terms stipulated in the contract are not all of equal importance.

1. Essential content

The essential content of a contract comprises those clauses on which the parties must necessarily reach consensus in order for the contract to be concluded and qualified as a certain type.³⁹ Thus, these are the clauses that typify and individualize the contract.⁴⁰ For example, under a sale agreement, the parties must agree that the seller transfers to the buyer the right of ownership of a certain item for a certain price. If the item will not be transferred but temporarily used against a certain amount, this will be a lease contract.

³⁸ Определение № 252 от 23.04.2019 г. по т. д. № 2462 / 2018 г. на ВКС, 2-по ТО.

³⁹ In the Anglo-Saxon legal system, the more important terms, those which are fundamental to the contract, are called 'conditions' and the less important, 'warranties'.

⁴⁰ **Таджер, В.** Гражданско право на НРБ обща част. Дял II. София, Наука и изкуство, 1973, с. 431.

2. Non-essential content

Non-essential content includes those clauses, on which the parties agree, in deviation from the typical legal consequences of the contract required by law.⁴¹ This means that the parties can agree on some other consequences, as long as they do not conflict with imperative norms of the law and rules of morality. Thus, the parties may settle something different from what is prescribed by dispositive legal norms regarding the relevant type of agreement. Non-essential content of a transaction are, for example, any of the modalities conditioning the effect of the contract on the expiration of a certain period, on the fulfilment of a certain future uncertain event or on the fulfilment of a burden. For example: the parties can stipulate a term for execution of the debtor's obligation under the contract. If the obligation has no fixed time period, the creditor can demand performance immediately as provided by law.

3. Natural content (implied terms)

The natural content of the contract is formed by clauses that are considered tacitly accepted by the parties, insofar as they derive directly from the law. For example, if the item sold does not belong to the purchaser, the rules of eviction will apply whether agreed or not. The same applies to the sale of an item with defects – liability for defects follows.

4. The contract can consist of a few clauses or be more detailed depending on the parties' will. In the case of unsettled issues, the legal provision will apply. Thus, if the parties do not stipulate the place of performance, the rules of Article 68 OCA will be applicable. If the parties do not stipulate the time of performance, the rules of Article 69 OCA will apply. When the parties wish to regulate their relations in detail, they can deviate from dispositive legal rules and/or include rules that are not provided by law. They can include the definition of words used in the contract, requirements for extension of the effect of the contract, requirements for amendments of the contract, clauses regarding non-performance including liquidated damages, specific rules on termination,

⁴¹ Таджер, В. Цит. съч., с. 431.

clauses for dispute resolution (e.g., an arbitration clause),⁴² clauses to make invalid provisions severable from the rest of the contract, requirements for sending notices, etc.

The parties can agree to avoid or restrict their liability in case of non-performance. Thus, we have two types of exemption clause:

- limitation clauses – where a party limits its liability under the contract – for example, up to a certain amount of damages;
- exclusion clauses – where a party avoids any liability under the contract for certain cases of non-performance.⁴³

Clauses that exclude or limit the debtor's liability for deliberate actions or gross negligence will be null and void if stipulated prior to the non-performance occurring. When such a clause arises in a consumer contract, it can be unfair and therefore invalid (see above).

5. If any term of the contract is unclear or incomplete, it is subject to interpretation and gap-filling. When **interpreting** contracts, the actual common will of the parties needs to be sought (Article 20 OCA). The aim of interpretation is to discover the actual meaning of the words used by the parties in order to identify their intention.⁴⁴ Individual provisions are interpreted in their interrelation and each is interpreted within the meaning arising from the contract as a whole, taking into account the aim of the contract and good faith.⁴⁵ The contract will be interpreted according to the meaning which a reasonable person would give to it.

If the contract is incomplete and does not cover any relevant matter, the legal rules (if any) will apply. For example, if the place of performance is not indicated, Article 68 OCA will apply.

⁴² Article 19(1) of the Civil Procedure Code: 'The parties to a property dispute may agree to settle it by an arbitration court, except when the subject-matter of the dispute is real-estate rights or possession of a real-estate, maintenance, labour relationship or in case one of the parties is a consumer within the meaning of § 13, Item 1 of the Supplementary Provisions of the Consumer Protection Act.'

⁴³ **Митев К.** Освобождаващи клаузи в договорите. София, Сиби, 2007.

⁴⁴ **Kötz, H.** European Contract Law. Oxford University Press, 2017.

⁴⁵ Определение № 262 от 7.02.2024 г. на ВКС по т. д. № 514/2023 г., II т. о., ТК.

IV. TYPES OF CONTRACTS

There are different types of contracts according to various criteria:

1. Formation

Consensual – the consent of the parties is sufficient to conclude the contract. Most contracts are informal – leases, manufacturing agreements, loans, etc. They need not be in writing, which makes them easy to conclude, especially in the case of contracts that are concluded every day, like purchase of goods. However, contracts for amounts exceeding BGN 5,000 cannot be proven by witnesses in court unless they have been concluded between spouses or relatives (Article 164(1), item 3 of the Civil Procedure Code).⁴⁶

Real – delivery of an item is required, in addition to consent, in order for the contract to be concluded – e.g., deposit, pledge, *commodatum* (loan). The contract is not concluded in the case of non-delivery of the item.

Formal – where special formalities are required for conclusion. The contract will not be valid if the required form is not met.⁴⁷ Buying a newspaper or a house are not the same thing. In certain cases, the formal contract prevents the party from inconsiderate actions as it warns that entering into the contract can be financially dangerous (e.g., a guarantee contract requires written form). The form of contract also guarantees third-party interests – they can become familiar with the content of the contract if having a legal interest. Moreover, a notary form indicates the exact date of the contract and certifies the content in some cases (Notary Deed, Notary Certificate of content).

A Notary Deed is required when:

- real estate is transferred (Article 18 OCA).⁴⁸ However, in order for the contract to be opposed to third parties, registration in the Registry Office, Property Register is required;

⁴⁶ Решение № 50100 от 12.01.2024 г. по т. д. № 1485 / 2022 г. на ВКС, 1-во ТО.

⁴⁷ Определение № 195 от 26.03.2013 г. на ВКС по т. д. № 589/2012 г., II т. о., ТК.

⁴⁸ The transfer of the right of ownership or establishment of another real right over immovable property which is owned by the state or municipally will be made in writing. A Notarial Deed is not required.

- a mortgage is established (Article 167(1) OCA). Registration in the Registry Office, Property Register is obligatory for the establishment of the mortgage.
- a testament is created – two witnesses must be present together with the testator and the Notary (Article 24(1) Inheritance Act).⁴⁹

Notary Certification of the signatures of the parties is required when:

- a motor vehicle registered in Bulgaria is transferred;
- an inheritance is sold (Article 212(2) OCA);
- a donation of movable property is made if it is not handed over upon contract conclusion (Article 225(2) OCA);
- a special pledge is established over shares from a limited liability company or commercial enterprise, etc.

Notary Certification of signatures of the parties together with certification of the content of the document are required:

- when shares from the capital of a limited liability company are transferred (Article 129(2) Commerce Act);
- when a commercial enterprise is transferred (Article 15(1) Commerce Act);
- when a marriage contract etc., is drawn up (Article 39(1) Family Code);.

Simple written form is required in case of:

- a guarantee agreement (Article 138(1) Obligations and Contract Act);
- a contract establishing a special pledge except over the assets indicated above;
- an employment contract (Article 53(2) Labour Code);

However, a contract can be deemed valid if the required form is not observed but the contract can be converted to another type of contract.⁵⁰

⁴⁹ Alternatively, there is also the handwritten testament which requires only written form (handwritten text) and no witnesses or Notary is needed.

⁵⁰ **Димитров, В.** Конверсия на сделки – същност и приложение. // Търговско право, 2023, № 2, с. 39 и сл.

For example, if a contract for the sale of real estate is not in the form of a Notary Deed but in written form it can be considered as a ‘preliminary contract’ (see below).

2. Equivalence of considerations

Remuneratory – the parties exchange correlative values, they exchange reciprocal considerations – e.g., sale, lease, interest-bearing loan, etc.

Gratuitous – where no correlative consideration is received by one party – e.g., donation, *commodatum*, etc.

3. The nature of the *vinculum juris* produced

Unilateral – only one party is bound to execute obligation(s), the other party has only right(s), e.g., *commodatum*, deposit, if no remuneration is stipulated, etc.;

Bilateral (synallagmatic) – both parties are bound to execute obligations, e.g., sale, a manufacturing agreement, etc.

4. Legal regulation

Nominate – provided and regulated by law;

Innominate – contracts not regulated by law – e.g., contract for transfer of property against the obligation to take care of and financially support the other party. Such contracts are regulated by general rules.

5. Relation to other contracts:

Principal – may exist alone: e.g., lease;

Accessory – depends on another contract for its existence, e.g., guarantee, mortgage.

When the principal agreement is terminated, the accessory one is also deemed terminated. For example: if the debt is paid, the pledge will be extinguished and the property returned.

6. Cause

abstract – where the law does not require specific reason⁵¹: e.g., promissory note, endorsement;

causal – when the law requires a specific reason: e.g., the buyer pays the money to the seller to acquire the property (*acquirendi causa*).

7. Commutative or aleatory

commutative – upon conclusion it is known what the benefit for each party will be. For example: the contract of lease is of this kind – the lessor provides property to be used against a certain price which is specified in the contract.

aleatory – an agreement concerned with an uncertain event that leads to benefit for one of the parties at the expense of the other. Insurance contracts are aleatory because an insured person can pay premiums for many years without sustaining a covered loss. Conversely, sometimes the person pays relatively small premiums for a short period and then receives coverage for a substantial loss by the insurance company.

8. Some of the most important contracts are:

- ◆ **Sale contract** – this is the most frequently used contract. Under this contract the seller assumes the obligation to transfer, to the buyer, ownership of a property (or another right) for a price and the buyer assumes the obligation to pay the seller and receive the property. The contract is informal unless the law requires a specific form (see above).
- ◆ Under a contract for **donation**, the grantor (donor) gratuitously transfers something to the grantee (donee) who accepts it. Thus, the donee will agree to the donation. If he does not there is no donation. We cannot force someone to accept a gift. The donation of movable property must be concluded in writing with notarised signatures, or by ‘handing over’. The donation of immovable property must take

⁵¹ **Конов, Т.** За абстрактните сделки и каузата на договорите. // Търговско право, 2002, № 2, с. 5 и сл.

the form of a Notary Deed. A promise to make a donation will have no effect. Donation of future property is null and void.⁵²

- ◆ Under a **lease agreement** the lessor will provide a property to the lessee for temporary use, and the lessee will pay him a certain price.⁵³ This contract may not be concluded for a period longer than 10 years, unless it is a commercial agreement, e.g., one of the parties is a trader. If the contract is signed for a longer period, it is valid for only ten years. The contract is informal but if the parties wish to enter the agreement in the Property Register, they must conclude the contract with notarized signatures. When the contract is registered it can be opposed against a subsequent acquirer of the real estate and the lessee cannot be evicted.
- ◆ Under a **loan agreement** the lender provides, to the borrower, money or other fungibles and the borrower assumes the obligation to return the same amount, or fungibles of the same type, quantity, and quality. The contract is informal, but the borrower will owe interest only if it is agreed upon, in writing (unless the agreement is concluded between traders).⁵⁴
- ◆ Under a **mandate agreement** the mandatory assumes the obligation to undertake, on the account of the mandator, those actions (usually legal) assigned by the mandator. The contract is gratuitous unless a remuneration is stipulated.⁵⁵

N.B. The mandatory will act on his own behalf if the mandatory contract is not accompanied with a Power of Attorney.⁵⁶ The Power of Attorney establish direct representation and is a unilateral act (not a

⁵² Русчев, И. Договорът за дарение на бъдещо имущество и на чужда вещ. // Собственост и право, 2010, № 4.

⁵³ Кожухаров, А. Облигационно право. Отделни видове облигационни отношения. Нова редакция и допълнения Петко Попов. София, Юриспрес, 2002, с. 197 и сл.

⁵⁴ Кожухаров, А. Облигационно право. Отделни видове облигационни отношения. Нова редакция и допълнения Петко Попов. София, Юриспрес, 2002, с. 275 и сл.

⁵⁵ Кожухаров, А. Облигационно право. Отделни видове облигационни отношения. Нова редакция и допълнения Петко Попов. София, Юриспрес, 2002, с. 325 и сл.

⁵⁶ Power of Attorney provided for the conclusion of a contract which requires a specific form need to be made in that particular form. However, if the contract will be concluded in the form of a Notarial Deed, the power of attorney will be made in writing with a notarized signature and content.

contract). Therefore, if there is a Power of Attorney, the mandatary will act on behalf, and at the expense, of the mandator. If the mandatary acts on behalf of the mandator, the rights and obligations from transactions concluded with third parties will arise directly for the mandatary and will not be transferred. If the mandatary acts in his/her own name, the rights and obligations from transactions with third parties will arise for him/her and then s/he will transfer those rights to the mandator.

Preliminary contract – is a contract that is concluded prior to the conclusion of a final contract. In the preliminary contract the parties agree to conclude a final one in the future. This contract is usually concluded when the parties cannot conclude a final contract because it requires a special form (notarized) or one of them does not have enough money, the necessary documentation, etc. For example, if I find an apartment I wish to buy but the seller does not have a sketch (which is necessary for conclusion of an agreement for the sale of real estate), we cannot conclude a final agreement. However, we can conclude a preliminary agreement so that I can be sure that the seller will not refuse to transfer ownership in future.

If the final agreement must be concluded in the form of a Notary Deed or notary certification is required, the preliminary contract must be **concluded in writing** (Article 19(1) OCA). Most often parties conclude a preliminary agreement for the transfer of immovable property⁵⁷ because the final agreement needs to be in the form of a Notary Deed which requires payment of notary and state taxes, collection of documents, etc.

A preliminary contract will contain provisions concerning **the essential terms** of the final contract (for a sale, the preliminary contract will include the asset, the price, the term, etc.) – Article 19(1) OCA.

The parties to the preliminary agreement promise to conclude a final one and if one of them refuses to conclude a final agreement, under the terms and conditions of the preliminary contract, the other party may bring action before the court for conclusion of the final contract or may terminate the contract.⁵⁸ In this case the contract will be deemed concluded as of the moment of entry into force of the court ruling. The idea is that if

⁵⁷ Решение № 94 от 28.08.2019 г. на ВКС по гр. д. № 3612/2018 г., III г. о., ГК.

⁵⁸ Решение № 40 от 23.04.2020 г. на ВКС по т. д. № 2110/2019 г., II т. о., ТК.

the other party does not agree to conclude a final agreement it cannot be forced to agree, but an action can be brought and the court will declare the preliminary contract as final. The court ruling will replace the contract and have the effect of a contract. If the obligation is for transfer of the right of ownership of a real estate, the court will verify if the prerequisites for the transfer of ownership are present, including that the transferor owns the estate. If, under the preliminary contract, the claimant is required to execute his consideration upon conclusion of the final contract, the ruling will replace the final contract with the condition that the claimant provides his consideration. In this case the claimant should make his consideration within two weeks of the entry of the ruling into force.

CHAPTER 3:

THE CONTRACT LIFECYCLE – PERFORMANCE AND REMEDIES FOR BREACH

Hristina Tancheva

ABSTRACT	KEYWORDS
Following conclusion of an agreement the parties must execute their obligations accurately and in good faith according to the provisions of the contract and the legal rules concerning the time of performance, place of performance, etc. In case of breach, the creditor has various remedies at his or her disposal – to claim performance plus damages for the delay, to claim compensation for non-performance, to terminate the contract (rescission), to withhold his or her own performance until he receives counter-performance in a bilateral contract and so on. When the debtor is in default, the creditor may claim pecuniary and non-pecuniary damages if suffered, or liquidated damages if stipulated in the contract. In the case of delayed monetary obligations, legal interest will accrue. The creditor is also obliged to act in good faith and cooperate in the execution of the obligation, if not mora creditoris occurs.	performance, maturity date, breach of contract, remedies, damages, liquidated damages, interest.

I. PERFORMANCE

Performance of an obligation is the execution of the debtor's obligation to do or not to do something or to deliver an asset according to the agreement. The debtor is bound to perform to the other party (the creditor) under the legal relationship. In case of a bilateral contract, each party is both debtor and creditor.

1. The debtor must perform his or her obligations in accordance with the provisions of the law and in observance of the following **principles**:

- **Accurate execution** – the debtor is obliged to perform what is stipulated in the contract (including regarding place of performance, time of performance, quality, quantity, etc.) Execution must be precise – it should match the contractual obligations, and be complete – the whole consideration. The creditor cannot be forced to accept something different from what is agreed, including payment in foreign currency.¹ However, the creditor could agree to receive something different from what is agreed by concluding a new agreement with the debtor (Article 66 of the Obligations and Contracts Act). For example, if A owes B the amount of 200 the parties could conclude an agreement providing that instead of the money, A will give his mobile phone to B. But without B's consent, A cannot hand over the phone and force B to accept. If the creditor and the debtor conclude an agreement for the debtor to transfer a receivable to the creditor instead of the initial obligation, the obligation will be extinguished following collection of the receivable, unless otherwise agreed. For example: A owes B a telephone, but the parties decide that, instead of the telephone, A will transfer his receivables from C in the amount of 300 to B. In this situation, the obligation of A to B will be extinguished when C pays to B the amount of 300. Moreover, the creditor cannot be forced to accept payment in instalments, even though the obligation may be divisible (Article 66 Obligations and Contracts Act). For example, if A owes B 500, A could not pay B only 100 unless B accepts the amount. B could refuse to receive instalments if he wants the whole amount.
- The debtor must execute his obligation **in kind** (*in natura*)² – this is applicable in the case of non-monetary obligations and means

¹ Тълкувателно решение 4/2014 ОСГТК на ВКС.

² This principle is not typical to common law where specific performance is an exceptional remedy.

that the debtor must execute the consideration as stipulated.³ Unless there is delay by the debtor and the creditor has no further interest in the performance in kind, the debtor must pay compensation (Article 79(1) OCA).⁴ However, when damages are claimed instead of performance, the debtor may propose performance in kind plus damages for the delay, provided that the creditor is still interested in the performance (Article 79(2) OCA). Therefore, the principle is in favour of both the creditor and the debtor.

- Each of the parties to the contract must perform its obligations arising in **good faith** and must not obstruct the other party from performing its obligations in the same manner. The debtor and the creditor are obliged to co-operate with each other in execution of the obligation. Obligations must be fulfilled with **due diligence**, except when the law provides for some other degree of diligence.

2. *Who needs to perform?*

The obligation must be performed by the *debtor*. Nevertheless, a third party could execute the obligation even against the creditor's will⁵ unless the creditor is interested in the obligation being performed personally by the debtor (Article 73(1) OCA).⁶ For example, if A is obliged to pay 100 to B, C could pay the amount and the creditor could not refuse, but if A is a famous singer and has promised to sing on B's birthday, C could not perform instead of A unless the creditor agrees.

³ **Калайджиев, А.** Облигационно право. Обща част. Седмо издание. София, Сиби, 2020, 206–207.

⁴ Решение № 228 от 12.07.2011 г. по гр. д. № 1859/2009 г. на ВКС, 4-то ГО.

⁵ If the third party has legal interest to pay, it will assume the rights of the creditor under Article 74 of the Obligations and Contracts Act (**Русчев, И.** Встъпване в правата на удовлетворения кредитор (суброгация). – В: **Герджиков, О., Камелия Касабова, Методи Марков, Иван Русчев, Георги Стефанов, Поля Голева, Тания Градинарова, Валя Гигова, Костадинка Недкова.** Обезпеченията в материалното и в процесуалното право. София, Труд и право, 2018, с. 139 и сл.

⁶ Определение № 398 от 30.06.2022 г. по т. д. № 1776 / 2021 г. на ВКС, 1-во ТО.

If there are several persons jointly and severally liable to the creditor, each of them could perform and the others will be released of liability towards the creditor – Article 123(1) OCA.

Instead of the debtor, the *creditor* could also execute the obligation when it is not personal (*intuitu personae*). The creditor is entitled to request permission by the court to execute the obligation himself, whereby the creditor will act at the debtor's expense (Article 80(2) OCA). When the obligation is for non-performance of an act, the creditor could request permission to remove, at the debtor's expense, what has been done in breach of the obligation (Article 80 (2) OCA).

3. *To whom?*

The obligation must be executed to the creditor or to a person authorised by him (e.g., an attorney), by the court or by operation of law (e.g., parents when the person is under 14 years of age). Otherwise, it will be valid only if the creditor has confirmed it or has benefited from it⁷ – Article 75(1) OCA.

4. *Where?*

The place of performance could be defined by:

- ✓ the contract;
- ✓ the nature of the obligation (if the obligation is to repair a building);
- ✓ the law.

If there is no special rule in law, the contract or performance by the nature of the obligation, the performance must be executed according to Article 68 OCA:

a) For *monetary obligations* – at the creditor's address at the time of the performance of the obligation;

b) For *obligations to provide particular movable property* – at the place where that property is at the time of the obligation's arising, and

⁷ **Кожухаров, А.** Облигационно право. Общо учение за облигационното отношение. Нова редакция и допълнения Петко Попов. София, Юриспрес, 2002, 188193.

c) In *all other cases* – at the debtor's address at the time of the obligation's arising.

Regarding the international sale of goods, there are universally recognized rules created by the International Chamber of Commerce – Incoterms (International Commercial Terms).⁸ These rules guide buyers and sellers when drafting a contract for the shipment of goods. Incoterms define the delivery point in the transaction where the risk of loss or damage to the goods passes from the seller to the buyer.⁹ The most frequently used are:

EXW – Ex Works – the seller is responsible for making the goods available at its premises. At this point, the buyer acquires ownership of the goods and handles all costs and risk after the products are collected;¹⁰

FCA – Free Carrier – the seller is responsible for delivering the goods to the buyer's premises.¹¹ He needs to load the stock onto the buyer's transportation. Then, the seller organises the shipping, including export clearance and meeting security requirements. The risk is transferred once the goods are loaded onto the buyer's transportation. Thus, any damage to the products when on board the vessel is the responsibility of the buyer. The buyer pays the cost of freight, bill of lading fees and insurance. Also, he pays for unloading and transportation costs to the final destination.

DAP – Delivered at Place – the seller delivers the goods to a named place of destination but is not responsible for unloading.¹² His responsibilities include packing, export clearance, carriage expenses and any terminal costs up to the agreed destination port. DAP means the buyer is responsible for all costs, duties and taxes associated with unloading the goods. The risk is transferred to the buyer at the final designated place of destination.

FOB – Free on Board – the seller delivers goods cleared for export and loaded on board the vessel at the named port. Once the goods have been loaded on board, risk transfers to the buyer, who bears all costs thereafter.

⁸ The latest version of the rules came into effect on 1st January 2020.

⁹ **Soler, D.** Practical guide to the Incoterms 2020 rules. Barcelona, Marge books, 2022.

¹⁰ **Маринова, Д.** Договорът за международна търговска продажба на стоки. София, Феня, 2013, 263–264.

¹¹ **Маринова, Д.** Цит. съч., с. 264.

¹² **Маринова, Д.** Цит. съч., с. 266.

5. *When?*

The time of performance could be:

- ◆ stipulated by contract;
- ◆ provided by law (e.g., unless otherwise agreed by the parties, the payment of the price under a sale agreement will be made at time of delivery of the property sold);
- ◆ determined by the court in certain cases (e.g., in case of court proceedings for the rescission of an agreement, the court could provide an additional time period to the debtor for execution of its obligation).
- ◆ if there is no fixed maturity date, this means that the creditor is entitled to demand performance immediately (Article 69(1) Obligations and Contracts Act). Thus, if the obligation has a fixed time period the creditor could not force the debtor to perform before this date but if the obligation has no fixed time period the creditor may demand performance at any time. In any event, the debtor is obliged to perform within a reasonable time. In case of a commercial transaction, if the contract does not specify a time of performance and the nature of the transaction or the business customs do not require otherwise, the obligation may be requested at any time during business hours at the place of performance (Article 303 of the Commerce Act). In case of monetary obligations under a commercial contract, if no maturity date is agreed upon, the payment must be made within 14 days after receiving an invoice or another payment notice (Article 303a(3) of the Commerce Act);
- ◆ if the time of performance is left at the debtor's discretion, the creditor may ask the regional court to provide a sufficient time period for performance to the debtor (Article 69(2) OCA).

The time period will be deemed stipulated *in favour of the debtor*, unless it follows otherwise from the contract or the nature of the obligation (Article 70(1) OCA). This means that the debtor could pay before the maturity date, at his discretion, but the creditor could not force the debtor to pay in advance. For example, if it is written in the agreement that the obligation will

be performed on 01.04.2023, the creditor cannot force the debtor to perform before this date but the debtor could pay, in advance, voluntarily.

If the time period is stipulated *in the creditor's favour*, the creditor could ask for execution before the maturity date, but the debtor cannot insist on execution before the set date. For example: under a deposit agreement A agrees to keep B's computer while B is on vacation until the end of the month. A cannot return the computer before the end of the month but B could demand its return before that date.

In the event of an interest-bearing monetary obligation, the debtor may pay before the deadline and deduct the interest for the rest of the period (Article 70(3) OCA). For example, if the creditor provided a loan to the debtor for a period of one year and calculated an interest for the whole period of 12 months (120 – 10 for each month), but the debtor pays back the loan on the 6th month, he could deduct the interest for the other 6 months (60).

The creditor may claim performance of an obligation **before the maturity date**¹³ in certain cases (Article 71 OCA):

- if the debtor has become insolvent (e.g., stops paying other obligations);
- if, through his actions, he has reduced the security provided to the creditor (e.g., the debtor destroys the property that is mortgaged)
- if he has failed to provide the promised security (e.g., the debtor fails to find a guarantee that he has promised).

In case of bank credit, the bank may request repayment of the amount under the credit before the maturity date:

- when it is stipulated in the contract (for example: it may be written that in case of non-payment of three instalments, the bank may request payment of the whole amount immediately);
- the credit is not used for the purpose, for which it was granted;
- the borrower provides false information (for example: about income received);

¹³ Тълкувателно решение № 3/2017 г. от 27.03.2019 г. на ОСГТК на ВКС.

- the security becomes insufficient and is not supplemented in due time following notification;
- the borrower fails to repay other credits to the bank due to serious financial deterioration. In this case, the bank will provide a sufficient time limit before exercising its right.

6. How?

In case of **monetary obligations**, parties could stipulate cash payment or bank transfer.¹⁴ When there is no clause to determine the payment method, the payment can be executed either in cash or by bank transfer. However, according to the Limitation of Cash Payments Act payments on the territory of Bulgaria may only be made via bank transfer when:

1. their value is equal to or exceeding BGN 10,000;
2. their value is below BGN 10,000 but they are part of a monetary consideration under a contract the value of which is equal to or exceeds BGN 10,000. For example, if A is obliged to pay 10 % of the whole amount (BGN 15,000) in advance, he will not be allowed to pay in cash the amount of BGN 1,500 because it is part of a consideration that exceeds BGN 10,000.

An obligation could be performed through **set-off** – when two persons owe each other money or other fungibles, each one of them may set off his receivable against his obligation, provided that the claim is executable and liquid (Article 103(1) OCA). The set-off will be effected with a statement made by either party to the other.¹⁵ Therefore, no contract is needed, only a unilateral statement by one of the parties, as the obligations could be either contractual or extra contractual. The set-off cannot be under term or condition except the condition that the claim will be upheld by the court.¹⁶

¹⁴ When the payment is carried out by debiting and crediting bank accounts, the obligation will be deemed performed upon crediting of the creditor's account.

¹⁵ However, claims that are not subject to forcible execution and claims ensuing from willful wrongful acts as well as claims for taxes cannot be set-off without the creditor's consent.

¹⁶ Русчев, И. Прихващане. – В: Герджиков, О., Камелия Касабова, Методи Марков, Иван Русчев, Георги Стефанов, Поля Голева, Таня Градинарова, Валя Гигова, Костадинка Недкова. Цит. съч., с. 132.

The two counter claims will be deemed extinguished up to the amount of the smaller one.¹⁷ For example: A owes B 100 and B owes A 200. When set-off is made, B will owe only 100 to A and A will have no obligation towards B.

The set-off has retroactive effect, from the first moment when set-off could be undertaken.¹⁸ For example: A is obliged to pay B 100 on 01.02.2021 and B has to pay A 300 on 01.03.2022. A sends B a statement for compensation on 01.12.2023. The set-off will be deemed made on 01.03.2022.

One party may have several obligations of the same type to another and, if the first payment cannot execute all the obligations, he may choose which of them to extinguish (Article 76(1) OCA). For example, if A has three monetary obligations to B, each of them in the amount of 100 but has only 100, A could choose which obligation to extinguish when paying the sum of 100.

If the debtor pays one of the obligations without making a statement which one, he will pay the obligation which is the most onerous for him (e.g., the one that is interest-bearing or the one secured by pledge, etc.). Should there be several equally onerous obligations,¹⁹ the oldest one will be deemed repaid, and if all of them occurred at the same time, they will be repaid proportionately.

If the performance is insufficient to cover the interest, costs and principal, the costs will be repaid first, then interest and finally principal. For example, if A has to pay principal in the amount of 1,000, default interest in the amount of 100 and 100 costs for collection of receivables and pays only 100, the sum will extinguish the costs. According to Interpretative Decision 3/2017 of the General Assembly of the Civil and Commercial department, Supreme Court of Cassation, interest in the sense of Article 76(2) OCA includes interest for delayed payment.

¹⁷ **Кожухаров, А.** Облигационно право. Общо учение за облигационното отношение. Нова редакция и допълнения Петко Попов. София, Юриспрес, 2002, с. 422 и сл.

¹⁸ **Конов, Т.** От кога настъпва погасителният ефект на така наречената „съдебна компенсация“ и какви са обективните предели на силата на пресъдено нещо на решението, с което възражението за компенсация е уважено? // Търговско право, 2020, № 1–2.

¹⁹ **Калайджиев, А.** Цит. съч., 263264.

Upon performance the debtor may ask the creditor for a **receipt** and, if the creditor refuses to provide such receipt, the debtor may refuse to perform the obligation as he needs a document to prove the performance of the obligation in case of dispute.

Performance **costs** will be borne by the debtor unless otherwise agreed in the contract. In the event of a change in the place of performance, cost increases due to such change will be borne by the party that caused them (Article 78 OCA).

II. BREACH OF CONTRACT

1. Introduction

A breach of contract²⁰ is committed when a party, without lawful excuse, fails or refuses to perform what is due under the contract, or performs improperly.²¹ In such cases the creditor will be entitled to the following remedies:

- ✓ to claim performance plus damages for the delay – damages are intended to compensate the injured party for the loss suffered as a result of the breach of contract;
- ✓ to claim compensation for non-performance instead of performance, i.e., the debtor will pay a certain amount of money and the creditor will execute its consideration (in case of bilateral agreement) as the contract is not terminated;
- ✓ to terminate the contract (rescission);
- ✓ to withhold his own performance until he receives counter performance in a bilateral contract (see above). When the debtor has a receivable against the creditor arising from the same relation as his or her own obligation (e.g., bilateral agreement), he or she may withhold performance until the counterparty performs its own

²⁰ **Jansen, N., R. Zimmerman.** Commentaries on European Contract Laws. Oxford, Oxford University Press, p. 1074 et seq.

²¹ **Smits, J.** Contract Law: A Comparative Introduction, Second Edition. Edward Elgar Publishing, 2017

obligation (Article 90 (1) OCA). In this case the court will rule that the defendant perform at the same time as the claimant. This is a method of defence of the party against a claim for performance by the counterparty. The purpose is simultaneous performance unless otherwise provided by contract or law.²² For example, if A and B conclude a sale agreement and A (seller) claims the price of the asset without providing the asset to B, B could make an objection that he himself will not pay until counter performance (provision of the asset).

The creditor cannot claim performance and termination of the agreement at the same time – he has to choose the remedy that best meets his interest. Thus, remedies which are not incompatible could be combined, e.g., termination and damages due to termination. As the rescission ultimately terminates the contract, the creditor may choose this remedy if he is no longer interested in the consideration. It is possible for the party to withhold its performance first and then, if no performance is delivered, to terminate the contract.

When compensation is claimed instead of performance, the debtor may propose to perform the initial obligation plus pay damages for the delay (if any), provided the creditor is still interested in the performance (Article 79(2) OCA). This rule preserves the debtor's interest in performing the obligation instead of paying compensation.

However, a debtor will not be liable if the performance is **impossible** due to a reason for which he cannot be found guilty (Article 81 OCA; Article 306 of the Commerce Act). For example, if the subject matter of the contract is destroyed due to force majeure²³ (fire, earthquake, etc.)

²² **Конов, Т.** Възражение за неизпълнен договор и право на задържане. София, Регули, 1996; **Русчев, И.** Възражение за неизпълнен договор. – В: **Герджиков, О., Камелия Касабова, Методи Марков, Иван Русчев, Георги Стефанов, Поля Голева, Тая Градинарова, Валя Гигова, Костадинка Недкова.** Цит. съч., с. 274 и сл.

²³ A force majeure is an unforeseen or unavoidable event of an extraordinary nature which has occurred after conclusion of the contract. A debtor to a commercial transaction who is unable to perform due to force majeure will notify the other party in writing within a reasonable time about the nature of the force majeure, and its potential consequences for the agreement. In case of failure to notify, compensation will be due for the damages resulting from such failure. The performance of obligations and related counter-obligations

the debtor will not be liable. The impossibility of performance could be *initial* or *subsequent*. In the first case the contract is null and void. If the impossibility occurs after conclusion of the contract and the debtor is not guilty, the contract can be terminated by operation of law. Should the impossibility be only partial, the other party may claim a respective reduction of its obligation or termination of the contract by the court, if it does not have sufficient interest in receiving partial performance. If the debtor was already in default, he may not be released from liability.

Therefore, the liability for non-performance arises when the debtor is guilty. However, guilt is presumed (only negligence)²⁴ which means that the creditor may prove only the non-performance and the debtor could rebut the presumption. The circumstance that the debtor lacks funds for performance of the obligation will not exempt him from liability (Article 81(2) OCA). This means that if the debtor owes money, he could not be exempt from liability in case of non-performance even though he is in hospital, abroad or even if he dies (the successors will be liable), etc. The debtor could always find money by taking credit or selling some property or starting an additional job and so on.

If the obligation is not of a personal nature, then a third party may perform it and the debtor will not be liable if it is properly executed. However, the debtor is responsible for the persons he has engaged for assistance in the execution or to whom he has assigned the execution of the contract wholly or partially (subcontractor) if such third party breaches the contract. Therefore, a debtor who assigns the performance of an obligation to another person remains responsible for the performance. Any third parties who are not engaged by the debtor and impede the performance of contracts in bad faith will be liable for damages.

will be ceased for the duration of the force majeure. If the duration of the force majeure be such that the creditor no longer has interest in the performance, he will be entitled to terminate the contract. The debtor will also have the same right.

²⁴ **Конов, Т.** Основанието на гражданската отговорност. – В: Подбрани съчинения. София, Сиела, с. 184.

2. There are different types of non-performance depending on the result and remedies:

▪ Delayed performance

When the date for performance of the obligation is fixed, the debtor will be in default if he has failed to fulfil his obligation until its expiration. If that date expires after the debtor's death, his heirs will be in default upon expiration of a seven-day period after the invitation to perform (Article 84(1) OCA).²⁵ For example, if it is agreed that the debtor will perform his obligation on 01.02.2022, he will be in default as from 02.02.2022. But if the debtor dies on 31.01.2019 his heirs will be in default seven days after the invitation to perform made by the creditor.

If no date for performance is fixed, the debtor will be in default after being invited to perform by the creditor (Article 84(2) OCA). For example, if the maturity date is not stipulated in the contract, the creditor could, at any time, invite the debtor to execute his obligation and provide him with a reasonable period for the execution – for example, three days. Following expiry of these three days the debtor will be in default if he does not perform.

If the obligation arises from tort,²⁶ the debtor will be deemed in default even without an invitation (Article 84(3) OCA). For example, if A broke B's telephone on 12.02.2017, this would mean that A is in default from 12.02.2017 and he owes legal interest (see the next paragraph) on the amount of compensation from that date until payment.

In case of **non-performance of a monetary obligation**, the debtor will owe damages in the amount of interest determined by law as from the date of default. For actually incurred greater losses the creditor may claim damages in accordance with general rules (Article 86 OCA). The Council of Ministers determines the rate of interest. Currently, the Council of Ministers

²⁵ Решение № 63 от 29.07.2019 г. на ВКС по т. д. № 1528/2018 г., II т. о., ТК.

²⁶ Tort is an act or omission that injures or harms another person or its property and represents a civil wrong for which a liability to pay damages arises. For example, if A breaks B's arm, A will pay compensation for pecuniary and non-pecuniary damages regardless of any criminal liability that could be imposed by court.

has determined the rate of the interest at 10 % plus the base rate²⁷ for a one-year delay. The daily amount of legal interest for overdue monetary obligations is equal to 1/360 part of the annual amount. When the contract is commercial, if the creditor has fulfilled its obligations and the debtor is in default of payment, unless agreed otherwise, the creditor will be entitled to legal interest from the date of the default as well as to compensation for the costs incurred due to the late payment, of an amount not lower than BGN 80. The creditor may claim compensation for any actual damages and expenses incurred as a result of the debtor's late payment and compensation for costs of a higher amount under the general rules.

If the debtor is in default, he will be liable for non-performance even though performance is impossible by a reason for which he would not have been liable before that, unless he proves that the creditor would have suffered the damages even in case of timely performance (Article 85 OCA). For example: A delayed in providing B the computer that is the subject matter of the agreement. If there is a fire that burns the computer, A will be liable unless he proves that the computer would have burned even in the event of timely performance (e.g., the fire engulfed the entire building where the property of the creditor and debtor is located).

N.B. If time is crucial to one or both parties, the obligations must then be performed within the time stipulated, and a case of delay will be considered as full non-performance. For example, if A orders a cake for his birthday on the 2nd of February, the time of performance is essential and if B performs on the 3rd of February this is not a delayed performance but a full non-performance even though only a day later.

▪ **Partial non-performance:**

Non-performance is full when the debtor does not execute his obligation at all or executes it so badly that it equates to 'full non-performance'.²⁸ Partial performance of contractual obligations may lead to a party being in breach of the entire contract should the creditor refuse to accept partial

²⁷ The base rate is determined by Bulgarian National Bank twice a year, in January and in July.

²⁸ **Калайджиев, А.** Цит. съч., с. 279.

performance. Therefore, partial performance must be accepted by the creditor, and the debtor will be in breach of the rest of the consideration. It is only applicable when the obligation is devisable (e.g., monetary).

Upon partial non-performance the creditor could:

- ◆ claim performance of the rest of the obligation plus damages, if any;
- ◆ claim compensation for the rest of the obligation;
- ◆ terminate the contract if the non-performed part is significant.

▪ **Poor quality performance**

There are no general rules for this type of non-performance, but we have a special regime regarding sale and manufacturing contracts.

The seller will be liable if the sold property has defects that significantly decrease its price or its fitness for normal use or the use to which it is prescribed in the contract.²⁹ The seller is not liable for defects which were known to the buyer at the time of conclusion of the sale agreement (Article 193(2) OCA). However, the seller will be liable even if he was unaware of the defect, i.e., liability is not based on seller's guilt. An agreement discharging him from liability will be invalid (Article 193(3) OCA).

When accepting the property, the buyer has to examine it within a reasonable period and immediately notify the seller of any defects he has noticed. Otherwise, the property will be deemed approved unless other defects, which are hidden, are established later. In this latter case the buyer has to immediately notify the seller of the defect unless the seller is aware of the defect. – Article 194(1) OCA.³⁰

The purchaser has the following options under Article 195 OCA:

- to return the property and claim the price paid and the expenses on the sale, i.e., to terminate the agreement and return what has been received plus the expenses related to the agreement;

²⁹ **Кожухаров, А.** Облигационно право. Отделни видове облигационни отношения. Нова редакция и допълнения Петко Попов. София, Юриспрес, 2002, 79–81.

³⁰ Определение № 50114 от 22.02.2023 г. по гр. д. № 1957 / 2022 г. на ВКС, 4-то ГО.

- keep the property and claim a reduction of the price;
- have the defects repaired at the seller's expense;
- claim delivery of a fungible commodity without defects.

In each case he could also claim damages.

According to Article 197 OCA, the buyer's claims will expire by limitation of:

- one year in the case of a sale of immovable property,
- six months in the case of a sale of movable property;
- three years if the seller was aware of the defect and did not disclose it.

The limitation period may be extended or shortened by agreement of the parties (e.g., the parties could stipulate a three-month or three-year limitation period). The limitation period commences from the moment of delivery.

There are special rules regarding **consumer sales**. The seller must deliver to the consumer goods that meet the requirements set by the contract and the law. The seller will be liable to the consumer for any lack of conformity which exists at the time when the goods were delivered and which becomes apparent within two years of that time. Any lack of conformity which becomes apparent within one year of the time when the goods were delivered will be presumed to have existed at the time of delivery unless otherwise proven or unless this presumption is incompatible with the nature of the goods or with the nature of the lack of conformity – Article 32 of the Act on the Supply of Digital Content and Digital Services and on the Sale of Goods.³¹

Under Article 33 of the Act on the Supply of Digital Content and Digital Services and on the Sale of Goods, in the event of a lack of conformity, the consumer will be entitled to any of the following remedies:

- have the goods brought into conformity – the consumer may choose between repair and replacement, unless the remedy chosen would

³¹ The Act implements Directive (EU) 2019/771 of the European Parliament and of the Council of 20 May 2019 on certain aspects concerning contracts for the sale of goods.

be impossible or, compared to the other remedy, would impose costs on the seller that would be disproportionate, taking into account all circumstances;

- receive a proportionate reduction in the price – the reduction of price will be proportionate to the decrease in the value of the goods which were received by the consumer compared to the value the goods would have if they were in conformity;
- terminate the contract – the consumer will exercise the right to terminate the sales contract by means of a statement to the seller expressing the decision to terminate the contract.

The consumer is entitled to receive a proportionate reduction in the price or terminate the contract if:

- repair and replacement are impossible or would impose costs on the seller that would be disproportionate;
- the seller has not provided repair or replacement;
- the seller has refused to bring the goods into conformity;
- a lack of conformity appears despite the seller having attempted to bring the goods into conformity;
- the lack of conformity is of such serious nature as to justify an immediate price reduction or termination of the sales contract; or
- the seller has declared, or it is clear from the circumstances, that the seller will not bring the goods into conformity within a reasonable time, or without significant inconvenience to the consumer.

Repairs or replacements will be carried out free of charge, within a reasonable period of time from the moment the seller has been informed by the consumer about the lack of conformity; and without any significant inconvenience to the consumer, taking into account the nature of the goods and the purpose for which the consumer required them (Article 34 of the Act on the Supply of Digital Content and Digital Services and on the Sale of Goods).

Alternatively, the trader could provide a commercial guarantee which will be binding on the guarantor under the conditions laid down in it. The guarantee will constitute an alternative remedy.

III. DAMAGES

1. Damages³² could be claimed when suffered by the creditor:

- *Pecuniary damages* – these include already incurred losses, as well as future loss which is reasonably likely to occur³³ (e.g., the item that is not provided on time is subject matter of a lease contract which cannot be executed and the lessor will lose the lease price).
- *Non-pecuniary damages* (such as pain and suffering from personal injury) are traditionally recovered in case of tort. However, legislation does not limit the liability in case of contractual non-performance and the court allows for claiming non-pecuniary damages if suffered.³⁴ For example, there are some contracts where the benefit is not tangible. The loss from a breach will be non-pecuniary or not a direct financial loss, for example in the case of loss of enjoyment of a holiday. Damages can, in some circumstances, be recovered for vexation and mental distress. It is debatable whether a legal entity can claim non-pecuniary damages as currently this is the subject matter of Interpretive Case No. 1/2023 of the General Assembly of Penal, Civil and Commercial departments of the Supreme cassation court and First and Second Departments of the Supreme Administrative Court.

2. *Liquidated damages*³⁵ are damages whose amount the parties determine in the contract in order to compensate the injured party upon breach – Article 92(1) OCA. Thus, it is a clause in a contract that provides payment of a specified amount (or other property) should one of the

³² **Kötz, H.** European Contract Law. Oxford, Oxford University Press, 2017.

³³ **Апостолов, Ив.** Облигационно право. Част първа. Общо учение за облигацията. Фототипно издание. София, БАН, 1990, 99–102; Тълкувателно решение № 3/2012 г. на ОСГТК на ВКС.

³⁴ Тълкувателно решение № 4/2012 г. на ОСГТК ВКС.

³⁵ **Halson, R.** Liquidated Damages and Penalty Clauses. Oxford University Press, 2018.

parties be in breach of the contract. Therefore, liquidated damages secure the performance of the obligation and serve as compensation for damages caused by non-performance as the damages do not have to be proved.³⁶ The obligation for payment of liquidated damages arises when the party fails to fulfil the specific contractual obligation, which the liquidated damages secure.³⁷

The creditor may claim compensation if the liquidated damages are not sufficient to cover the loss but will need to prove the whole amount of the damage, e.g., if the damages are in the amount of 1,000 and the liquidated damages are determined at 100, the creditor could claim compensation for the remaining 900, but must prove the whole amount of the damages.

There are different types of liquidated damages regarding non-performance, such as:

- for delay in performance – liquidated damages can be determined as a percent of the delayed consideration or otherwise. For example, it could be stipulated in a sale contract that in the event of delay the debtor will pay liquidated damages of 0.1 % of the price of the sold item for each day of delay.
- full non-performance or partial performance;
- in case of contract rescission – where, due to non-performance, the creditor terminates the contract.
- poor quality performance – e.g., the sold item is defective.

N.B. It is possible to claim liquidated damages for more than one breach of contract as long as the breaches are not mutually exclusive. In other words, one could request compensation for delayed and poor-quality performance but not claim for full non-performance and for poor quality performance.

³⁶ **Марков, М.** Неустойка. – В: **Герджиков, О., Камелия Касабова, Методи Марков, Иван Русчев, Георги Стефанов, Поля Голева, Таня Градинарова, Валя Гигова, Костадинка Недкова.** Цит. съч., с. 108 и сл.; **Голева, П., Тотка Калчева, Стефан Кюркчиев, Красимир Машев, Георги Хорозов.** Неизпълнение на договора. София, Труд и право, 2015, с. 94.

³⁷ Решение № 108 от 23.12.2020, по гр. д. № 1113 / 2020 на ВКС, 3-то ГО.

Under Article 92(2) OCA, the amount of the liquidated damages could be reduced by the court if:

- ✓ they are excessive compared to the damage incurred³⁸ – this is the case when the amount of liquidated damages is extraordinarily disproportional to the amount of that which was affected by the breached contract. For example, if the damage amounts to 100 and the liquidated damages are stipulated to be 10,000;
- ✓ the obligation has been performed improperly, or
- ✓ the obligation has been performed partially.

3. The parties may stipulate the payment of ‘earnest money’. According to Article 93(1) OCA, such *earnest* serves as proof that the contract has been concluded and guarantees its performance. This is a sum of money or other asset that has been provided at the conclusion of a contract to secure its performance.³⁹ In case of non-performance, the earnest serves as compensation to the creditor. If the party that has provided the earnest does not perform its obligation, the other party is entitled to terminate the contract and keep the earnest.⁴⁰ If the party that has received the earnest fails to perform its obligation, the other party may claim double the amount of the earnest in the event of contract termination. For example, if A and B conclude a preliminary contract for the sale of real estate in the amount of 100,000, B (the purchaser) could provide A with the sum of 10,000 upon signing of the contract which will serve as guarantee for conclusion of the final contract, advance payment and compensation in case of a breach.

Nevertheless, if the party that is not in default prefers to seek performance of the contract and not to terminate it, then compensation for damages will be determined in accordance with the general rules and the

³⁸ **Калайджиев, А.** Цит. съч., 430–431; **Таков, К.** Към въпроса за намаляването на неустойката. – В: Юбилеен сборник в чест на професор Живко Сталев. София, Сиби, 2005; **Русчев, И.** Към въпроса за намаляване на неустойката поради прекомерност. – В: Сборник доклади от Международна конференция БСУ, 2010.

³⁹ Решение № 228 от 18.12.2023 г. по гр. д. № 587 / 2023 г. на ВКС, 3-то ГО.

⁴⁰ **Марков, М.** Задатък. – В: **Герджиков, О., Камелия Касабова, Методи Марков, Иван Русчев, Георги Стефанов, Поля Голева, Тания Градинарова, Валя Гигова, Костадинка Недкова.** Цит. съч., с. 93.

earnest will be returned. Therefore, the earnest can be kept by the party that received it or claimed the double amount from the party that provided it only in case of termination due to non-performance. Where the contract is not terminated, the earnest will be returned and the damages will be compensated according to law.

IV. RESCISSION OF CONTRACTS

1. Introduction:

Rescission of contracts means unilateral termination of the agreement by the creditor in case of breach.⁴¹ A breach gives the injured party the option to terminate the contract or to affirm it and claim further performance plus damages (if any) or to claim compensation instead of performance. Termination depends on the injured party's will because the party in default should not be allowed to rely on its own breach in order to get out of the contract. Rescission should be distinguished from contract expiration. Expiration refers to an agreement that terminates in accordance with its provisions, either because it has a fixed expiry date (for example, a lease contract concluded for 3 years) or because there is a right to terminate contained in the contract. Moreover, the parties can terminate the agreement before its expiration by mutual agreement. Therefore, a contractual right to terminate is distinct from the legal right to terminate for breach (rescission), which is discussed below.

2. *Grounds:*

- ✓ bilateral contract;
- ✓ significant non-performance;⁴²
- ✓ reason for which the debtor is liable (e.g., if the debtor is negligent)

⁴¹ Голева, П., Тотка Калчева, Стефан Кюркчиев, Красимир Машев, Георги Хорозов. Цит. съч., с. 370 и сл.

⁴² Решение № 472 от 13.09.2010 г. на ВКС по гр. д. № 736/2009 г., III г. о., ГК; Решение № 102 от 03.08.2010 г. на ВКС по т. д. № 897/09 г., II т. о.

Should a debtor under a bilateral contract not perform his obligation due to a reason for which he is liable, the creditor could rescind the contract by providing the debtor with an appropriate time period for performance with a warning that he will deem the contract rescinded upon expiration of that period. If the contract has been concluded in writing, the warning must also be made in writing (Article 87(1) OCA). For example, if A had to create a sculpture by the end of October but did not perform this obligation on time, B could rescind the contract providing A with an additional period of three days and a warning that, after this period, the contract will be terminated.

Under Article 87(2) OCA, it is possible for the creditor to rescind the contract without providing an additional period for performance:

- if the performance has become fully or partially impossible. For example, if A broke the furniture that he had to provide to B, B could rescind the agreement with immediate effect.
- if, due to the debtor's default, the performance has been rendered useless.⁴³ For example, if A delayed in providing B with a computer, B could buy another computer from C and rescind the agreement with A because the first computer is rendered useless.
- if the obligation had necessarily to be fulfilled within the agreed time. For example, if I had ordered a cake for my birthday which I did not receive on the specific day I could rescind the contract without providing additional time for performance as I do not need the cake on the next day.

A contract cannot be rescinded if the non-performance is immaterial with regard to the creditor's interest – Article 87(4) OCA. For example, if A owes B 1,000 kg potatoes and provides him with 980 kg, B cannot rescind the agreement because the non-performed portion is only 20 kg and could be considered immaterial. The rule is not imperative and the parties may agree that even immaterial non-performance can be ground for rescission.⁴⁴

⁴³ Решение № 51 от 28.07.2015 г. по т. д. № 279, ТК, II отд. на ВКС.

⁴⁴ Решение № 202 от 25.07.2012 г. по гр. д. № 1145/2011 г. ВКС.

The rescinding of a contract for the transfer, establishment, recognition or termination of real rights on immovable property will be done by the court⁴⁵ – Article 87(3) OCA. For example, if A bought a house which is not the property of the seller (B), A could rescind the agreement by bringing an action before court against B.

The defendant can offer performance in the course of the proceedings and the court may provide a time period for that purpose depending on the circumstances.⁴⁶

3. Limitation period:

The right to rescind a contract will expire, by limitation, after a period of **five years**⁴⁷ beginning from the non-performance – Article 87(5) OCA.

4. Effect:

The rescission of the contract will have **retroactive effect** except for contracts requiring continuous or periodic performance⁴⁸ – Article 88(1) OCA. For example, if A and B concluded, on 01.08.2022, a contract for the manufacturing of chattel and A breached this agreement, B could rescind it and this will have retroactive effect – from the date of conclusion. If A concluded a lease agreement on 01.08.2022 and the lessee (B) stopped paying, A could rescind this agreement without retroactive effect because of the continuous performance.

5. Consequences:

- The parties are not bound to perform the obligations under the contract as it is terminated.
- The creditor will be entitled to compensation for damages arising from the non-performance.

⁴⁵ Тълкувателно решение № 142-6 от 11.XI.1954 г., ОСГК ВС.

⁴⁶ Определение № 730 от 04.11.2013 г. по търг. д. № 1083/2012 г. на ВКС.

⁴⁷ Решение № 116 от 8.01.2020 г. на ВКС по т. д. № 3025/2018 г., I т. о., ТК; Решение № 40/23.04.2020 по дело № 2110/2019 на ВКС, ТК, II т. о.

⁴⁸ **Голева, П.** Продължителните договори. // Търговско и облигационно право, 2019, № 10, с. 30 и сл., както и **Таков, К.** Към понятието „периодични плащания“. // Търговско право, 2011, № 4, с. 33 и сл.

- Extra-contractual obligations for returning the consideration received will arise.⁴⁹ If it is impossible, then the party will return the value of the consideration – e.g., if one party paints the apartment of the other. However, there is no such obligation in the case of contracts for continuous or periodic performance because, until the breach, both parties performed proportionately (unless paid in advance).

Sometimes, when one or both parties are in default, they could decide upon making an agreement to compromise on their original positions. In this case the contract is discharged by forming a further contract to end the original one and to prevent or cease disputes.

Our legal system does not regulate the anticipatory breach (when it is clear that the debtor will not execute in time) with a general rule.⁵⁰

V. NON-PERFORMANCE CAUSED BY THE CREDITOR (*MORA CREDITORIS*)⁵¹

1. Introduction

The creditor is obliged to act in good faith and cooperate in execution of the obligation. Performing some obligations does not require the creditor's assistance.⁵² For example, an obligation to transfer money to a bank account of the creditor. By contrast, if the debtor needs the creditor's cooperation, the debtor cannot perform unilaterally: e.g., not allowing the debtor to enter a house that he is contractually obliged to repair, or preventing him from delivering goods to the creditor's premises, etc.

⁴⁹ Решение № 326 от 09.07.2013 г. по гр. д. № 1192/2008 г. на ВКС.

⁵⁰ However, there is a special rule regarding the manufacturing contract. Article 262(2) OCA provides that, if it becomes evident that the contractor will not be able to perform the work on time or that he will not perform it in the way agreed or as due, the person ordering the work may terminate the contract and claim damages under the general rules.

⁵¹ *Mora creditoris* is a Roman institute – see the requirements in Roman law in **Zimmerman, R.** The Law of Obligations. Roman Foundations of the Civilian Tradition. Cape Town, Wetton, Johannesburg, Juta & Co Ltd., 1992, p. 819 et seq.

⁵² **Голева, П., Тотка Калчева, Стефан Кюркчиев, Красимир Машев, Георги Хорозов.** Цит. съч., с. 170 и сл.

1.1. *Grounds* provided by Article 95(1) OCA:

- when, without proper reason, the creditor refuses to accept the performance offered by the debtor⁵³ or
- fails to provide assistance without which the debtor would be unable to perform his obligation.

1.2. *Consequences* provided by Article 96(1) OCA:⁵⁴

- ✓ the risk will be taken by the creditor – this means that if the property that will be delivered perishes due to force majeure, the debtor will not be liable;
- ✓ if the debtor has also been in default, he will be discharged from the consequences thereof – this means that if, due to delay by the debtor, he should pay liquidated damages (or interest), he will be discharged because of *mora creditoris*;
- ✓ the necessary expenses incurred due to the creditor's default will be borne by the latter – e.g., expenses for storage of the goods being the subject matter of the contract.

1.3. *Options* provided by Article 97–98 OCA:

- Should the obligation be to deliver something and the creditor delays acceptance, the debtor may be discharged by depositing the property due for safe-keeping at an appropriate place determined by the regional court.
- Money, securities and valuables may be deposited for safe-keeping in a bank at the place of performance even without a court's permission.⁵⁵
- If the property due is perishable or its safe-keeping involves significant cost or inconvenience, and if its nature prevents it from being deposited, the debtor, after notifying the creditor

⁵³ Решение № 164 от 3.02.2016 г. на ВКС по т. д. № 1890/2014 г., I т. о., ТК.

⁵⁴ Решение № 428 от 18.01.2012 г. по гр. д. № 1097/2010 г. на ВКС.

⁵⁵ **Танчева, Х.** Проблеми при практическото приложение на правилата за забавата на кредитор. // Търговско право, 2019, № 2.

thereof, may request from the regional court to permit him to sell the property and deposit the amount received in a bank in the creditor's name.

- If the subject of the obligation is not the delivery of an item and the creditor refuses either to accept the performance or to provide the assistance required, the debtor may terminate the contract and seek compensation for the necessary expenses incurred as a result of the creditor's default. For example, if A is obliged to repair B's car, but B does not bring the car to A's service station, A can terminate the contract and claim compensation if he incurred expenses related to the repair (bought special spare parts).

CHAPTER 4:

VOID AND VOIDABLE CONTRACTS UNDER BULGARIAN CIVIL AND COMMERCIAL LAW: A BRIEF NOTE

Irina Bogdanova

ABSTRACT	KEYWORDS
This chapter deals with various grounds on which a contract or other juridical act may be void or voidable and provides a brief overview of the general rules of invalidity of contracts in Bulgarian law. Special attention is paid to the vices of consent and some of their legal effects, as well as to the few ‘means’ provided in the law, allowing to ‘save’ a void or voidable contract from the consequences of invalidity, primarily by conversion,¹ performance, ratification and partial invalidity. Beyond the scope of this chapter are some other effects of invalidity of contracts such as the possibility of obtaining damages whether or not the contract is voided, of converting an invalid act into a valid one or of ratifying voidable contracts, which are briefly mentioned at the end of this exhibition. Problems concerning restitution because of the invalidity of juridical acts are also beyond the boundaries of the present report and are outlined only in general terms.	void contracts, voidable contracts, vitiating factors

¹ On conversion as a preserving mechanism in roman legal jurisdictions see Manuel, C., Díez Soto. *La conversión del contrato nulo (Su configuración en el Derecho comparado y su admisibilidad en el Derecho español)*. Barcelona, J. M. Bosch, 1994.

I. INTRODUCTORY REMARKS

There are various factors, which can affect a contract by depriving it of legal effect or of legal consequences with retroactive effect. As an institute of civil law, the invalidity of juridical acts is the total of mandatory rules regulating all those grounds for nullity and vitiating factors resulting in voidable contracts, such as mistake, threat, lack of consent etc., that are determinants of the validity of a contract.² Under Bulgarian civil law contracts that violate legal requirements or show other legal deficits are deemed invalid. Regarding invalid contracts, there are two subgroups to distinguish: void contracts and voidable contracts.³ Thus, because of non-compliance with the requirements for validity, certain juridical acts either do not produce legal effects or produce them but may be annulled by a court decision in which case it is as if they were null and void from inception (*ab initio*).

1. Legal framework and scope of applicability

In Bulgaria, as in most Continental countries, the legal framework for invalidity of juridical acts consists of mandatory rules, which are generally established, in public interest, with the idea that the law cannot tolerate transactions concluded with a defect. Because of their mandatory character, the legal provisions regulating the validity of legal acts cannot be derogated with an additional agreement between parties nor are the parties free to create grounds for invalidity different from those exhaustively laid

² For some broader arguments centring on fairness and morality beyond the concept of contracts with flawed consent, see **Anson, W.** *Principle of the Law of Contract*, 30th Ed., Oxford, Oxford University Press, 2016.

³ This technical manner of explicitly differentiating between two categories of invalid contracts: null and void contracts, on the one hand, and voidable contracts, on the other, is quite familiar in most European jurisdictions. For further details, see *Principles, Definitions and Model Rules of European Private Law - Draft Common Frame of Reference (DCFR)*. Prepared by the Study Group on a European Civil Code and the Research Group on EC

Private Law (Acquis Group), Edited by Christian von Bar, Eric Clive and Hans Schulte-Nölke and Hugh Beale, Johnny Herre, Jérôme Huet, Matthias Storme, Stephen Swann, Paul Varul, Anna Veneziano and Fryderyk Zoll (available at: https://www.law.kuleuven.be/personal/mstorme/european-privatelaw_en.pdf), p. 382 et seq.

down by the law. In addition, it is impossible to contractually modify the consequences of invalidity.

The general rules, dedicated to the invalidity of contract, are set out in the Obligations and Contracts Act (hereinafter: OCA) of 1951 on the general rules of contract law, provided in the former Obligations and Contracts Act of 1891. These general rules are included as a part of section II of the Obligations and Contracts Act, titled ‘Sources of obligations’ and are placed after the section, dedicated to the effects of the contract and before the provisions concerning agency, i.e., from Article 26 to Article 35. Aside from these rules, there are numerous other special provisions, scattered in various other laws and by-laws regulating special hypotheses of invalidity of juridical acts. For instance, naming only some of the most important, according to Article 42(1) Inheritance Act, the testamentary disposition will be null when it was made in favour of a person who does not have the right to receive by devise. Article 113 of the Obligations and Contracts Act stipulates that an agreement for abridging or extending established limitation periods, as well as renunciation of the limitation before it expires will be invalid. Under Article 130 (4) of the Family code, any gift, abandonment of rights, lending and securing of other person’s debts by a minor child are proclaimed to be invalid.⁴

The provisions regulating the conclusion of valid juridical acts apply not only to contracts but also to other types of juridical acts, including unilateral acts, as stipulated in Article 44 OCA. The provisions set forth for contracts in Article 44 OCA apply *mutatis mutandis* to unilateral expressions of will in those cases in which the law permits them to create, alter or terminate rights and obligations. Meanwhile, there are many examples of juridical acts that, due to their nature and peculiarities, fall out of the scope of application of the general rules of invalidity formulated in Articles 26–35 OCA. One such example involves unilateral acts comprising decisions of legal entities which are subject to a specific system of grounds of invalidity, procedures for claims and consequences of invalidity, showing significant differences compared to general rules. The same holds true for the decisions of the condominium ownership. Judgment

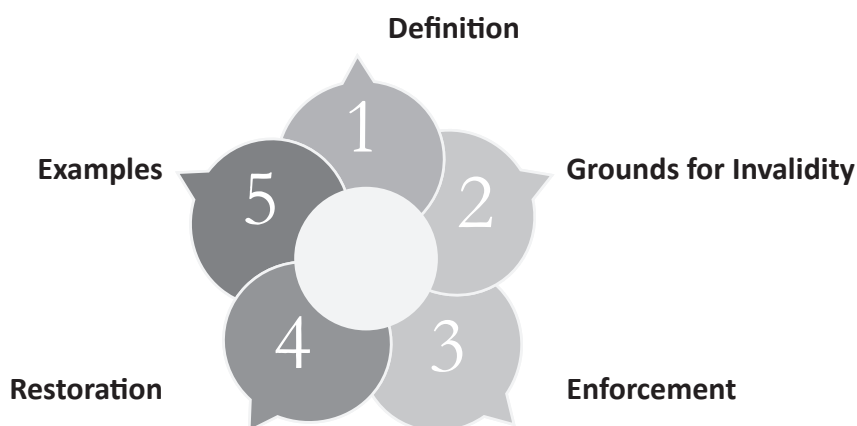
⁴ For a detailed study on some special provisions dealing with invalidity, see **Димитров, М.** Основанията за нищожност по чл. 26, ал. 1 ЗЗД. София, Сиби, 2013.

No. 39/19.02.2013 under Case No. 657/2012 of the Supreme Court of Cassation holds that the decisions of the General assembly of the owners in a condominium ownership constitute a specific type of multilateral acts, taken by an impersonal group of persons for the achievement of a common goal, to which the general rules on invalidity are not applicable. In this respect, the general rules do not apply also the nullity of a marriage, a court judgment, or certain administrative acts.

2. Delineation of void and voidable contracts

The Obligations and Contracts Act in its part concerning the general rules of invalidity of contracts differentiates explicitly between two categories of invalid contracts: void and voidable contracts. However, Bulgarian legislature has been quite inconsistent in the usage of these two terms and has sometimes misleadingly used them as interchangeable synonyms. This is why when we encounter any of the two terms, we will have to, by interpreting the relevant provision, determine the specific type of invalidity referred to in each case.

Differences between Void and Voidable Contracts



2.1. Void agreements and juridical acts – the concept

A null and void juridical act is a juridical act, which, due to the absence of an essential element or elements will, under no circumstances, produce the legal effects aimed by the parties. Void contracts are contracts that from their inception are neither valid nor enforceable. Neither party is bound to perform its obligation under the contract and no legal action can be maintained against such party if it fails to do so. In comparison, in the event of an inactive (and not void transaction), then certain additional conditions need to occur for finalization of the transaction and there is uncertainty as to whether they will. Up until these additional conditions occur, the legal transaction is in abeyance, but once those additional conditions and terms are accomplished, the contract is fully valid and enforceable.

A juridical act which is null and void is deemed not to have taken place. A void contract is void from the very onset and not merely voidable by a party or by a court. According to Bulgarian law, for a person to raise the issue of nullity, the legal transaction doesn't need to have been previously declared null and void by a court ruling. The intentions and the knowledge of the parties are irrelevant.

Example 1: If A sells to B immovable property which is exclusive property of the state, this contract is null as it infringes the existing legal prohibition concerning legal transactions with state-exclusive property which is a res extra commercium.

Example 2: If a minor enters into a contract for rent, the contract is void due to lack of consent because minors cannot express legally binding will.

Example 3: If X concludes the sale contract for his flat with Y with only a notary-certified signature, then the contract is null due to non-compliance with the form required by law for the transaction to be vested (e.g. contract of sale of immovable property without notary deed)

2.1.1. Types of Nullity

Full and Partial Nullity

- a. Full nullity:** nullity is full when, because of it, the entire juridical act is overturned

Ex: A who is under full interdiction due to serious mental disease enters into a sale contract with B purchasing a piece of land. The contract between A and B is invalid because A cannot express a validly binding will and there is a lack of consent.

- b. Partial nullity:**⁵ nullity is partial when it *only affects part of the juridical act*. Hence the invalidity of a few clauses does not render the entire contract void given that the clauses may be replaced by binding prescriptions of the law or if the transaction can be presumed to have been concluded even without the void clauses. Consequently, the part of the transaction that is not affected remains valid. The sole provision expressly dealing with partial nullity is Article 26(4) of the OCA, which states that the nullity of certain parts does not render the entire contract void where those parts are superseded *ex lege* by mandatory rules of law or where the transaction could reasonably be presumed to have been concluded by both parties without the invalid parts. Although this provision refers only to nullity, it also applies to cases of partial voidability. On the other hand, although only contracts are referred to, the provision applies also to unilateral and/or multilateral transactions. The typical case that the legislator has considered with 26(4) OCA is the vitiation of parts of the intention of a transaction. The law regulates two hypotheses in which in this situation the defectiveness of a part of

⁵ For a comprehensive and thorough analysis of the institute of partial nullity, see Русчев, И. Частична недействителност на правната сделка. // Пазар и право, 2001, № 3, 14-20.

the expression of intent does not entail invalidity for the whole transaction:

- The first hypothesis refers to cases where the content of the defective parts can be replaced by content prescribed in an imperative legal rule;
- The second hypothesis concerns the possibility of ignoring the invalid parts when it can be assumed that the parties would have validly concluded the transaction even without the invalid clauses.

Example 1: A loaned an amount of money to B at an annual interest rate of 50% which was part of the standard terms of the contract. Such a clause contravenes good morals and infringes the law as an unfair clause, which leads to its nullity that does not affect the rest of the contract.

2.2. Voidable juridical acts

The vices that cause the voidability of transactions are listed in Articles 27–33 of the OCA and generally refer to flaws in the will of a person that may affect the ability of that person to express a valid will.⁶ Such vitiating factors in the formation of contracts are: fraud, mistake, threat and undue influence, lack of capacity, and extreme necessity.

A voidable transaction gives rise to the effects of a valid transaction but is entered into subject to the will of the party to whom the law has granted right of action to have the transaction avoided with retrospective effect.⁷ After its annulment, the voidable juridical act gives rise to consequences almost equal to those of a void juridical act, i.e., it is considered null and void from the time of its conclusion.

The action for annulment of a voidable transaction may be brought to court only by the person whose will was corrupted and flawed against the other party within the time limit of 3 years. The departure point for the term of 3 years differs depending on the grounds for annulment. The right

⁶ See **Малчев, М.** Унищожаемост на гражданско-правните сделки. София, Сиела, 2010, 20–53.

⁷ As an exception, only contracts concluded because of extreme necessity and under apparently unfavourable terms can be avoided with effect *ex nunc* – from now on.

to claim the annulment of a voidable transaction may also be extinguished if the beneficiary waives its right to annul the contract. If the annulment of a voidable juridical act is not sought during the term of extinction of the right to annul set by law, the transaction remains valid and may no longer be annulled. Consequently, its legal effects no longer run the risk of being reversed.

3. Difference between null and voidable juridical acts in brief

- A null and void juridical act is considered to have never taken place; consequently, it produces no legal effects. In principle, nullity occurs *ipso jure* and there is no need for a court ruling to declare the transaction null and void. Nevertheless, the right to request from the court to have the contract declared null and void does not cease by the lapse of time.
- A voidable juridical act produces all its legal effects up until it is declared null and void by a court ruling. If the annulment of the juridical act is not sought within the term set by law for the extinction of such right or the defective legal transaction was ratified, then the voidable transaction remains valid in all respects.

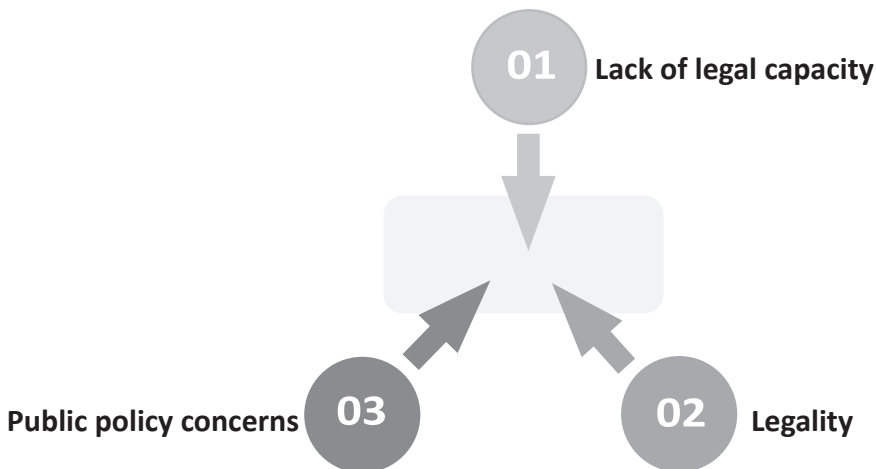
II. VOID AND NULL JURIDICAL ACTS

Under Bulgarian law, void⁸ contracts are those which have no legal effect because of their defectiveness from their conclusion and in which ratification is usually not possible. This explains why, as aforementioned, a null and void transaction is considered to have never taken place and is ‘legally nothing’ as far as it is denied *ab initio* to produce the legal effects desired by the parties. Moreover, the subsequent cessation of the prohibition or the cause of nullity does not render the contract valid, regardless of whether the parties have performed their contractual obligations or not.

⁸ The subject matter is sometimes described as ‘illegality’. However, ‘illegality’ is not necessarily the most appropriate term for some infringements of fundamental principles or mandatory rules. In some cases, the contract may be immoral rather than illegal and, in some cases, it may simply suffer from a defect of a rather formal or regulatory nature that does not make it by all means illegal at the same time.

The nullity of transactions is also called initial nullity, absolute nullity, etc. Contract nullity is determined by its object (content) or its cause. Proof of this statement is Article 26 OCA – a general rule providing for the various grounds of nullity of juridical acts under Bulgarian law, where the reasons rendering a juridical act invalid are grouped in two separate paragraphs. Thus, according to Article 26(1) OCA, contracts contravening or circumventing the law, as well as contracts infringing good morals, including contracts on estate in expectancy are null and void. In the wording of para. (2) of Article 26 OCA null and void are also those contracts that have an impossible subject, as well as contracts which lack either consent or the form prescribed by law, or grounds. Fictitious contracts are also null and void. The grounds are presumed to exist until otherwise proved. The existence of any of those grounds constitutes a legal impediment to the occurrence of the legal effects intended by the parties.

What is a Void Contract



2. Grounds for invalidity

2.1. Contracts contravening and circumventing the law

Provisions ensuring that a contract contravening or circumventing the law is deemed to have no legal effect and is void exist in almost all continental countries as opposed to contracts that are contrary to good morals.

1.1.1. When a juridical act contravenes the law

A contract is void and null to the extent that it contradicts the law, states Article 26(1) first proposal. In this case, the contract must infringe some mandatory rules included as part of normative acts or by-laws. Contradiction with the law means contradiction with a specific legal norm. A contradiction with the law is in place when there is a contradiction with an imperative legal norm,⁹ as dispositive legal norms cannot be infringed. This mandatory legal norm can belong to any branch of law as long as it is relevant to the transaction and is of mandatory nature. In addition, those mandatory rules with which the contract is not compatible are usually prohibitive provisions that usually serve to protect certain public interests. Hence whether or not a juridical act contradicts the law can be established by comparing the content of the juridical act and the rule of law.

Nullity due to contradiction with the law is an entirely objective ground for the illegality of juridical acts because, for the existence of nullity, it is irrelevant whether the parties knew or were aware that they were breaking the law. In addition, the subjective attitude of the parties to the transaction is irrelevant to the nullity of the transaction.

The claimant, who has brought action under Article 26(1) OCA, should state factual allegations as to what the infringement of the law consists of, and may, but is not obliged to, point out the specific legal provision that is contravened. He or she may incorrectly refer to the alleged infringement of a legal provision, or the said provision may not be mandatory, or there may

⁹ Of course, on a more specific level, the more pertinent question to be posed in each case is why a law prohibits certain behaviour (even making it criminally punishable) even in the case where the injured party expresses agreement with it.

even be no legal prescription at all corresponding to his or her allegation. All this does not affect the regularity and admissibility of the proceedings.¹⁰

Conflict with the law affects the substance of the transaction. A nullity of the transaction occurs generally when the essential content of the transaction contradicts a mandatory norm. However, when the conflict with law affects only clauses of non-essential content, nullity is partial.

Example 1: A, a joint owner, is waiving his right to partition common property by means of a formal declaration with notary certified signature. This unilateral expression of will is void as it contravenes the existing prohibition for waiver of the right of partition.

Example 2: In 2022 A started providing money loans at a significant value, as an occupation, without having the necessary licence to carry out banking activities. All loan contracts were announced null as contravening the mandatory provision of Article 2(5) of the Credit Institutions Act.

The liability for damage concerning the nullity of the contract is considered the second major area to which the notion of *culpa in contrahendo* is applied, besides the liability for conducting negotiations in bad faith. This means that if any damages occur because of the conclusion of a contract which is not in compliance with the law, the aggrieved party may claim remuneration.

1.1.2. Circumvention of the law as grounds for invalidity of the juridical act

Equally null and void is every contract, which, even though not contrary to a prohibitive provision of the law, constitutes an attempt to circumvent a prohibitive provision of the law. Under Article 26(1) OCA, circumventing the law (referred to in Roman law as *agere in fraudem legis*) is an independent vitiating factor leading to the invalidity of the juridical act – contract or unilateral act. Circumvention of the law takes place usually when, through a chain of formally legal and allowed transactions,

¹⁰ Решение № 22 от 04.11.2021 г. по дело № 1743/2020 на Върховния касационен съд, IV отделение.

the contracting parties aim to achieve a goal expressly forbidden by the law with a mandatory provision. In this case, the parties are not carrying out these transactions to obtain the immediate, typical legal results, but to achieve another, further purpose, the direct implementation of which would be contrary to the law.

Thus, through formally legal means, an unlawful result is aimed at, since each of the legal transactions accomplishing the factual composition for the circumvention of the law examined independently is formally valid and in compliance with the law. This explains why, unlike contravention of law, circumvention needs the intention of both parties – this is the so-called subjective element. Hence, for circumvention of the law to take place, the parties to the transaction must be aware that they are seeking to achieve a result prohibited by law by engaging in one or more transactions, each of which is not in itself contrary to the mandatory rules of law.¹¹

Under circumvention of the law, the rules for validity are formally observed but the parties' real intention is to achieve prohibited results through permitted legal means. In comparison, in the case of conflict with the law, the conduct of the parties to the transaction is in direct violation of a mandatory rule of law. **Circumvention of the law requires the following elements:**

- Performance of two or more transactions, each of which in itself does not contradict mandatory rules. This explains why circumvention of the law cannot exist if there is just one legal transaction, because if the latter leads to consequences conflicting with the law, then we have illegality due to contradiction with law and not circumvention of law;
- Prohibited or not permitted by law result is being reached;
- The participants in the transaction (the parties or their representatives) are aware – know or must have known that through these transactions they will achieve a purpose which is prohibited by law and which they intended from the very onset. Therefore, whether the contract will be qualified as circumventing the law strongly depends on the fault, intention and bad faith of the parties.

¹¹ For more details on the difference between circumvention of the law and contravention of the law, see **Василев, Л.** Гражданско право. Обща част. (Нова редакция от проф. Ч. Големинов). Варна, ТедИна, 1993, с 295.

Example: A represents B as lawyer in a lawsuit where there is an argument between B and defendant C over the ownership of a house in the mountains. During the court proceedings, A proposes to B to buy the house. However, to circumvent Article 185 OCA containing mandatory prohibition for judges, prosecuting attorneys, state and private executive magistrates, recordation judges, and lawyers to buy the rights which are disputed before the court to which they belong or in whose jurisdiction they act, except if the buyer is a co-owner of the disputed right, the contract is concluded between Y and B. A month after the transaction between Y and B, A buys the same house from Y, thus circumventing the prohibition of Article 185 OCA with the awareness and intention of achieving forbidden results which are in place for both contracting parties.

1.1.3. Infringement of good morals as a ground for invalidity of the juridical act

It is not only contracts contravening and circumventing the law that are void, but also those that are at variance with good morals.

What are good morals?

Usually, good morals are defined as certain unwritten behavioural rules mainly of moral and ethical nature, *derived from the society's perception of what is fair, just and ethical and corresponding to the minimum of moral as fundamental principle in law whose borders and boundaries vary through the years*. Good morals are understood as a complex of social, cultural and moral rules, which show a certain stability in the course of history, represent substantial historical tendencies, and are shared by a dominant part of the society meaning that the prevailing part of the society accepts these rules as norms of good, moral and fair, and they thus have the character of basic rules.¹² Conflict with good morals is an objective condition that does not depend on the fault or good faith of any party. That is why no intent or bad faith on the side of the counterparties is of any relevance when the court exercises its discretion in deciding whether a certain juridical act is immoral or not.

¹² See Решение № 50104 от 11.08.2023 г. по гр. д. № 2639 / 2022 г. на Върховен касационен съд, 4-то гр. отделение.

Moreover, good morals form an independent basis for the invalidity of juridical acts only when there is no other reason for invalidity.¹³ Hence if an agreement is simultaneously *contra bonos mores*, but also in conflict with certain mandatory rules and infringes an imposed prohibition, then there will be no place for invoking contradiction with good morals as a vitiating factor.

When a contract contradicts good morals, the result is nullity, regardless of the intensity of the infringement. As long as this vitiating factor is objective, it does not matter what the individual understanding of the contracting parties is for good and moral and whether they realise that the contract as a whole or certain parts of its content contravene good morals.¹⁴

Example 1: If A concludes a sale contract with B under which a gross disparity exists, then the contract may be considered invalid due to infringement of good morals insofar as they are defined as a limit to the freedom of contract, as set out in Article 9 of the Obligations and Contracts Act.

In *Example 1* the emphasis is put on the excessive disparity rather than the particular vulnerabilities of the weaker party. In case law and legal doctrine, it is considered that one such misbalance between considerations in a contract comprises a violation of moral, unwritten norms of social life from the point of view of which it is morally unacceptable for the concluded contract to give rise to the relevant legal consequences.¹⁵

Example 2: A gives a loan to B at interest of 70 % above the average rate interest for the country. The interest clause is void as it contradicts good morals.

¹³ In the same manner the German (CC § 138) and Austrian (CC § 879) codes speak of violation of good morals. The Swiss obligations code (LOA, Article 20) speaks simply of immorality.

¹⁴ According to Решение № 50217 от 09.11.2022 г. по гражданско дело № 1201/2022 г. на Върховния касационен съд, Трето гражданско отделение, the breach of good morals may be established if it is evident directly from the content of the contract, if it arises from duly introduced facts or from the evidence in the case.

¹⁵ According to Решение № 153 от 24.07.2015 г. по дело № 3014/2014 г. на Върховния касационен съд, Трето търговско отделение, the non-equivalence of the consideration, when it results in the violation of such norms in the manner indicated, renders the contract null and void on the ground that it is contrary to good morals.

1.1. Nullity of contracts on estate in expectancy

Article 26 (1) OCA declares invalid all legal transactions referring to future inheritance as a special case of negotiations against good morals due to the fact that the parties wish and rely on the death of the grantor.

1.1.1. When is estate ‘in expectancy’?

According to Article 1 of the Inheritance Act, an estate is deemed open for inheritance at the moment of the death of the deceased at his or her last residence. Therefore, the term ‘in expectancy’ refers to every estate which is not yet open for inheritance at the time of conclusion of a contract aiming disposition of some of the individual elements of that aggregate (individual rights, obligations and factual relationships) or the entirety of inheritable rights, which, after a person’s death, are expected to constitute his or her inheritable estate. The nullity of transactions on estate in expectancy is based on the impact of the transaction on a future estate before the grantor has even died, which is considered contrary to *boni mores*.¹⁶ According to Bulgarian case law, contracts on estate in expectancy entail the disposition of property rights which the person does not own but expects to acquire by succession. In order for the court to find nullity, there must be evidence that the property, subject to disposition, is part of an inheritable estate which is not yet open for inheritance within the meaning of Article 1 of the Inheritance Act.¹⁷

1.1.2. Is a subjective element necessary?

Some recent uncertainty in legal practice has raised the question of whether the above provision – that the object of the transaction is objectively part of someone’s future inheritance – is sufficient for a contract involving estate in expectancy to be void as a stipulation or there should also be some bad faith, intention and knowledge of the contracting parties. The majority of scholars and case law share the opinion that whether the contracting

¹⁶ Решение № 50167 от 22.02.2023 г. по т. д. № 1088 / 2021 г. на Върховен касационен съд, 1-во търг. отделение.

¹⁷ This is explicitly stated in Тълкувателно решение № 1 от 27.04.2022 г. по тълк. д. № 1 / 2020 г. на Върховен касационен съд, ОСГТК.

parties knew or must have known that the legal consequences of their transaction are directed to estate in expectancy is of no relevance. In contrast, some of the newest research papers examining this type of transactions suggest that what makes these contracts invalid is precisely the bad-faith conduct of the contracting parties who knew they were bargaining over future inheritance. The author states¹⁸ that where the prospective grantor is not a contracting party, then both parties must be aware that the object of the transaction is an element of the future inheritance of a particular person. In addition, the transaction should objectively be directed over the inheritance not yet opened of that person, and the parties must treat at least one of them as either an heir or legatee (present or future) or as a person who will acquire rights from the would-be heir or legatee.

In the majority of cases, the transaction relating to estate in expectancy will involve disposition (e.g. transfer of rights). However, it can also include the management of such estate (*for example a lease contract over a flat you expect to acquire by way of testimony where your aunt has appointed you as a sole heir of her estate*). Transactions on estate in expectancy may affect not only specific single property rights in the future estate but may also affect the right of succession itself. One such case would be the preliminary waiver of the right of acceptance of inheritance before it is open for inheritance.¹⁹

A wide range of persons with no limitation may carry out a transaction aimed at the disposition of rights as part of future inheritance. Hence, the contractor over future inheritance may be the grantor himself, his or her legal heirs of all lines of succession, as well as the heir appointed through testamentary disposition. The same is true for individuals who are neither in the circle of legal heirs nor can be presumed to be named in the testator's will.

Example 1: X and Y are brothers and X is extremely poor and unsuccessful. One day he goes to his father asking for money; in

¹⁸ For further details, see **Недев, Д.** Субективната страна на сделките върху неоткрити наследства available at <https://www.challengingthelaw.com/obligacionno-pravo/neotkriti-nasledstva/#sdfootnote7sym>.

¹⁹ For more on the matter, see **Кацарски, Ал.** Основанието за нищожност при договори с неоткрити наследства. // Съвременно право, 1999, кн. 6, 50–51.

return he declares his intention and readiness to sign a declaration promising he will not seek inheritance from the father after the death of the latter. This unilateral statement is void as it is directed towards estate in expectancy.

Example 2: An agreement that a certain receivable cannot be the subject of a testamentary legacy constitutes a contract on estate in expectancy, and as such is void. No person can bind oneself by contract to make a bequest of his or her estate or any part of it. Neither can any person bind oneself not to make a bequest of his or her whole estate or of a bequest of a separate right included in that estate and if such bindings are made, they are void as contracts involving estate in expectancy.

Example 3: A signs a preliminary contract with B promising him to sell him his father's house once he inherits it after the death of the current owner.

1.2. Invalidity of contracts with an impossible object

Many legal systems in Europe²⁰ consider a contract that, at the time of its formation, sets out obligations that are impossible to perform, to be void. Following this tradition impossibility of the object is the first among five grounds for nullity of contracts in Bulgaria exhaustively listed in the provision of Article 26 (2) OCA. *Per argumentum a contrario* for a valid legal effect to be attached to consent in the formation of contracts, this consent must refer to a possible object at the time of contract conclusion.

Unlike all other grounds for invalidity mentioned in Article 26 (2) OCA that refer to various aspects and characteristics of the contracting parties' will, an impossible object relates to the consequences of those expressions of will.

²⁰ This holds true for Austrian law in the case of 'evident' impossibility. French law, and the law of Belgium and Luxemburg, require 'un objet certain qui forme la matière de l'engagement' (CC Article 1108).

1.2.1. When is the object of a contract impossible?

Defining the initial impossibility of the object of a contract requires a clarification of the essence of the object as such. In Bulgaria, the classical doctrine, albeit with significant nuances, is united around the view that the object of a stipulation is a feature not of the contract but of the obligations. Starting from this definition we can state that the object of a contract within the meaning of Article 26(2) OCA consists of the objects of the non-monetary obligations arising from that contract in their entirety. Given that, it is easier to understand why according to Bulgarian civil doctrine the category ‘impossible object’ encompasses both cases of factual and legal impossibility.²¹

Factual impossibility of the object of a contract

Factual impossibility of the object, also known as physical impossibility, frustrates and prevents the formation of a valid contract in all cases where the object of the contract does not exist at the time of its conclusion and it is clear that it is impossible to be produced, to occur and to be established. In other words, such object cannot possibly exist in reality.²² In other words, the object is physically impossible when it is clear that it concerns a thing, which cannot be created in the foreseeable future given the current state of technology. Factual impossibility is when the object neither exists nor is possible considering the natural laws and the stage of development of science and society.

Examples of such impossible objects of contract are a time machine or an invisibility cloak.

Example 1: A assumes an obligation towards B to sell him a time machine allowing B to visit his relatives from the past. The contract of sale is void as having an impossible object.

²¹ See **Павлова, М.** Гражданско право. Обща част. София, Софи-Р, 2002, с. 535.

²² According to Решение № 49 от 29.04.2022 г. по гр. д. № 1945 / 2021 г. на Върховен касационен съд, 3-то гр. отделение, the factual impossibility of the object means that it does not exist in reality at the conclusion of the transaction and cannot arise or be created.

Example 2: B concludes a consumption loan over individually specified goods that at the time of contract conclusion have perished due to casus fortuitous. The object of the contract is physically impossible.

Legal impossibility of a contract object

Recent legal disputes challenge the concept of the legal impossibility of the object. As far as the legal impossibility of the object is concerned, the latter occurs when there is an overwhelming legal obstacle to the formation or disposition of the object. In contemporary case law, it is reasoned that the legal impediment may arise from statutory prohibitions on the transaction or restrictions on the object's division.

Example 1: A transfers to B the ownership over parking spot No. 21. However, under the Bulgarian Spatial Development Act, a parking spot does not constitute a valid and independent object of property rights. Therefore, the contract is void under Article 26 (2), first proposal OCA.

Recent case law and legal doctrine debates on the issue of the applicability of Article 26 (2) in transactions in real parts of estate. Some of the more recent court rulings hold that in transactions involving a real part of real estate, the possible objects of the contract are all those parts of the real estate that can be separated as an independent object of property rights.²³ They also hold that it is irrelevant to the validity of the transaction whether the separation is approved by the authorised technical authorities at the date of conclusion or the possibility of such separation exists solely objectively. Another group of court decisions expresses the opposite position. It holds that under Article 26(2) COA, a contract is null and void due to the impossibility of the object if, at the time of its conclusion, the property – the object of disposal – does not exist in fact or does not meet the requirements for a separate object established in the applicable land development legislation.

The existence of controversial case law has led to the issuance of

²³ Решение № 21 от 01.07.2015 г. по гр. д. № 6057 / 2014 г. на Върховен касационен съд, 2-ро гр. отделение.

Interpretative Decision 3/2014 in which the supreme court judges took the position that initial legal impossibility of an object is in place where there are insurmountable legal obstacles to its creation or disposal. One such legal impediment is the existence of a normative prohibition for the conclusion of the legal transaction or impossibility for separation of the object as a previous part of immovable or movable property. According to recent case law, it is now accepted that if, at the time of a property transaction, the designated parts of the property (such as a building, dwelling or other objects) are not separated, but can be separated as a separate object, as long as such separation follows the requirements outlined in the zoning legislation in force at the time, then the contract is not null and void due to an impossible object.²⁴

1.2.2. Initial impossibility against post-contractual (supervening) impossibility

The initial impossibility of the object of a contract depriving the contract of its legal effects should be differentiated from the impossibility of the object occurring after the contract is already concluded. The latter deals with the enforceability of contracts due to the occurrence of some unforeseen incidents and leads to the discharge of the contract.

The following are the main types of supervening impossibility or post-contractual impossibility given in the law literature:

- Destruction of the subject matter of the contract: A contract gets discharged when its subject matter is destroyed without any fault of the parties after the contract's formation.
- Death, illness or personal incapacity: When the performance of a contract is dependent upon the personal skills or qualification of a party, the contract becomes discharged if such party becomes ill, incapable or dead before the contract's performance.
- Change of law: In some cases, a contract may be rendered impossible by unexpected subsequent changes in law which make it illegal.

²⁴ Решение № 49 от 29.04.2022 г. по гр. д. № 1945 / 2021 г. на Върховен касационен съд, 3-то гр. отделение.

1.3. Juridical acts void for lacking will or consent

Among scholars and legal practitioners, it is beyond dispute that a contract or unilateral act is void due to lack of consent or expressed will when there is a conscious discrepancy between internal will and expressed will.²⁵ Without consent, a transaction cannot be concluded at all. Regarding bilateral transactions, however, the wills of the parties must be mutual, reciprocal and completely overlapping concerning the object of the bargain.

In this respect, it must be noted that if the lack of consent is unconscious then the avoidance rules will be applicable. This means that both parties and the single party in a unilateral act must be aware that the externally expressed will does not correspond to their real will. This is the case when, during a presentation, the lecturer says something as a joke or gives an example by offering one of the students to buy his phone to exemplify the binding legal effect of an offer in the process of negotiations. Hence, the aforementioned circumstances exclude the possibility of the will thus expressed to be taken seriously.

When must consent be lacking for the contract to be void on these grounds? Consent must be lacking at the time the contract is concluded. Subsequent lack of consent has no legal significance.

1.3.1. Hypothesis of juridical acts void for lacking will or consent

Will may be missing during the process of contract formation. Thus, if the seller or the buyer refuses to sign a notary deed for a transfer, then the transaction will not take place even though, for example, the notary has placed his signature.

Another example is the so-called *reservatio mentalis* which is the Roman term for mental reservation, describing the situation where a person makes an offer to buy a thing and simultaneously makes the mental stipulation that he or she has no will to buy at all. A mental reservation to

²⁵ For further details, see **Таджер, В.** Гражданско право на НРБ. Обща част. Дял II. С.: Наука и изкуство, 1973, 259–260.

a legally binding agreement has no legal effect if not shared by all parties to the agreement. Further, we are facing a lack of consent, if the will was extracted with imminent physical violence because the contracting party that has been subjected to violence has no real intention to enter into a legally binding agreement.

Example 1: If A concludes a contract with B only because of the physical metus used by B, then this distorts the voluntariness of the consent because the law regards such pressure as illegitimate — and what the law regards as illegitimate becomes, from that perspective, no consent at all.

Finally, yet importantly, there is also no will when one of the parties to the contract is completely incapacitated. Under Bulgarian law, minors and persons under full judicial interdiction cannot validly conclude legal acts because the law does not recognise their legal capacity to express a legally binding will. This explains why if a minor or a person who is fully interdicted concludes a sale contract, then the legal effect is lack of consent and invalidity of the contract.

Also, in certain circumstances, abuse of language not known or familiar to one of the contracting parties can also result in nullity of the contract due to lack of consent. Finally, in the case of misunderstanding, where the parties believe that they have reached an agreement, but have different assumptions relating to the cause, object or legal nature of the contract, the contract cannot be concluded.

1.4. Void contracts incompatible with mandatory requirements for form prescribed by law

In many European legal jurisdictions, non-conformity with the required form makes the contract void. In this respect, Bulgarian civil law is no exception. The requirement to comply with a certain form when undertaking a legal transaction is primarily related to the need for legal certainty. In addition, the formality of a juridical act imposed with mandatory rules serves as a guarantee that what is objectively expressed by the counterparties coincides with what they subjectively desire. That is

why under Article 26 (2), third proposal OCA, a contract is deemed invalid if it has not been concluded in the statutory essential form. The same holds for the conclusion of a contract for which the law prescribes a mandatory form as a prerequisite for validity²⁶ (*ad validitatem*) of the transaction. Only then not observing the so-required form will result in the nullity of the contract.

Of course, there are certain legal exceptions to this rule – the good-faith reliance of a party on the (informal and null) statement is protected by the law – the other party cannot invoke nullity if it did not challenge the validity of the statement upon its receipt (Commerce Act, Article 293(3)). This is the legal logic behind the rule of Article 293 (3) laying down that a party cannot plead nullity should its behaviour imply that it has not contested the validity of the statement. Beyond the exception envisioned in Article 293 of the Commerce Act, a form- defective contract cannot be validated through performance.

Example 1: A contract for the sale of immovable property will be deemed null or void pursuant to Article 26(2)(3) OCA when the contract itself is not concluded in the form of notary deed, as prescribed by the mandatory rule of Article 18 OCA (Judgment No. 52 of 14.05.2021 in case No. 4923 / 2019 of the Supreme Court of Cassation, 4th Civil Division).

Example 2: The requirement that the notarial deed (with the declarations of intent for the conclusion of the contract contained therein) be read to those involved by the notary, is imperative and its violation leads to nullity of the notarial act and invalidity of the contract as incompatible with the required form.

1.5. Lack of *causa* as a ground for invalidity of contract

The nullity of a contract is determined by either its object (content) or its *causa*. According to Article 26 (2), contracts without *causa* are void, although *causa* is a rebuttable presumption. Thus, enshrining in law the

²⁶ Therefore, lack of prescribed form *ad probationem* will not lead to nullity of the legal transaction under Article 26 (2) OCA.

requirement for causa, the Bulgarian legislator clearly followed the French Code Civil before its major reform in 2016 when the obscured requirement for causa as a constitutive element of the contract was abandoned.

What is causa?

In legal doctrine, the requirement for causa in contracts is usually defined as the direct, immediate and typical objective of a contract.²⁷ In this respect causa is presented as an instrument of control to the autonomy of the will applicable mainly to the so-called unnamed contracts – *pacta innominata*. Where the agreement reached between the parties has no legal framework, the normative demand for causa is a form of defence against the possibility of an atypical pact (*pacta innominata*) with prohibited goal that will lead to infringement of public order. What is of interest in both typical and atypical contracts is the (concrete) causa which makes it possible to ensure that the aims pursued by the parties are not unlawful (contrary to law or morality, the latter case known as unlawful causa – *causa torpe*).

On the other side, causa within the context of atypical agreements that have no legal framework serves as a guarantee of the seriousness of the binding intention of the persons entering into a contract at the negotiations stage.

Despite this, the meaning and significance of causa as a requirement for the formation of a valid contract remains obscure and is surrounded by some uncertainty.

Example I: A enters into a contract with B for the transfer of immovable property in exchange for maintenance and care obligations. Being his general practitioner, A knows about B's severely deteriorated state of health and his inevitable forthcoming death. This contract lacks causa because one of the parties knows of the existence of a disease implying death of the transferor soon after the date of contract conclusion and his aim is not to perform the obligation for service in exchange for the acquired property. Thus, the contract is deprived of legal reasons.

²⁷ For more details, see **Конов, Тр.** За абстрактните сделки и каузата на договорите. – В: Подбрани съчинения. София, Сиела, 2010, с. 482.

1.6. Nullity of fictitious contracts

The last ground for invalidity of juridical acts included in Article 26 (2) OCA refers to simulative agreements, also known as fictitious contracts. Fictitious contracts are those contracts by which the parties deliberately conceal the real type of transaction concluded between them or the absence of a transaction, creating in third parties a false impression as to the existence of a legal transaction or the true content and type of the existing legal relationship between them. In cases where a contract is deemed null and void due to lack of genuine will and consent or where the transaction is fictitious, there may appear to be an externally expressed will, but behind it, there may not be any internal volitional decision or the actual will remains hidden in the internal relations of the contracting parties.²⁸

1.6.1. Types of simulation in contract law

Bulgarian legal doctrine and practice distinguish between absolute and relative simulation. An absolute simulation will be present when, through the simulated transaction, the parties conceal the absence of a transaction between them. There is only a fictitious contract and no other hidden agreement. The fictitious contract is therefore void as the parties did not have real intention and will to bind themselves. Hence, the fictitious contract may be viewed as a special form of lack of consent between the parties.²⁹ In cases of absolute simulation, the parties have no intent to be legally bound and simply want to create legal semblance for the occurrence of a transaction; there is usually no second agreement, revealing the true and intended type of transaction.

Example 1: A wishes to avoid foreclosure on his property. For this reason, he concludes a sale contract with his brother transferring to him his expensive cars. Both A and his brother are aware that they have no real intention to conclude the agreement – neither the seller

²⁸ See Решение № 49 от 29.04.2022 г. по гр. д. № 1945 / 2021 г. на Върховен касационен съд, 3-то гр. отделение.

²⁹ Решение № 100 от 27.06.2019 г. по гр. д. № 4179 / 2018 г. на Върховен касационен съд, 3-то гр. отделение.

wishes to sell, nor the buyer wishes to buy property in question. This contract is void.

Example 2: B who is a debtor heavily threatened with distraint of goods by creditors may pretend to sell the goods to a friend, neither having any intention to transfer ownership. This is the so-called overt contract or apparent contract while in this case no second concealed or covert agreement is entered into.

If a fictitious contract disguises another, simulated contract that the parties intend to conclude, the latter should be considered formed, provided that the conditions for its validity are met. In this event, we have a relative simulation where there are two agreements: an overt one (the fictitious transaction) and another, which is intended to remain secret.³⁰ The covert agreement is sometimes embodied in a document (variously called a back-letter, counter-letter or side-letter). The situation is therefore different to the case where there is a single agreement, which is merely ambiguous or vague so that its meaning fails to be discovered by interpretation.

Example 1: A wants to deprive his two children of the opportunity to challenge his testimony after his death. That is why he decides to sell all of his immovables to B. At the same time, A and B have reached a secret agreement that the price under the sale contract would not be paid because A's real intention is to donate all of his immovables to B.

Finally, the simulation may relate to the true beneficiary of the contract. For example, a sale is concluded with one person when the true buyer is another person. In this last type there may, but not necessarily be, an overlap with the rules on representation. In any case of conflict, the rules on representation will prevail because they are the special rules for the situation.

³⁰ Решение № 99 от 01.09.2020 г. по гр. д. № 4688/2019 г. на Върховен касационен съд, 4-то гр. отделение.

1.6.2. How to prove simulation in front of the court

Admittedly, proving simulation in front of the court is challenging. This is partly so because of the strong limitation imposed by procedural law. Article 165 of the Civil Procedure Code provides that witness testimony is also admissible when a party seeks to prove that the consent expressed in the document is apparent, if there is documentary evidence in the case, coming from the other party or certifying its statements before a state authority, which make it probable that the consent is apparent. This restriction does not apply to third parties or to heirs where the transaction is directed against them.

This means that a party to a contract attempting to prove that the contract is void due to being simulative must obtain written evidence from the other party, or evidence certifying statements of the party before a state authority, which makes it possible to use the statement that the consent is simulative as witness testimony. Of course, there is no need for testimony if there is a counter-letter or side-letter, which is a written document, which usually embodies the concealed agreement between the parties. Also, the prohibition for testimony under Article 164 of the Civil Procedure code will be derogated if there is a written document or expression of will, addressed towards third parties, making the statement of simulation reasonably justified and well-founded.³¹

1.6.3. Effects of fictitious contracts between parties

In the case of absolute simulation, the contract is void and ineffective both for the parties and for third parties. In comparison, if there is a combination of an apparent (fictitious) contract and a covert one, the fictitious agreement will be deemed null, while the parties will be considered legally bound with the consequences of the hidden agreement as long as the latter complies with the other mandatory requirements for validity of

³¹ See Богданова, И. Поняко материалноправни и процесуалноправни въпроси на симулативните сделки, available at <https://gramada.org/%D0%BF%D0%BE-%D0%B-D%D1%8F%D0%BA%D0%BE%D0%B8-%D0%BC%D0%B0%D1%82%D0%B5%D1%80%D0%B8%D0%B0%D0%BB%D0%BD%D0%BE%D0%BF%D1%80%D0%B0%D0%B2%D0%BD%D0%B8-%D0%B8-%D0%BF%D1%80%D0%BE%D1%86%D0%B5%D1%81%D1%83%D0%B0/>

juridical acts. This conclusion is based on the explicit text of Article 17 (1) OCA, which provides that if the parties conceal an agreement reached between them by way of a fictitious agreement, it is the rules concerning the fictitious agreement that apply, as long as the fictitious agreement meets validity requirements.³²

1.6.4. Effects of fictitious contracts with regard to third parties

In cases of relative simulation, it would, however, be contrary to the requirements of good faith and fair dealing to allow the parties or one of them to invoke the secret true agreement in an issue against a third party who has reasonably and in good faith relied on the simulated contract. This is why Article 17 OCA protects third parties. According to the aforementioned normative provision, rights acquired in good faith by third parties from the transferee under a fictitious agreement will be preserved except in the case of rights on immovable property acquired after the action establishing the fictitiousness is registered in the land register. This provision also applies to the transferee's creditors under a fictitious agreement who have levied a distress or an injunction on the object of the agreement.

2. Legal effects of the nullity of contracts

If a contract or a unilateral juridical act suffers any of the aforementioned vitiating factors, which cripple and invalidate it, then the said contract or the unilateral juridical act will have no binding effect neither over the contracting parties nor over involved third parties. As mentioned above, an invalid contract is considered non-existent – as if it was never concluded. However, null transactions do give rise to some limited legal consequences.

³² In some countries, this conflict situation is resolved in the interest of third parties. For example, in Italy the hidden agreement will prevail over the simulated one if the latter is detrimental to the third party, and vice versa, the simulated contract will prevail if the third party has relied on it in good faith. In Serbia the situation is comparable and the non-existence of a fictitious or simulated contract is confined to the legal relationship between the contracting parties. According to Serbian obligation law, a claim for the termination of non-existence of such contracts cannot be addressed to a third party who acted in good faith.

The basic legal consequence of declaring a contract null and void is *restitutio in integrum*. This means that if a party has already fulfilled its obligation, the unjust enrichment rules apply, and any benefit received under the void contract must be reversed.³³ Thus, Article 34 OCA prescribes that both parties are obliged to restore the benefits conferred based on a null and void contract. The restoration is primarily to be achieved in kind. However, if that is not possible (for example if the object has perished), or the restitution in kind is not compatible with the nature of the benefits conferred,³⁴ appropriate monetary equivalent must be paid, according to the market prices valid at the time of relevant the court decision, unless the law prescribes something else (as per Article 57 OCA). If the party that received the benefit subject to restitution has disposed of it or consumed it after becoming aware that he or she is holding it without legal ground, then such party will be liable for either its actual value or the price received for it, whichever is higher.

An additional legal consequence of nullity that may arise in certain cases is the liability for damages. Obligation law in Bulgaria, and not only, prescribes that the party to whom the ground of nullity of the contract is attributable, will be held liable to the counterparty for the damage sustained due to such nullity. For this liability to arise it must be proven that the party to which the vitiating factor resulting in nullity is attributable acted in bad faith. This means that he/she knew or should have been aware of the ground of nullity, taking into account the circumstances of the respective case. The liability for damages in relation to the nullity of the contract is considered the second major area to which the notion of *culpa in contrahendo* is applied, besides the liability for conducting negotiations in bad faith.

³³ Решение № 60287 от 16.02.2022 г. по гр. д. № 973 / 2021 г. на Върховен касационен съд, 3-то гр. отделение.

³⁴ This will be the case where one of the parties has performed a certain kind of service under the null contract.

2.1. Who can invoke the nullity of a contract

On 27.04.2022 the Bulgarian Supreme Court of Cassation (SCC) issued Interpretative Decision No. 1/2020 in which the court provides long-awaited guidance in solving the problem of whether the court is obliged to monitor the nullity of legal transactions that are relevant to the resolution of the legal dispute *ex officio*. According to SCC, when the nullity of a legal transaction or parts of it are relevant to the resolution of a legal dispute, then the court may declare *ex officio* (in the absence of objection by any of the participants in the proceedings) the nullity in the argumentative part of the court decision only if the nullity stems directly from the transaction or from evidence in the case.

In terms of the range of persons entitled to request the declaration of nullity of the contract, this right belongs to both counterparties and their heirs. The question of whether a third party may initiate the judicial declaration of the nullity of a contract it is not a party to is a bit more complicated. The legal doctrine and case law in Bulgaria have accepted the affirmative answer. Of course, in those cases the third-party claimant must demonstrate its meaningful legal interest in the declaration of contract nullity. For instance, the creditors of the decedent have a legal interest to request declaration of nullity of a lifelong maintenance contract concluded by the decedent, since the value of the inheritance estate may thus increase, hence the chances of successful collection of creditors' claims also increase. The same holds true for a creditor of either one of the contracting parties that might see its position worsened by the invalid contract. Such creditor may initiate action to declare the contract void. From a procedural point of view, it is important to note that in an action brought by a third party for the nullity of a contract, both counterparties must participate and be constituted as respondents. It is important to underline that an action to declare invalidity does not cease by the lapse of time and is not subject to a limitation period; therefore, it can be brought forward at any time.

2.2. Conversion

It is not possible to validate a void contract though it is sometimes possible to convert the void contract into a different and valid one.³⁵ Indeed, obligation law does not explicitly regulate the legal institute of *conversion*. However, among scholars and practitioners there is the widespread opinion that a void contract can produce the effects of a different contract³⁶ if:

- it possesses all its essential elements, and
- considering the purpose of the agreement, both parties would have agreed upon such a different type of contract if they had been aware of the invalidity of the original contract.

Conversion is not applied by the court *ex officio* and the court may not carry out a conversion without reference to it by a litigant and without the consent of the parties to the contract.

III. VOIDABLE CONTRACTS

1. Instead of introduction

Agreements between parties that satisfy the requirements of contract formation generate contractual rights and obligations. The same is true for unilateral acts where the law recognises them as sources of rights and obligations. Meanwhile, such rights and obligations may be defeated, wholly or partially, by recognized vitiating factors³⁷ such as mistakes,

³⁵ For some historical remarks on conversion, see Zimmermann, R. *The Law of Obligations. Roman Foundations of the Civilian tradition*. Cape Town, Juta and Co., 1996, p. 683.

³⁶ Рачев, Ф. Гражданско право. С образци на писмени защиты. 3-то прер. и доп. изд. София, УИ „Стопанство“, 2003, с. 424

³⁷ We can agree that aside from illegal and immoral contracts, which are accepted as policy motivated, the vitiating factors are generally explained in terms of some defect in the essential voluntariness condition of contract formation. For more on this see **Chen-Wishart, M.** *The Nature of Vitiating Factors in Contract Law*. (December 10, 2015). *Philosophical Foundations of Contract Law*, Oxford University Press. Available at: <https://ssrn.com/abstract=2709046> or <http://dx.doi.org/10.2139/ssrn.2709046>.

duress, fraud and so on.³⁸ Aside from illegal and immoral contracts, which are accepted as policy-motivated, vitiating factors are generally explained in terms of some defect in the essential voluntariness condition for contract formation. As such, vitiating factors have even been discussed alongside contract formation.

Voidable contracts in contrast to void contracts have legal effect, but this effect can be revoked at the request of a particular person. So, initially, voidable contracts are contracts that are valid and binding unless avoided or declared void by a party to them on the grounds prescribed by the law. Invalidation may be claimed only by the aggrieved party, the party with vitiated will in whose interest the law allows such invalidation. The right to claim invalidation is limited to three years. The limitation period commences on the day the person comes of age, or the interdiction is lifted, or the mistake or fraud is discovered or the threat ceased, and in all other cases – on the day of contract conclusion.

In Bulgaria, the general legal framework for voidable contracts is provided in Article 27 OCA et seq. The rule of Article 27 OCA contains a catalogue of all vices distorting the will by providing that contracts, concluded by persons of legal incapacity, or by their agents without observing the requirements established for such agents, as well as contracts concluded under mistake, fraud, threat or extreme necessity may be avoided. Specific legal provisions are (inter alia) contained in the Family Code, the Competition Protection Act and the Inheritance Act. The grounds for voidability are set out exhaustively in the law.

What is common between all the exhaustively listed grounds of avoidance is that their existence shows vitiated consent or intent to conclude the contract.³⁹ In contrast to the grounds leading to the nullity

³⁸ Actually, in many national laws it is customary to refer to a general notion of vices of consent under which mistake, threat and fraud are factors which prevent the formation of a valid consent to a contract and thus give rise to a right to avoidance. For more, see Principles, Definitions and Model Rules of European Private Law - Draft Common Frame of Reference (DCFR). Prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group) (available at: https://www.law.kuleuven.be/personal/mstorme/european-privatelaw_en.pdf), p. 480 et seq.

³⁹ See Решение № 2 от 22.04.2020 г. по гр. д. № 1153 / 2019 г. на Върховен касационен съд, 4-то гр. отделение.

of a juridical act, the existence of some of the vitiating factors negates the conditions for enforcing the contract but only if the contract is avoided by the party whose will was defective at the time of contract formation. This is why voidable contracts generate all the legal consequences and effects, which the law normally recognises as a valid and binding agreement. And, where the party that has the right to invalidate the contract brings action, then the contract may be avoided with a court ruling and then its legal effect will cease retroactively i.e., from its conclusion.

2. Lack of capacity to conclude a contract

In the wording of Article 27 OCA, contracts concluded by persons of legal incapacity, or by their agents without observing the requirements established for such agents, are subject to invalidation. We can say that incapacity negates not so much the freeness of consent or its independence but the fullness of consent. To understand incapacity as a reason to avoid a contract we have to explain that under Bulgarian law, the capacity for concluding a juridical act is the capacity of a person to conclude such an act in person. Only mature and healthy individuals hold this capacity.

2.1. Persons with no or limited capacity to undertake a valid juridical act

From a comparative perspective, every person is competent to contract who is of the age of majority according to the law to which he or she is subject, and who is of sound mind and is not under full or limited interdiction.⁴⁰ In Bulgaria, the legislator has accepted the objective criterion, i.e., age, to establish whether a person is legally capable, through personal acts, of acquiring rights and assuming obligations. At the age of eighteen natural persons acquire full legal capacity. Before that, the law distinguishes between minors and infants. Persons under the age of fourteen years are considered *infants*. They cannot conclude contracts or perform legal actions through personal acts. Their parents or guardians who act on

⁴⁰ It is important to note that in many soft law codifications lack of capacity as a ground of invalidity, which may negate or vitiate consent or intention, is not dealt with because it is considered more a matter of the law of persons than of contract.

their behalf (Article 3 of the Persons and Family Act) represent them. The same is true for people under full juridical interdiction. Both categories are deprived of the ability to personally express legally effective and binding will. This means that if a contract is concluded by an infant or a person under full prohibition, then the contract is completely void and null due to lack of will and is not voidable. In this respect the term *incapacitated person* used in Article 27 OCA is subject to corrective interpretation as the wording of the text is broader than its intended meaning.⁴¹ Further, a minor cannot ratify his or her contract upon attaining the age of majority. Whatever contract is made during infancy will be deemed void *ab initio*.

Example 1: At the age of 13, John signs a purchase contract with George in a notarised form. Given that John is an infant and acted personally at the time of contract formation, then the latter is void due to lack of consent. This is because John cannot assume obligations and acquire rights through his actions.

Persons between the ages of fourteen and eighteen years are *minors*. They can perform legal actions without the consent of their parents or custodians. However, the law provides minors with limited ability to conclude certain transactions on their own. Thus, according to Article 4 of the Persons and Family Act, when undertaking basic day-to-day transactions to meet their current needs (contracts for necessities) and to dispose of what they have acquired through their labour, minors can bind themselves without the need of parental or guardians' consent. From this point of view, when a minor or a person under restricted interdiction concludes a contract without the consent of a parent or custodian, the contract is voidable due to the lack of capacity of one of the parties.

Example 2: At the age of 16, John signs a purchase contract with George in notarised form. Given that John is a minor and that, when concluding the contract, he acted personally without the prior or subsequent consent of one of his parents, then the agreement may be avoided.

In addition to this, according to Article 130 (3) of the Family Code, disposal of immovable or movable property by way of formal transaction

⁴¹ See Таджер, В. Цит. съч., с. 279.

and with bank deposits as well as securities belonging to a child is permitted with the permission of the Regional Court of the child's present address, if the disposal is not contrary to the best interests of the child.

In the case of contracts for the sale of immovable property, there is no court permission; the contract concluded by the minor with the additional consent of the parent may be avoided. It is also worth mentioning that the law imposes strict prohibitions for certain legal acts to be undertaken before reaching the age of majority. These legal transactions are donation, waiver of subjective rights, lending money and securing someone else's obligation (Article 130 (4) Family Code). By exception, securing someone else's obligation through pledge or mortgage may be done under the procedure of para. (3) in case of need or evident profit for the child or in case of outstanding needs of the family.

3. Mistake (error) as vitiating factor

The freeness and voluntariness of consent is defeated when the consent is reached as a result of mistake.⁴² Mistakes can be either unilateral (a mistake of one party only) or bilateral (a mistake of both parties). In general, the law provides relief – the right of avoidance – where the mistake is unilateral because cases of mutual mistake are closer to lack of consent as a ground for nullity. According to Article 28 OCA, a mistake constitutes a ground for the avoidance of a contract. This provision reflects the idea that it is a relevantly common occurrence for a party to conclude a contract based on misapprehension of the facts or law affecting the contract. In this regard, a few points are worthy of note. First, in our legal doctrine, mistake is usually regarded as a form of unconscious discrepancy between the person's idea, respectively knowledge, of the circumstances relevant to conclusion of the transaction on the one hand, and the objective reality on the other.⁴³ As a result, mistakes as a vitiating factor appear where a combination of delusion about the objective reality and the conviction that the misapprehension represents the objective reality exists, i.e., the delusion

⁴² For further details, see **Шопов, А.** Унищожаваност на договорите поради грешка. София, Сиби, 2013.

⁴³ Решение № 148 от 10.09.2019 г. по гр. д. № 2183 / 2018 г. на Върховен касационен съд, 4-то гр. отделение.

is accepted as objective reality by the mistaken party. In order for a mistake to have effect, it must exist at the moment the contract is concluded. Last but not least, it is important that the party concluded the specific act under the decisive influence of the self-induced misapprehension. Only on such occasions consent can be said to be given by mistake (error) – where the consent would not have been given if it were not for the mistake. Under Bulgarian law, there is no prerequisite that the mistake is known or caused deliberately by the non-mistaken party.

3.1. Different types of mistakes

Furthermore, a party who has entered a contract under some mistake or misapprehension should not normally be entitled to avoid the contract unless the misapprehension is very serious. Thus, a contract may be set aside for mistake only if the mistake is such that but for the mistake the mistaken party would not have concluded the contract or would have done so only on fundamentally different terms. This explains why legal scholars have long agreed that the existence of certain types of mistakes defeats the freeness of consent.

3.1.1. Mistake regarding the type and the content of the juridical act – the so-called error *in negotium*.

This is the case where the self-induced mistake has led to incorrect apprehension as to the type of contract.

Example: A enters into a contract with B with the idea of buying his house but instead signs a rent contract for the same house.

3.1.2. Mistake as to the subject of the contract

A mistake as to the subject constitutes grounds for invalidation of the contract, provided that the mistake concerns significant properties of the subject. A mistake in the subject matter implies an unconscious discrepancy between the party's perceptions and reality where the contract is concluded under the influence of this delusion.⁴⁴ Relevant to the defective intent are

⁴⁴ Решение № 238 от 06.04.2020 г. по гр. д. № 4277 / 2018 г. на Върховен касационен съд, 4-то гр. отделение.

misrepresentations or ignorance of certain facts concerning substantial characteristics of the subject of the contract. Relevant mistakes as to the subject, giving the right of avoidance, should affect essential qualities of the object and must seriously hinder the intended usage of the object of the contract.

Example 1: A wants to buy an automatic concrete mixer for his father's building company but instead buys a manual concrete mixer due to lack of knowledge and mistake.

Example 2: B – the seller of a property used for residential purposes – tells a prospective purchaser that he would be able to use the property as a restaurant. Following conclusion of the sale contract, it becomes evident that there is a prohibition on using the property for purposes other than residential, of which the seller of the property was unaware. The purchaser may void the contract.

3.1.3. Mistake as to the person

According to Article 28 (1) a mistake as to the person constitutes grounds for invalidation provided that the contract has been concluded with reference to the person. This means that avoidance of the contract due to a mistake in the creditor or the debtor is only possible where the debt was assumed or the right was assigned *intuito personae*. Those are cases where consideration of the person was the principal cause of the agreement. Only then does the law allow a mistake as to the person as a ground for nullity which predetermines the very narrow scope of applicability of this kind of mistake.

A mistake limited only to the calculations does not constitute grounds for invalidation and is subject to correction. In this way, the law refuses relief also in cases where the mistake concerns only the value of the subject matter of the contract.

3.1.4. Mistake in the expression and the content of the will.

These types of mistakes may also be called mistakes in communication.

Example: A frequent form of mistake is when one party makes some error in communicating intentions, e.g. by writing 10,000 instead of 100,000.

Errors in the considerations which motivated the parties to enter into the contract do not constitute a ground for avoiding a contract.

3.2. Remedies

The common remedy for a mistake is for the mistaken party to avoid the contract as a whole or in part within a certain time limit – namely three years after discovery of the mistake. The question of damages is dealt with in Article 28(3) which provides that the party claiming invalidation must compensate the other party for the damages sustained as a result of conclusion of the invalidated contract unless it proves that it was not at fault for the mistake or that the other party was aware of the mistake.⁴⁵ According to case law, no remuneration is due if the party in mistake has no fault for inducing the mistake or even if acting negligently, where the other party knew or should have known about the existence of incorrect apprehension and took advantage of it.

4. Fraud

Fraud is a situation in which one party has been intentionally led into a mistake by the trickery of the other party or by a third party. As a ground for the avoidance of a juridical act fraud is dealt with in Article 29 OCA. According to this legal provision, fraud is a ground for avoidance of a contract where one party has been induced by the other to enter into it by fraudulent misrepresentation.

Based on this text, case law holds that the aggrieved party may avoid a contract when the other party or third party has deliberately induced the conclusion of the contract by fraudulent misrepresentation, whether by words or conduct, or fraudulent nondisclosure of any information which good faith and fair dealing or any pre-contractual information duty required that party to disclose. Where the fraud originates from a third party, the

⁴⁵ See Решение № 245 от 07.11.2017 г. по гр. д. № 585 / 2017 г. на Върховен касационен съд, 4-то гр. отделение.

aggrieved party may claim invalidation of the contract only if upon conclusion of the contract the other party knew of such fraud or could not have been ignorant of it (as per Article 29 (2) OCA). This explains why in a case of fraud there is no reason to protect any interest the fraudulent party may have in upholding the contract; nor is the risk of being deliberately misled one that a party should be expected to bear.

According to case law, varying actions may be qualified as fraud such as using untrue and false information or concealing or distorting certain facts of essential importance for the object of the contract, fraudulent nondisclosure of any information which good faith and fair dealing, or any pre-contractual information duty, required that party to disclose. It does not matter whether the incorrect information is provided in words or takes the form of misleading conduct. The consent of one of the parties is also deemed defeated by fraud where the other party knowingly maintains an existing false apprehension or impression of the defrauded party which does not correspond to objective reality. As a result, the person is deliberately misled regarding crucial circumstances surrounding the conclusion of the transaction which results in the vice of his or her will. Statements, which are mere sales talk, are not considered fraudulent representations within the meaning of Article 29 OCA. A contract concluded as the result of fraud may be set aside by the aggrieved party.

Example 1: A leases a house to B. The house suffers from severe dampness but just before leasing it, A intentionally had the walls repainted to conceal the dampness, which B therefore did not notice. B may avoid the contract due to fraud used by the other party to make him conclude the contract.

Example 2: A sells to B a very high-priced rare piece of art, intentionally convincing him it was created by Van Gogh. It turns out the painting was a reproduction. A has the right to avoid the contract.

To succeed in avoiding a contract due to fraud, the plaintiff (aggrieved party) has to prove several elements in front of the court:

- that the contract was concluded because of fraudulent misrepresentation intentionally created or maintained by the other

party or by a third party to make the plaintiff enter into the contract. As already mentioned, when the fraud originates from a third party, the deceived party is entitled to claim invalidation of the contract only if upon conclusion of the contract the other party knew or could not have been ignorant of it.

- that the other party's misrepresentation or non-disclosure was intended to deceive – that is, to cause the other party to make a mistake.⁴⁶
- that relying on the fraudulent misrepresentation, the plaintiff formed a false idea of reality (deception). This misconception can refer to various elements of the content of the transaction in a broad sense. It may relate, for example, to how will is expressed. The criterion for whether a party is deluded is subjective – the personal qualities of the deluded party should be taken into account. An assessment should be made whether or not the person has sufficient life experience, meaning that the same actions will, in some cases, be regarded as defective and in others will not constitute a defect.
- Finally, yet importantly, the plaintiff must prove that there is a causal relation between the misrepresentation and the carrying out of the transaction by the aggrieved party. The deception must therefore be the proximate and concrete cause and reason of the volitional act.

Fraud gives the misled party the right to avoid the contract, if the action for avoidance is filed within a year's prescriptive period. Only the party in whose interest the law allows such invalidation may claim invalidation. In addition, the defrauded party may claim remuneration for damages.

5. Threat or coercion

In the wording of Article 30 (amended, SG No. 12/1993) threat constitutes grounds for contract invalidation provided that one of the parties was forced either by the other party or by a third party to enter into the contract through provoking reasonable fear. Consent is said to

⁴⁶ There is no fraud when the other party fails to point out some fact of which the other party is ignorant, if there is no intention of deception.

be caused by coercion⁴⁷ when it is obtained by persuading someone to conclude a contract using threats, intimidation and emotional violence. These are cases where the motivational process preceding the expression of the will of the aggrieved party has been violated and as a result, will was vitiated. If there is physical coercion – there is no will and we are facing nullity of the contract. For example, a person who was made to sign by someone who grabbed his hand and moved it along the paper, did not consent and did not even appear to agree.⁴⁸

Normally coercion will involve the use of threats of acts which are wrongful in themselves – threats of physical violence or damage to property, but this is not necessarily so.⁴⁹ The fearful representations may have as their object the life, health, honour or property interests of the party to the transaction in prejudice to his or her welfare or the welfare of relatives.

The threats used by the other party or third party as a means to conclude a contract must provoke reasonable fear. In legal theory and case law, it is suggested that reasonable fear is a subjective element. The notion of well-founded fear is in any case relevant to the nature and intensity of the threat and, on the other hand, susceptibility to threats should also be taken into account. Where the threat is made by a third party, unlike fraud, there is no requirement in Article 30 OCA that the other party knew of the threat. What is most important is that relief will not be given unless the threat influences the threatened party's decision.

Example 1: A and B are partners in business. A wishes to buy B's share of the business and, to induce B to sell her share, threatens to

⁴⁷ In common law coercion, also known as duress, is a vitiating factor. Duress is defined as some kind of threat, violent or other action that is used to coerce somebody into doing something against their will. In the context of contract law, this refers to situations where a party uses duress against the other party in order to force them into entering into a contract which they either do not want to conclude or the terms of which are unfavourable for the coerced party.

⁴⁸ In intimidation, we are faced with influencing a person's will by the exercise of mental influence, not physical coercion.

⁴⁹ There may be a situation of such dominance or emotional or economic dependence that one party can force the other person to act by simply giving an order. In addition, a threat to inflict economic loss wrongfully, e.g., by breaking a contract, can equally constitute duress.

have some goods belonging to B wrongfully seized and impounded if she does not sell. B agrees to sell her share to A. B may avoid the contract.

The effect of the threat must have been such that forced the claimant into the contract.

Example 2: A is forced through constant threats for his life and the life of his wife to conclude an agreement transferring his property to B who is the author of the threats and of the psychological coercion that motivated A to sign the contract. Under these circumstances, A has the right to set the contract aside.

Example 3: A threatens to shoot B, if B does not agree to sell his property to A at the stated price; B's consent, in this case, was obtained by coercion.

Remedies

The party coerced or subjected to threat may avoid the contract, provided that the claim is instituted in front of a court within three years since the threat ceased. There may also be a right to damages.

6. Temporary incapacity of the contracting party to understand or directing its acts

When incapacity exists, a party is not eligible to enter into a contract. As already mentioned, natural persons of limited or absent legal capacity to contract are minors, infants, and those put under full or restricted interdiction through a court decision. What will happen though if a legally capable person enters into a contract while intoxicated or experiencing certain illnesses or mental disorders resulting in lack of mental capacity required to understand the nature and consequences of his or her actions? According to Article 31 OCA where a person of legal capacity is unable, at the time of contract formation, to understand the nature and consequences of his or her action, then the contract may be set aside. The second paragraph of Article 31 notes that invalidation of such contract may not be claimed after the death of the person unless prior to his death there was a

request that the person be placed under interdiction or where proof of legal incapacity is derived from the contract itself.

6.1. When a contract is concluded in a state of temporary incapacity

Article 31 (1) OCA is applicable to any case where one of the contracting parties is formally fully capacitated but at the time of contract conclusion was unable to understand or to direct his or her actions, usually due to short-term mental or psychological disturbances. An intoxicated person may also lack the mental capacity necessary to contract and is considered to be temporarily incapable. For the avoidance of a contract on the terms provided in Article 31(1) OCA it is necessary that this condition was present at the time of the transaction. The negating fact of the will in the hypothesis of Article 31 OCA consists in the fact that the contract was entered into in a state of unsound mind.

Example 1: X suffers from schizophrenic disorder and epilepsy. He was initially diagnosed in 1991 but was placed under full guardianship only in 2011 (by a final judgment in case No 2274/2010 of the Varna Court of Justice), and his sister Y was appointed his guardian. In 2010 not understanding his actions X transferred to Z through a donation contract the ownership over a house he possesses in his village. Due to his mental illness and disability, X was unable to adequately and objectively comprehend and assess his actions in entering into the donation contract and the latter is voidable under Article 31 OCA. X may invalidate the contract within 3 years from its conclusion with a constitutive claim.⁵⁰

⁵⁰ ‘Condition forming’, or constitutive action is the action seeking to create, alter, or nullify a legal relation through the exercise of a ‘condition forming’, potestative right. For example, given the fact that the right of each spouse to demand the dissolution of the marriage is a ‘condition forming’ right, the lawsuit for divorce is a ‘condition forming’ legal action seeking to terminate the existing legal relation of the marriage.

6.2. Void or voidable is the contract in which one of the contracting parties was in a state of permanent and lasting inability to understand or direct his actions?

In recent law theory and legal practice, it is much debated whether a contract concluded by a fully capacitated person⁵¹ who was permanently and lastingly incapable of understanding or directing his actions at the time of contract conclusion is void due to lack of will under Article 26 (2) OCA or voidable under Article 31 COA.

According to one group of authors and legal practitioners, if, when undertaking a certain legal transaction, a counterparty is unable to understand and direct his or her actions due to seriously impaired state of health and mind, then the contract may be set aside under Article 31 OCA. It is believed that this is the correct legal qualification of the claim regardless of the fact whether the state of ‘factual incapacity’ was temporary or permanent because lack of will (in unilateral transactions) and of consent (in contracts) within the meaning of Article 26(2)(1)(2) OCA must be conscious. Although formally closer to the wording of this provision, one such interpretation will often lead to unfair results leaving without legal protection parties whose state of ‘factual incapacity’ is permanent. This situation explains to a certain point the existence of the opposite interpretation, namely that Article 31 OCA is applicable where the state of ‘factual incapacity’ is only temporary – short-term and not permanent or continuous. The proponents of this understanding believe that a contract will be void and not only voidable if it is concluded by a person of legal capacity who, at the time of conclusion, was unable to understand or direct his or her actions and the reason for that condition is permanent.⁵²

⁵¹ Which means that the person was not legally put under full or restricted interdiction.

⁵² For further information on the dispute, see: Русчев, И. За съотношението между чл. 26, ал. 2 и чл. 31 33Д – десет години по-късно, available at <https://news.lex.bg/%D0%B7%D0%B0-%D1%81%D1%8A%D0%BE%D1%82%D0%BD%D0%BE%D1%88%D0%B5%D0%BD%D0%B8%D0%B5%D1%82%D0%BE-%D0%BC%D0%B5%D0%B6%D0%B4%D1%83-%D1%87%D0%BB-26-%D0%B0%D0%BB-2-%D0%B8-%D1%87%D0%BB-31-%D0%B7%D0%B7%D0%B4/>

This dispute was resolved on 30.05.2022 when the Bulgarian High Court of Cassation issued Interpretative Decision No. 5. In the opinion shared by the majority of cassation judges, Article 31 COA is applicable in all cases when a formally capacitated person has concluded a contract while not being able to understand or direct his or her actions. It was assumed that the duration of this condition of factual incapacity is irrelevant, because a person's inability to understand or direct his or her actions may occur as a consequence of a variety of causes, both temporary – alcohol intoxication, the effects of drugs, etc., and permanent. Hence as long as the statutory provision of Article 31 OCA fails to distinguish between specific causes according to the type and extent to which they affect the person's capacity to act reasonably, then no result different from the right of avoidance can occur regardless of the duration of the state of factual incapacity. Therefore, based on Article 31(1) OCA, contracts entered into by persons with legal capacity in a state of permanent incapacity to understand or direct their actions are only voidable, and not void due to lack of will or consent.

Upon the expected restoration of the ability to understand and direct personal actions, the person with legal capacity can claim the annulment of the contract under Article 31 whereby the 3-year limitation period under Article 32(2) OCA starts to run from the day the contract is concluded. The length of the term provided by law to exercise the right of avoidance is considered sufficient for the counterparty with vitiated will to overcome the condition of factual incapacity and to decide whether to attack the contract or not.

7. Contract concluded under extreme necessity and unfavourable terms

According to Article 33 OCA, a contract entered into because of extreme necessity under obviously unfavourable terms, is voidable. The court may invalidate such a contract fully or for the future only. Invalidation will not be admissible if the other party proposes to repair the damage. The right to claim invalidation will be limited to one year from the date of contract conclusion. Invalidation on the grounds of extreme necessity will not affect the rights acquired by third parties prior to registration of the claim.

To succeed in avoiding a contract concluded under extreme necessity and unfavourable terms the claimant has to prove the following three substantial prerequisites before the court:

- There must be a state of extreme necessity for one of the contracting parties. According to case law, a state of extreme need or necessity occurs when there is lack or insufficiency of material means to meet basic needs, such as lack of money for maintenance, health treatment of the person or his/her relative, for the payment of due debts, etc. To conclude on the existence or absence of a state of extreme need within the meaning of Article 33 OCA, it is essential to establish a shortage of funds for a specific pressing need that can be evaluated as extreme. Hence, it is not enough to establish a shortage of money on the side of the aggrieved party.
- Next – the state of extreme necessity should be the apparent reason why the party did not take better care when agreeing and concluding a contract under obviously unfavourable terms. According to case law, the sole fact that what is to be supplied or provided by each party is not of objectively equal value does not necessarily mean that the contract has unfavourable terms within the meaning of Article 33 OCA. This is because it is commonly held, under Article 9 OCA, that the parties are the best judges of the relative value of what is to be exchanged. As a result, the doctrine regards the equivalence of considerations as a subjective criterion that does not depend on the objective economic value of the counter considerations. There would therefore be too much uncertainty as to whether a party could escape from a contract when its terms are simply disadvantageous and not unfavourable. This means that there should be a significant difference between the values of the two considerations at the time of contract conclusion if the latter is to be defined as concluded under unfavourable terms. The existence of an unfavourable contract is a matter of specific factual assessment in each case. Grossly unfavourable terms within the meaning of Article 33 OCA in the conclusion of a contract of sale, in the most common case, are present when there is a clear, apparent inequivalence between

the seller's and the buyer's consideration under the contract, in the presence of a very significant discrepancy between the actual value of the item sold and its sale price under the contract.⁵³

- Finally, yet importantly, the claimant has to prove the existence of a causal relation between the state of the extreme necessity of one of the contracting parties and its decision to conclude the unfavourable contract. This means that the claimant must prove to the court that the state of extreme necessity has strongly influenced his/her will, exerting pressure and resulting (in a motivational process) in the decision to enter into the specific contract. In other words, if it was not for the state of extreme necessity, the claimant would rather not have entered into the unfavourable transaction.⁵⁴

Example 1: On 12.01.2022 A and her husband sold to B their flat in Sofia for 5,000 euro while the market price of the property at that time was 57,000 euro. The sellers were elderly with failing health and needed money for medical treatment and funds to meet their daily expenses as their income was extremely low. In the course of a year, B kept proposing to help the elderly couple if they agreed to sell him the flat at a 'more favourable price than the market value' and finally the spouses, having no other choice, decided to undertake the transaction. The contract concluded on 12.02.2022 is avoidable under Article 33 OCA.

7.1. Remedies

Unlike in the general case of avoidance, where the court's decision has a retroactive effect, here it is possible for the court's decision to avoid the transaction *ex nunc* (i.e., forward-looking). The court may cancel the contract completely or for the future. If the other party offers to compensate the damages, the contract may remain in force. The cancellation right expires within a time limit of 1 year following contract conclusion.

⁵³ Решение № 50029 от 07.03.2023 г. по гр. д. № 2279 / 2022 г. на Върховен касационен съд, 1-во гр. отделение.

⁵⁴ Решение № 87 от 10.07.2017 г. по гр. д. № 3941 / 2016 г. на Върховен касационен съд, 3-то гр. отделение.

Cancellation due to stringent/extreme necessity does not affect the rights of third parties that were acquired before the claim for cancellation was filed and registered.

7.2. Third parties and contracts voidable under Article 33 OCA

According to the express provision of Article 33 OCA, the retroactive effect of the avoidance can be limited only between the counterparties, without affecting the rights of third parties and subsequent acquirers, providing that the latter acquired their rights before the claim for avoidance was registered. This is the so-called notice-protective effect of the registration of applications under Article 33 OCA.⁵⁵

8. Ratification of voidable contracts

Article 35 OCA provides the counterparty with vitiated will with the opportunity to ratify a voidable transaction. This rule reflects the idea that only the party on whose behalf the cancellation is permitted by law may request the cancellation. Article 35 differentiates a few ways the ratification can be done.

- Express ratification – such ratification requires a written instrument, authored by the party entitled to demand contract invalidation. Moreover, the written instrument must indicate the grounds for invalidation. Thus, the party entitled to avoidance of the contract declares that he/she has the right to set aside the contract. Consequently, this method of validation cannot be used when the party has already fulfilled its obligation or its right to claim avoidance has expired;
- Conclusive/ implied ratification – a voidable contract may be ratified through voluntary performance by the party entitled to demand invalidation, provided that the latter was aware of the existence of a vitiating factor when it performed the contract.

⁵⁵ See Решение № 491 от 07.07.2010 г. по гр. д. № 1348 / 2009 г. на Върховен касационен съд, Гражданска колегия, I г. о.

Example 1: A, knowing he was in mistake when entering into lease contract, decides to fulfil completely or partially his contractual obligations. As a result, the contract is ratified and no longer voidable.

Failing to avoid the contract within the respective time limits does not result in the so-called ‘tacit’ ratification of the contract. This is so because under Article 32(3) OCA the defendant in an action to enforce a voidable contract may seek avoidance by demurrer even after the limitation period has expired.

8.1. Can a contract voidable due to extreme necessity and unfavourable conditions be ratified?

As an exception, the law prescribes that a contract subject to cancellation due to extreme necessity and unfavourable conditions may not be ratified. Nevertheless, the validity of such legal transaction can still be preserved in cases where the other party remunerates the aggrieved party – the one that was in a state of extreme necessity resulting in contracting under unfavourable conditions. This is not a case of implied ratification of a voidable a contract though, because the justification of *laesio* as vitiating factor is the disturbance in proportionality between the value of the performance and counter-performance. If this disturbance is removed, then the justification for setting such a contract aside disappears and no ratification is necessary.

9. Restitution in cases of voidable contracts

According to Article 34 (amended, SG No. 12/1993) where a contract is recognized as null and voidable or is invalidated, each party must give back to the other party everything it has received therefrom. The right of recovery arises only in cases where an obligation was performed under an avoidable contract that was eventually avoided as a particular case of lack of *iusta causa* under the provisions, dedicated to unjust enrichment. The voidable contract is an example of lapsed justification – lapsed cause under Article 55(1) OCA. Therefore, if no performance was rendered under the voidable contract, then no obligation for restitution between parties will arise. If one of the parties performed, the other party is obliged to restore the benefits conferred. If both perform, both are to restore what was performed by the other.

Example 1: A signed as a guarantor a contract of lease after he was unintentionally led to believe by his employer that his signature was necessary only to witness the signatures of others. A year later, A filed a claim to avoid the suretyship contract stating that at the time the latter was concluded an unconscious discrepancy between the party's perceptions and reality existed, under the influence of which discrepancy the party entered into the contract. The court upheld the claim but as long as there was no performance or counter-performance of the avoided contract, no mutual obligation for restitution occurred.

CHAPTER 5:

THE FUNDAMENTALS OF SECURED OBLIGATIONS

Hristina Tancheva

ABSTRACT	KEY WORDS
Securities serve to guarantee the performance of monetary or non-monetary obligations (contractual or extra-contractual). Depending on the way the interests of the creditor are guaranteed, securities can be personal – another person is liable to the creditor together with the debtor (surety, joint and several liability, bank guarantee), and real – the obligation is guaranteed with a particular movable (pledge) or immovable (mortgage) asset. Pledged property will be delivered to the creditor by general rule, although there are also registered pledges that are established without providing possession of the pledged property, but through the conclusion of a formal contract and its registration in the Central Pledge Register or into another register provided by law. A mortgage is established upon contract conclusion in the form of a notary deed and its entry in the Property register.	surety, joint and several liability, bank guarantee, pledge, mortgage, registration, movables, immovables.

I. INTRODUCTION

Upon conclusion of a contract, even though the terms and conditions have been agreed, the contracting party assumes the risk that the other party may not perform its obligations. To safeguard against this, there are legal instruments that assure performance and protect the creditor in case of default. Thus, securities are legal means to protect the creditor's interests – when receivables are secured, the creditor has a guarantee that even if the debtor does not fulfil its obligation, the receivable can be collected.¹

¹ Akseli, O.N. International Secured Transactions Law. Routledge, 2011.

Any kind of obligation – including future, conditional, natural and voidable obligations – may be secured.

Securities are *accessory* rights provided to the creditor – they secure particular receivables in a such way that transfer of the receivable leads to transfer of the security as well. In some cases (for example, when transferring receivables secured by a mortgage), there are certain requirements to preserve the security. When the principal right is extinguished, the accessory rights are also extinguished. The invalidity of an agreement on security does not lead to invalidation of the principal obligation. Hence, should the principal obligation be invalid, the security will have no effect.

Depending on the manner in which the interests of the creditor are guaranteed, securities are:

- **Personal** – along with the debtor, another person is also committed to fulfil the obligation (guarantee, joint responsibility, bank guarantee). When the principal obligation becomes due, the property of the other person is subject to an enforcement procedure in case of non-performance.
- **Real** – the obligation of the debtor to perform is guaranteed with a given asset. Real securities can also be established by third parties who are not personally obliged to perform but are liable through their property. They can establish a pledge or a mortgage. When the principal obligation becomes due, the property which is pledged or mortgaged may be alienated for the payment of the creditor.

There are also other figures that serve as security such as the right of retention² (Article 91 of the Obligations and Contracts Act (OCA); Article 315 of the Commerce Act (CA)), like liquidated damages (see Chapter Three); earnest (see Chapter Three), the claims under Article 134 and 135 OCA, etc.

² Русчев, И. Право на задържане. – В: Герджиков, О., Камелия Касабова, Методи Марков, Иван Русчев, Георги Стефанов, Поля Голева, Тания Градинарова, Валя Гигова, Костадинка Недкова. Обезпеченията в материалното и процесуалното право. София, Труд и право, 2018, с. 287 и сл.

In the case of monetary debt, the debtor is liable to the creditor with the entire property that is subject to enforcement.³ The entire property of the debtor serves as general security for his creditors who have equal right to be satisfied by it, provided there are no legal grounds for preference⁴ – Article 133 OCA. This means that all creditors have an equal right over the debtor's property no matter when their receivables have arisen unless there is some preference. For example: A, B and C have receivables from D in the amount of 900. The receivables of A arose from a contract concluded on 01.10.2020, those of B from a tort dated 01.11.2021 and those of C from a contract concluded on 01.12.2022. If D has only 900 then, in case of enforcement, A, B and C will receive the amount of BGN 300 each, regardless of the fact that they obtained the right to their receivables at different times and on different grounds.

³ Under Article 444 of the Civil Procedure Code, when the debtor is a natural person, the execution cannot be applied to some assets that belongs to him, e.g.:

- objects for daily use of the debtor and his family specified in a list adopted by the Council of Ministers;
- food necessary to the debtor and his family for one month;
- fuel necessary for heating, cooking and lighting for three months;
- machines, instruments, devices and books, personally necessary to the debtor practicing a free-lance profession or to a craftsman for the needs of his practice;
- the home of the debtor, if neither he nor any of the members of his family with whom he lives, have another home.

⁴ Under Article 136 OCA, the following receivables will be satisfied preferentially in the following order:

1. receivables on costs for seizure and enforcement, as well as actions under Articles 134 and 135 OCA – from the value of the property for which they were made, in respect of the creditors in whose favour these costs have been incurred;

2. state receivables for property taxes or motor vehicle taxes – from the value of the property or the vehicle, as well as receivables arising from concession remuneration, interest and liquidated damages under concession contracts;

3. receivables secured by a pledge or mortgage – from the value of the pledged or mortgaged property;

4. receivables for which the right of retention is exercised – from the value of the retained property;

5. employees' receivables arising from labour relationships and maintenance receivables;

6. receivables of the state except fines;

Claims under items 5 and 6 will be satisfied preferentially from the entire property of the debtor.

In order to avoid such equal satisfaction, creditors can negotiate securities. The most commonly used securities are guarantee, pledge and mortgage.

II. PERSONAL SECURITIES

1. Guarantee (Surety)

A guarantee is a contract concluded between the guarantor and the creditor under which the guarantor undertakes a commitment to be liable for the performance of the debtor's obligation – Article 138 OCA. Thus, the guarantee is a security for the obligation of another person.⁵ For example: if A applies for a bank credit, the bank may require someone to guarantee his obligation and A must find a friend, relative or someone else to guarantee that he will pay back the amount.

We have two parties to the contract:

Creditor – the party who has receivables due from the debtor (the person that is liable to the creditor under another relationship (usually contractual) – he is not party to the guarantee contract);

Surety/Guarantor – the person who secures/underwrites execution of the obligation of the principal debtor. Every natural person over the age of 18, as well as any legal entity, can be a guarantor.

A guarantee contract must be **in writing** to be valid⁶ (oral promises do not constitute a guarantee agreement). A guarantee may exist only for an actual, specific obligation (a clause 'I guarantee all the obligations of A' cannot be valid). The main purpose of the contract of guarantee is to secure the payment of the debt undertaken by the principal debtor. If no such debt exists, there is nothing for the surety to secure. Hence, in cases where the debt is invalid, no liability of the surety arises. However, the guarantee may be undertaken for a future or conditional obligation. A guarantee may also be given for a part of the debtor's obligations or under easier terms

⁵ **Калайджиев, А.** Поръчителството. София, Сиби, 1993.

⁶ Решение № 60260 от 19.08.2022 г. по гр. д. № 490 / 2021 г. на ВКС, 4-то ГО.

(Article 139 OCA). If the guarantor has undertaken an obligation exceeding the debtor's obligation or under more onerous conditions, his obligation will be deemed undertaken under the terms and conditions of the principal obligation.⁷ For example: if the debtor owes 1,000 to the creditor but, in the guarantee contract it is written that the guarantor is liable for 1,200, the obligation of the guarantor will be restricted to the amount of 1,000.

A guarantee will cover all consequences of non-performance of the principal obligation, including costs for collection of the receivables – Article 140 OCA. The guarantor will be liable not only for the principal but also for any damages related to the non-performance.

A guarantor will be liable *jointly and severally* with the principal debtor – Article 141(1) OCA. This means that the guarantor is liable for the same amount (not for the half or other part, but for the whole) as the debtor unless there is another provision in the contract. For example: if the debtor owes 500, the guarantor is liable for the same amount as well as for the consequences of any non-performance such as damages, liquidated damages, interest, etc.

The guarantor has certain rights against:

- the *principal debtor* – if the guarantor performed the obligation to the creditor he may claim, from the debtor, everything he paid, including the principal, interest, and expenses he has provided.⁸ The guarantor has also a right of subrogation – which means that after paying the creditor, the guarantor obtains the rights of the satisfied creditor which may help him recover the amount from the debtor;
- the *creditor* – a guarantor can make all of the debtor's objections to the creditor, as well as to set off a claim of the debtor against the creditor's receivables. For example: if the debtor has performed half of the obligation, the guarantor may object to the creditor's claim on the basis that half of the obligation is already performed

⁷ Решение № 50006 от 10.01.2023 г. по т. д. № 714 / 2020 г. на ВКС, 1-во ТО.

⁸ **Голева, П.** Поръчителство в гражданското и менителничното право. – В: **Герджиков, О., Камелия Касабова, Методи Марков, Иван Русчев, Георги Стефанов, Поля Голева, Тания Градинарова, Валя Гигова, Костадинка Недкова.** Обезпеченията в материалното и процесуалното право. София, Труд и право, 2018, 426–429.

or if the contract between creditor and debtor is terminated, the guarantor can object that the obligation is extinguished.

- the *co-sureties* – if the debtor has several guarantors for a single debt, a guarantor who has performed the obligation may claim from the other guarantors their due portions (Article 141(2) OCA), e.g., if the amount due is 900 and there are three guarantors, the one that paid is entitled to receive 600 from the other two (each of them being liable for 300).

If the debtor has fulfilled his obligation, he is required to notify the guarantor immediately (Article 144 OCA) in order to avoid double payment of the obligation.

A guarantor will remain liable even after the maturity date of the principal obligation if the creditor has brought action against the debtor within six months of that date – Article 147(1) OCA. For example: if the maturity date of the obligation is 01.07.2023, the guarantor will be liable until 01.01.2024 if, before this date the creditor has brought action against the debtor.

However, an extension of the period provided by the creditor to the debtor will have no effect upon the guarantor if the latter has not agreed to this – Article 147(2) OCA. This means that if the maturity date is initially stipulated to be on 1st of April, but the creditor subsequently agrees to extend the term to 1st of December, the adjustment will have no effect on the guarantor unless he agrees and the guarantor will be released.⁹ In case of repayment of the obligation in instalments with different maturity dates, the six-month term under Article 147(1) begins from the demandability of the entire debt.¹⁰

⁹ Решение № 225 от 3.08.2016 г. на ВКС по т. д. № 3696/2014 г., I т. о., ТК.

¹⁰ Тълкувателно решение 5/2019 на ОСГТК ВКС.

2. Joint and several¹¹ liability

‘Joint and several liability’ is a legal phrase that refers to two or more people taking on responsibility for an obligation.¹² Joint and several liability arises when parties include it in the contract or in the cases provided for by law¹³ – Article 121 OCA.¹⁴ This is personal security, because the creditor has more than one debtor obliged to perform a single obligation. Thus, the parties will agree on the joint and several liability of the debtors (more than one) or the law will provide for such liability of several persons.¹⁵ However, if two or more persons undertake an obligation under a *commercial transaction*, they will be considered jointly and severally liable, unless it follows otherwise from the transaction.¹⁶

The creditor is allowed to claim performance of the obligation, in whole, by any one of the several debtors as, if one of them performs, the others will be released from the obligation towards the creditor – Article 123(1) OCA. Thus, performance by one joint debtor will discharge all the co-debtors. For example: A, B, C, D are jointly and severally liable to pay the debt to E in the amount of 1,000. If A pays the whole amount, B, C and D are not obliged to pay E any more.

The creditor can sue any of the debtors at his discretion. Bringing an action against one debtor will not affect the creditor’s rights with respect to the other co-debtors – Article 122(2) OCA.

Payments to the creditor by one debtor will be borne equally by all joint debtors, unless otherwise ensuing from their relationship – Article 127(1) OCA. Each joint debtor who has performed more than his own share may bring action against the other co-debtors for their respective parts. For

¹¹ The word ‘several’ is an archaic word, meaning separate.

¹² **Калайджиев, А.** Облигационно право. Обща част. Седмо издание. София, Сиби, 2020, с. 501 и сл.

¹³ **Русчев, И.** Солидарност и неделимост. – В: **Герджиков, О., Камелия Касабова, Методи Марков, Иван Русчев, Георги Стефанов, Поля Голева, Тания Градинарова, Валя Гигова, Костадинка Недкова.** Обезпеченията в материалното и процесуалното право, София, Труд и право, 2018, с. 172.

¹⁴ Определение № 29 от 10.01.2020 г. по т. д. № 609 / 2019 г. на ВКС, 1-во ТО.

¹⁵ For example, jointly and severally liable are two persons who committed a tort. The surety and the debtor are also jointly and severally liable before the creditor.

¹⁶ **Герджиков, О.** Търговски сделки. София, Труд и право, 2008, 44–45.

example, if A, B, C, D are jointly and severally liable to pay the debt to E in the amount of 1,000, and A pays the whole amount, B, C and D will pay A equal parts in the amount of 250 unless there is another stipulation.

The obligation of a co-debtor can have a different maturity date. Therefore, the limitation period can expire at a different time. The cessation or interruption of the limitation period against a ‘joint and several’ debtor will not affect the other co-debtors – Article 125(1) OCA. However, if the debtor with regard to whom the limitation period has not expired has performed the obligation, that debtor may bring an action against the others who have been discharged as a result of the limitation.

Should performance become impossible and only one of the debtors is responsible for that, the creditor is entitled to claim full damages from him – Article 126(1) OCA. The other debtors will be liable jointly and severally only for the value of the initial debt. Default by one jointly and severally liable debtor will not be enforceable against the other co-debtors.

If one of the debtors dies, his successors are liable for the debt according to the share of the inheritance of each. For example: if the debt is in the amount of 900, there are three debtors and, one of them dies, his two successors will pay 450 each (if they have equal shares of the inheritance).

3. Bank guarantee

Under a bank guarantee a bank undertakes, in writing, to pay to the person specified in the guarantee a certain amount of money according to the conditions provided therein – Article 422 of the Commerce Act.¹⁷ Thus, a bank guarantee guarantees the payment of a sum of money to a beneficiary whereby the bank only pays that amount if the debtor does not fulfil the obligations outlined in the contract.¹⁸ This is a unilateral

¹⁷ See also Uniform Rules for Demand Guarantees which reflect international standard practice in the use of demand guarantees and balance the legitimate interests of all parties.

¹⁸ Герджиков, О. Цит. съч., с. 274 и сл.; Касабова, М. Банкова гаранция. – В: Герджиков, О., Камелия Касабова, Методи Марков, Иван Русчев, Георги Стефанов, Поля Голева, Тания Градинарова, Валя Гигова, Костадинка Недкова. Обезпеченията в материалното и процесуалното право, София, Труд и право, 2018, с. 673 и сл.

formal act.¹⁹ The bank acts as a guarantor for the debtor, agreeing to cover his payment obligation to a third party under certain conditions. In simple terms, if the debtor does not pay, the bank will pay the creditor. Bank guarantees serve the purpose of facilitating business in situations that would otherwise be too risky for the beneficiary to engage in. For example, if the seller of goods will deliver the goods within a month, but will receive the price after three months, the seller can ask for a guarantee of performance. The buyer can conclude an agreement with the bank to guarantee the payment, with the bank issuing a letter to that effect. This letter ensures that the bank will pay a set amount to the beneficiary if the bank's customer defaults on a certain payment or obligation.

III. REAL SECURITIES

1. *General rules:*

- A receivable may be secured by a *pledge over movable property*, over a *receivable* and a *mortgage on immovable property* – Article 149(1) OCA.
- Pledge and mortgage may be established both for one's own or another person's obligation. Should the pledge or mortgage secure someone else's obligation, the owner of the pledged or mortgaged property can make all the debtor's objections to the creditor, as well as set off any claim of the debtor against the creditor's receivables. For example: if A mortgaged his house to cover B's obligations, A can make all the objections that B may have against the creditor, e.g., A can make an objection that the limitation period for B's obligation has expired.
- Pledge and mortgage will follow the secured receivable when it is transferred and will be extinguished if the receivable is extinguished – Article 150 OCA. For example: if I mortgage my house and then sell the house to another person, the mortgage will remain over the real estate even though the ownership is transferred to the other person.

¹⁹ Решение № 22 от 02.08.2016 г. по т. д. № 3349 / 2014 г. на ВКС, 1-во ТО.

- Pledge and mortgage are indivisible even though the debt may be divided among the successors²⁰ – Article 150(2) OCA. Therefore, the debtor's successors, having paid the debt, cannot ask for the proportionate extinguishment of the pledge or mortgage if the debt is not completely fulfilled. Neither can those of the creditor's successors who received his share of the debt return the pledged item or cancel the mortgage, to the prejudice of the other successors who have not been paid. The creditor must return the pledged item when the debt is wholly fulfilled to all the successors collectively. For example: if B, C and D are successors of A (debtor for the amount of 900) and each of them has 1/3 of A's property, each of them has to pay the amount of 300 but only when the whole amount of 900 is paid, can they request the return of the pledged item. Hence, even if one of the successors pays the whole amount, he alone cannot ask for the pledged item to be returned.
- Pledge and mortgage can encumber the whole property or part therein.
- Every natural person over the age of 18, and any legal entity can establish a pledge or mortgage over their property. Persons below this age can pledge their property with a custodian's consent (minors) or through their guardians (infants). Infants and minors can mortgage their property with regional court permission if the mortgage does not contravene the child's interests – Article 130(3) of the Family Code. In case of another person's debt, it may be secured through a pledge or mortgage, with the permission of the regional court,²¹ only in the event of the need of, or obvious benefit to, the child or in respect of any emergency needs of the family – Article 130(4) of the Family Code.
- If claims secured by pledge or mortgage, are not collected, the pledgee can obtain satisfaction from the value of the subject of the pledge or mortgage having a preference over other creditors. However, an agreement which stipulates, in advance, that if the obligation is not performed, the creditor will become owner of the pledged/mortgaged property, as well as any other agreement which

²⁰ Решение № 50222 от 16.12.2022 г. на ВКС по гр. д. № 370/2022 г., IV г. о., ГК.

²¹ Решение № 1201 от 12.08.2022 г. на РС – Плевен по ч. гр. д. № 4319/2022 г.

stipulates, in advance, a manner of satisfaction for the creditor other than the one provided for by law will be invalid – Article 152 OCA. For example: if it is written in the contract that, in case on non-performance by the debtor, the creditor will become owner of the pledged mobile phone, this clause will have no effect. Hence, the prohibition does not apply to:

- ✓ A subsequent voluntary act by the debtor in transferring the property to the creditor in payment of the debt – this is a new contract (*datio in solutum*), as the creditor's consent is needed, or
 - ✓ A subsequent voluntary act of the debtor in authorising the creditor to alienate the property – this is a new contract (mandate) which can be withdrawn at any time.
- Where there are several pledges or mortgages on one property the creditors will be satisfied preferentially in the order in which the pledges and mortgages were established – Article 153 OCA. For example: over one car (in the amount of 10,000) there are three pledges. The first, established on 01.06.2019 for a debt in the amount of 5,000, the second on 01.11.2020 for a debt in the amount of 4,000 and the last on 01.10.2021 in the amount of 3,000. In such a case, the creditor with the first pledge will be satisfied first with the whole amount due, then the second will be satisfied for the whole sum and finally, the third will receive only the residual amount of 1,000.
- Pledge and mortgage will be extinguished in the event of the destruction of the pledged or mortgaged property or in the case of expropriation for state or municipal needs. However, the pledgee and mortgagee will be entitled to preferential satisfaction from any insurance amount (if an insurance policy is concluded) or from any compensation due in accordance with the order of preferences – Article 154 OCA. For example: if the mortgaged apartment was destroyed by an earthquake but there is an insurance policy covering this risk, the insurance company will satisfy the mortgagees in accordance with the order of their mortgages.

Distinction between mortgage and pledge:

- ◆ A pledge is established on movables and a mortgage on immovables;
- ◆ In ‘pledge’, the property is delivered to the pledgee (except in the case of registered pledges and pledges over receivables), or by common consent to a third person, while in ‘mortgage’, delivery is not necessary;
- ◆ A pledge does not need to be registered (except for registered pledges and pledges over receivables),²² whereas a mortgage is not valid unless registered in the Registry Agency.

2. Pledge on movable property

This is a contract by virtue of which the debtor or third party delivers to the creditor, a movable property²³ or receivable for the purpose of securing fulfilment of a principal obligation.²⁴ If the debt is paid, the item delivered will be returned to the debtor. In commercial law we also have ‘pledge’ which is created, in certain cases, by operation of law. For example, a carrier will be entitled to a pledge over a cargo for his claims under the contract (Article 375 of the Commerce Act). Also, a commissioner will be entitled to a pledge on items acquired by him for the account of a principal, or which that principal has provided to him (Article 357 of the Commerce Act).²⁵

²² Transferable receivables may be pledged as security of an obligation. For example, if A has a receivable from B, A could pledge this receivable to guarantee the performance of obligations to C.

The pledgor must inform the debtor of the pledge and hand over, to the pledgee, those documents which prove the pledged receivable, if any. A creditor who has a pledge on a receivable must undertake all acts required to preserve it. He will collect interest on the pledged receivable, as well as the principal, should it become due. Anything collected by the creditor will be kept by him as a pledge. If it is in cash, the amount will be deposited in a bank as security for the creditor.

²³ **Kieninger**. E.M. Security rights in movable property in European private law. Cambridge University press, 2004.

²⁴ **Кожухаров, А.** Облигационно право. Общо учение за облигационното отношение. Нова редакция и допълнения Петко Попов. София, Юриспрес, 2002, с. 626 и сл.

²⁵ **Герджиков, О.** Цит. съч., 69–70.

Characteristics:

- A pledge contract is ‘real’ which means that it will be valid only if the pledged item is handed over to the creditor or to another person determined by him and the pledgor.
- If the secured receivable exceeds BGN 5, the pledge cannot be opposed against third parties if there is no document in writing bearing an authentic date and indicating the property and the receivable.
- The contract is unilateral which means that obligations arise only for the creditor – to keep and return the item.²⁶

Rights of the Pledgee:

- ✓ To retain the pledged item in his possession or in that of a third person to whom it has been delivered, until the debt is paid – Article 157(1) OCA. The creditor will not have the right to use it unless agreed otherwise;
- ✓ To be reimbursed for expenses incurred in its preservation;
- ✓ To satisfy from the pledged item. The creditor will be entitled to preferential satisfaction from the pledged property’s value through enforcement procedure (court proceedings are needed) only if he has not returned it to the debtor. The property will be deemed returned if it is in the debtor’s possession. Should the creditor be deprived of possession of the property, he may, on grounds of his pledge, claim it back from the person holding it.

Obligations of the Pledgee:

- ✓ To take care of the pledged property with due diligence – he will be liable for its loss or deterioration if guilty. The pledgee is not authorised to dispose of the pledged item.
- ✓ To inform the pledgor, without delay, of any danger to the pledged item;

²⁶ **Кожухаров, А.** Облигационно право. Общо учение за облигационното отношение. Нова редакция и допълнения Петко Попов. София, Юриспрес, 2002, 645–646.

- ✓ To return the pledged property when the principal obligation is paid or otherwise extinguished (e.g., if a limitation period expires).

Rights of the Pledgor:

- ✓ To demand the return of the pledged item upon extinction of the principal obligation.

Obligations of the Pledgor – the contract is unilateral, as only the pledgee has obligations. Nevertheless, if the pledgee suffers any damages due to the property or expenses made for its preservation, the pledgor will pay compensation.

There is also a *pledge over receivable* under Article 162-165 OCA. Only transferable receivables can be pledged, as the debtor will be notified for the pledge. The pledgor must hand over to the pledgee the documents proving the pledged receivable, if any. The pledgee is obliged to carry out all acts required for maintaining the pledged receivable. He is obliged to collect the interest on the pledged claim, as well as the principal, should it become due. The assets that the creditor has collected will be kept by him as a pledge. If it is in cash, the amount will be invested in a bank as security for the creditor.

3. Registered pledges

Registered pledges are regulated by the Special Pledges Act (SPA).

Why is the pledge special?

- The pledge is established without providing possession of the pledged property – the debtor can use the pledged property in his own activity.²⁷ For example: a merchant can pledge his package production machine to secure a credit. Nevertheless, the merchant can continue to produce packages to earn income and thus pay his debt.
- It must be registered in the special register in order to be established

²⁷ **Калайджиев, А.** Облигационно право. Обща част. Седмо издание. София, Сиби, 2020, с. 590 и сл.

- Article 2(1) SPA (Central Pledge Register or another register provided by law – Commercial Register, Patent office, etc. depending on the asset).
- The pledge will be opposable to third parties from the moment of its registration. The entry into the Register determines the order of satisfaction, i.e., if there is more than one pledge, the creditor first entered will be satisfied before other creditors;
- The contract for a registered pledge will be concluded in writing and, only in certain cases, with notary certification of the signatures (pledge of commercial enterprise and company shares) – Article 2(1) SPA. Any amendments to the contract will be executed in the same form.
- Registered pledges are only contractual – no registered pledge may arise by operation of law;
- The receivable secured by a registered pledge can be described in generic terms, possibly a conditional or future debt, as the pledge will secure the debt and all interest and liquidated damages arising from the secured debt.

Who can be a pledgor?

Not every person can establish a registered pledge over his belongings. The pledgor must be a **merchant**, or fall within certain categories of persons provided by Article 3 SPA, such as:

- natural persons engaged in agricultural activity;
- craftsmen;
- municipalities which secure municipal debt incurred under the terms of the Municipal Debt Act;
- the Bank Deposit Insurance Fund, when it secures loans used by it;
- non-profit legal entities which carry out an economic activity, with regard to the economic activity carried out by them, etc.

What can be pledged?

Under Article 4 SPA, the pledged property can be:

- movable property, except for ships and aircraft;
- machines and facilities;
- receivables, dematerialized securities and shares of collective investment undertakings;
- shares in general and limited partnerships, limited partnerships with shares or limited liability companies;
- rights in patents for inventions, utility models, registered marks, industrial designs, topologies of integrated circuits and certificates for plant species and animal breeds;
- commercial enterprises²⁸ (which consist of rights, obligations and factual relations);
- agricultural products, raw materials, goods and materials, etc.

Pledgor's Rights:

Under Article 8(1)–(2) SPA, the pledgor will have the right to retain possession of the pledged property, so that he can:

- use the pledged property in his activity, in accordance with its intended use;²⁹
- dispose of the pledged property within the scope of the ordinary activities involved in his occupation. A pledge will be extinguished when a third party acquires, through a transaction executed by the pledgee within the scope of his ordinary occupational activities, rights over the pledged property, which are incompatible with the pledge. The pledgor will be obliged, upon extinction of the pledge, to satisfy the pledgee with the funds received from transfer of the property. If the disposition is not within the scope of his ordinary activities, the explicit consent of the pledge creditor, duly entered into the Central Pledge Register or in the respective other register, will be needed. For example, if the pledgor is a seller of televisions

²⁸ Георгиев, Г. Залог на търговско предприятие. София, Сиела, 2021.

²⁹ Гилова, В. Залог по търговското право. Особен залог. – В: Герджиков, О., Камелия Касабова, Методи Марков, Иван Русчев, Георги Стефанов, Поля Голева, Тания Градинарова, Валя Гилова, Костадинка Недкова. Обезпеченията в материалното и процесуалното право. София, Труд и право, 2018, с. 507.

and he pledges his stock in favour of B and then sells some of the televisions to his customers, the pledge will be extinguished and B will be satisfied by the sale value.

Pledgor's Obligations

Under Article 9 SPA the pledgor who retains possession of the pledged property will be obliged to keep it with due diligence and, in particular, must:

- insure the pledged property, at his own expense, in such a way that enables the pledgee to benefit from any insurance compensation;
- inform the pledgee of the condition of the pledged property;
- inform the pledgee of all proceedings concerning the pledged property;
- inform the pledgee, in writing, of all activities that may cause transfer of the pledge or establishment of third-party rights over it;
- sell the pledged property in the event of potential spoiling, after giving notice to the pledgee, and deposit the value of the sale in a bank account as security for the pledgee;
- provide the pledgee with opportunities to examine the condition of the pledged property;
- not dispose of the pledged property after commencement of enforcement. Disposal transactions performed by the pledgor in respect of the pledged property after commencement of enforcement cannot be opposed to the pledge creditor.

Pledge Creditor's Rights:

- He will have the right to satisfy his claim from the pledged property with preference (including from its value, income from the pledged property, insurance compensation if it is destroyed, etc.). The pledge creditor can satisfy his claim by selling the pledged property himself (without court intervention) or according to the procedure of the Civil Procedure Code.

- He will be entitled to obtain information concerning this property provided by those state authorities and third parties who hold, keep or have the pledged property on their books.
- He can take measures for: preserving, maintaining and insuring the pledged property, as well as for receiving income from it and increasing the sale price or minimizing sale expenses.
- If the pledgee's claim is not fulfilled, he can be satisfied with the pledged property, as no court proceeding is needed. Should the pledgor be in default of his obligations under the pledge contract, the pledgee may demand performance before the debt matures, and satisfy his claim from the pledged property. The creditor will observe certain procedures for satisfaction (see the next paragraphs).

The pledgee will enter the commencement of enforcement in the Register and the pledgor will no longer be allowed to dispose of the pledged property. Upon commencement of enforcement the pledged property will be provided to the pledge creditor. He will have the right to take measures for its preservation, to manage it and to sell it while exercising the care of a good merchant. The debtor can no longer manage and dispose of the pledged property with effect after entering the commencement of the enforcement – Article 32 SPA.

The pledge creditor, who has entered commencement of enforcement, will have the right to sell,³⁰ on his own behalf and at the expense of the pledgor, the pledged property after the expiration of two weeks from the commencement of enforcement – Article 37 SPA.

The amount that is received upon the sale of a pledged item will be submitted to a depository appointed by the pledge creditor. He must be a lawyer or a registered auditor (Article 38(1) SPA). The depository cannot be the debtor or the pledgor himself, a creditor of the debtor or the pledgor, etc. He will prepare a list of creditors (on the basis of the information entered in the registers) and keep, in a special bank account, the amounts

³⁰ Гигова, В. Залог по търговското право. Особен залог. – В: Герджиков, О., Камелия Касабова, Методи Марков, Иван Русчев, Георги Стефанов, Поля Голева, Тания Градинарова, Валя Гигова, Костадинка Недкова. Обезпеченията в материалното и процесуалното право. София, Труд и право, 2018, с. 510.

received when selling the pledged property and will distribute the amounts amongst the creditors.

4. Mortgage³¹

A mortgage is a contract³² by virtue of which the debtor or third party provides real estate for the purpose of securing the fulfilment of a principal obligation.³³ The mortgage is a security over real estate. The mortgage guarantees that the creditor will collect his receivables or the debtor can lose his property which may be sold in a public sale and the creditor satisfied from the price realised.

Characteristics:

- ◆ A mortgage can be established by the debtor or by a third party who wishes to secure the debtor's obligation.
- ◆ The contract is formal – it must be concluded in the form of a Notary Deed;
- ◆ The contract is bilateral, as both parties have obligations.
- ◆ A mortgage is established by registration in the Property Register.

What can be the subject of a mortgage:

- immovables – land, building, apartments, etc. Real estate will be divided according to legal requirements – e.g., one cannot mortgage one room in an apartment, only the whole property.

³¹ The term comes from French and means 'dead pledge'.

³² We also have mortgage by operation of law which will be registered upon the creditor's application in certain cases (Определение № 120 от 17.02.2014 г. по ч. пр. д. № 819/2014 г. на ВКС):

1. in favour of the alienator of immovable property – on the alienated property as security for his obligation under the contract, and

2. in favour of the co-partitioners to whom a supplementing of the share will be paid – on immovable property left in the share of a co-partitioner who is liable for the payment of the share;

3. in favour of the bank in respect of immovable properties and the real rights thereto, which are acquired in whole or in part through bank credit.

Should the law provide for providing security before a court, the said security may be a mortgage.

³³ **Марков, М.** Ипотеката. София, Сиби, 2008.

- real rights – e.g., the right to construct; however, the right of use of real estate is personal and cannot be mortgaged;³⁴
- ship – the regime is provided by Merchant Shipping Code.

What will the contract contain:

According to Article 167:

- ◆ the names and address, personal identification number (if they are Bulgarian citizens, for foreigners: date and place of birth and citizenship) of the creditor and the debtor, as well as of the owner of the property if the mortgage is established for another's obligation (if any of the parties is a legal entity – its trade name, legal form and identification code);
- ◆ the property on which the mortgage is established – it may be established only with respect to a specified property. A mortgage may be established only on property which belongs to the mortgagor at the time of contract conclusion;³⁵
- ◆ the secured receivable, its maturity date, and the interest rate if interest is agreed, as well as the amount for which the mortgage is established if the receivable is non-monetary. It is important that the exact amount of the debt is determined as the mortgage secures the debt up to this amount. For example: the debt of A towards B is in the amount of 50,000 and a mortgage secures the debt for this amount but the real estate that is mortgaged is in the amount of 100,000. Thus, another creditor C, who has a receivable in the amount of 20,000 can register a second mortgage security.

Under Article 170 OCA, the establishment of a mortgage will be **invalid**,³⁶ if the mortgage contract contains uncertainty as to the identity of:

- ✓ the creditor;
- ✓ the owner of the property;
- ✓ the debtor;

³⁴ Решение № 50221 от 19.12.2022 г. по гр. д. № 238 / 2022 г. на ВКС, 4-то ГО.

³⁵ Решение № 39 от 24.03.2014 г. по гр. д. № 5059/2013 г. на ВКС.

³⁶ Определение № 50320 от 10.05.2023 г. по т. д. № 1448 / 2022 г. на ВКС, 1-во ТО.

- ✓ the property;
- ✓ the secured receivable;
- ✓ the sum for which the mortgage is established.

A mortgage will receive its rank upon its registration (Article 169 OCA). Mortgagees will be entitled to a preferential satisfaction from the price in the order of their mortgages. For example: if a real estate is mortgaged on 01.08.2021 in favour of creditor A who has receivables in the amount of 100,000 and then on 01.07.2022 the same real estate is mortgaged for another debt in favour of creditor B who has receivables in the amount of 50,000 and again on 01.06.2023 in favour of creditor C who has receivables in the amount of 30,000, and, finally, the real estate is sold at a public sale for 130,000 all the mortgages will be extinguished and the three creditors will be satisfied as follows: the first will be completely satisfied, the second one partly satisfied at 30,000 and the third will not receive anything.

A registration in the Registry Agency will be valid for **10 years** from the date on which it was made – Article 172(2) OCA. It may be extended, if the registration is renewed, before the expiration of this period.³⁷ The registration may be renewed by an application to which a copy of the contract must be attached. Should the time period expire and no renewal is made, the mortgage can be deleted.

Amendments in the secured debt must also be registered. Thus, the transfer and pledging of a receivable secured by mortgage, the assumption of such a debt, as well as its novation and substitution in an obligation secured by mortgage, must be made in writing with notarised signatures and entered in the Property Register in order to have effect with respect to the mortgage – Article 171 OCA.

³⁷ According to Interpretative Decision 3/2021 of General Assembly of the Civil and Commercial Departments of the Supreme Court of Cassation, following expiry of the 10-year period and the deletion of the mortgage it could be registered again if the obligation that was secured is not performed. However, the new registration cannot be opposed to third parties that have acquired ownership of the property and entered their deed before the new entry of the mortgage.

The mortgage will secure the claim irrespective of any changes that may have occurred in the latter, but only up to the amount covered by the registration – Article 174 OCA. However, if it is entered that the receivable is interest-bearing, the mortgage will also secure the interest. In addition, the mortgage will secure the creditor's claims for expenses incurred in its establishment and renewal, and court and execution expenses.

Rights of the mortgage creditor (mortgagee):

- ◆ to request restraint from actions over the mortgaged property – the mortgagee has the right to request, from any third party, not to undermine the condition of the property;
- ◆ to preferential satisfaction from the price realised from the property – a creditor whose receivable is secured by a mortgage will be entitled to be satisfied preferentially from the mortgaged property's sale, irrespective of whose ownership it is.³⁸ However, the mortgage does not extinguish the title of the mortgagor who does not lose his right to dispose of or use the property. For example: if A, as the owner of a real estate, has mortgaged it in favour of B and then sold the real estate to C and, finally, C sold the real estate to D, the mortgage follows the real estate. Therefore, B can be satisfied from the real estate as it can be sold at a public sale. Nevertheless, the real estate is owned by D. D bought the real estate, encumbered with the mortgage, and can prevent its sale paying the receivable to B and claim the amount from A.

Deletion of the mortgage:

- Upon public sale of the property all mortgages on it will be extinguished³⁹ – Article 175(1) OCA;
- Upon fulfilment of the obligation, the registration of a mortgage can be deleted on the grounds of the creditor's consent, which must be certified by a notary – Article 179 OCA;

³⁸ Определение № 79 от 07.02.2013 г. по търг. д. № 894/2012 г. на ВКС.

³⁹ Определение № 794 от 06.11.2014 г. по ч. пр. д. № 3215/2014 г. на ВКС.

- If the creditor refuses to give his consent for deletion, the mortgage can be deleted on the basis of an effective court ruling⁴⁰ – Article 179 OCA;
- In the event that 10 years from registration have elapsed and there is no renewal, each person can ask for deletion.

The deletion will be made by application to which the creditor's consent, or a copy of the effective court ruling, must be attached. The deletion will extinguish the mortgage.

⁴⁰ Определение № 74 от 04.02.2014 г. по търг. д. № 1791/2013 г. на ВКС.

CHAPTER 6:

A FUNCTIONAL APPROACH TO TIME LIMITS IN CIVIL AND COMMERCIAL LAW. EXTINCTIVE PRESCRIPTION: SURVEYING THE LANDSCAPE

Irina Bogdanova

ABSTRACT	KEYWORDS
This paper aims to explain the concept of ‘time limit’ or ‘term’ in civil law traditions with a focus on the limitation of actions, also known as ‘extinctive prescription’ in civil law jurisdictions such as Bulgaria. The initial section of the chapter delves into the various meanings of the word ‘term’, which include an additional clause to the juridical act that forms the ‘<i>accidentalia negotii</i>’ of the contract, an expression or determination of time, and a period for the extinction of a right or its acquisition. The chapter then briefly compares the acquisition of title to property due to the lapse of time (known as ‘acquisitive prescription’) to the loss of a right resulting from the passage of time (known as ‘extinctive prescription’). The second portion of the paper is exclusively focused on extinctive prescription, starting with its historical origins and legal effects, including the underlying policy considerations for its existence, as well as a comparative perspective and its specific application under Bulgarian civil law. At the end of the exhibition, special attention is paid to the length of different delays, general rules on the commencement of prescription, and the ‘interruption’ and ‘suspension’ of extinctive prescription and their effect.	time limits in civil law, extinctive prescription, acquisitive prescription

I. INTRODUCTORY REMARKS ON THE CONCEPT OF ‘TIME LIMITS’ IN CIVIL LAW

In civil law tradition, the words ‘time limit’ are used in several different ways:¹

- ✓ as an additional clause to the juridical act, forming the so-called *accidentalia negotii*² of the contract;
- ✓ as an expression or determination of time;
- ✓ as a period for the extinction of a right or its acquisition;

1. Stipulating time limit as an additional clause in a juridical act

A term clause³ is a provision in a contract that has different legal effects depending on its type and scope. For instance, a term clause can determine when a contract becomes effective and how long it lasts. In Bulgarian civil law, a term clause is one of the most frequently used transaction modalities.

Example 1: This Agreement will become effective on March 1, 2022, and will remain in force and effect until December 31, 2023, unless earlier terminated according to the terms outlined in the contract.

A term clause can also determine when a receivable is due⁴ or when ownership is transferred.

¹ On time limits in civil law, see **Бъров, Д.** Учебник по гражданско право с увод в правото. Свищов, Фонд „Научни цели“ при ВУСЧН, 1948, 257–260.

² In Bulgarian legal theory, the term ‘*accidentalia negotii*’ refers to additional agreements that are not essential to establish a valid and enforceable contract. These agreements may include delivery terms, performance location, penalty clauses and other similar terms. They are considered as ancillary agreements and are not necessary for the effective conclusion of a contract.

³ For more details, see **Василев, Л.** Гражданско право на Народна република България. Обща част. Трето преработено и допълнено издание. София, Наука и изкуство, 1956, 407–408.

⁴ See Решение № 124 от 12.10.2017 г. по гр. д. № 4080/2016 г. на Върховен касационен съд, 3-то гр. отделение.

Example 2: On June 21, 2023, A contracts to sell a flat to B with ownership being transferred 3 months after the contract is signed.

1.1. Effects of the term clause

It is important to note that the provisions in a contract and their effects can vary from contract to contract. For example, when a ‘term clause’ is used in a contract, it may refer to the legal effect of a certain juridical act or the reversal of its legal effects at a future point in time.

Example 1: A and B sign a rent contract that will become effective two months after its registration in the land register.

The ‘time clause’ can also modify the effect of a legal act when it relates to renewal or extension rights, termination rights, and/or obligations that survive termination/expiration.

Example 2: According to the supplementary agreement to a sale contract, if the buyer fails to pay the price within four months from contract conclusion, the contract will be considered automatically terminated.

However, there are certain juridical acts whose effect cannot be predetermined or modified through term clauses. For instance, according to Article 104(1) of the Obligations and Contracts Act (OCA), a set-off is effected through a statement made by either party to the other, and this unilateral statement may not be subject to a time period. Additionally, a general testamentary disposition cannot be made under a suspensive (commencement) period, and the law does not allow the right of succession to arise from a time other than the time of the opening of the succession (as per Article 17(2) of the Inheritance Act).

2. The ‘term’ as an expression of time or determination of a certain period

The term, as an expression of time or determination of a certain period, is considered a juridical fact. It is a future certain event – the lapse of a period, whose legal effects vary depending on the type of term and its scope of application. The term as an expression or determination of time means either a certain point in time or a certain period within which or after which an event will occur.

Example 1: A agrees with B to transfer the ownership of his apartment to him on March 30, 2023.

Example 2: On June 8, 2024 A and B concluded a preliminary contract for the sale of a house under which B was obliged to pay the price in advance – within a month after the possession of the house was handed to him by A.

2.1. Different types of terms

Legal theory has established different classifications for various types of terms, depending on the way the term is established, its legal effect, and its sources.

2.1.1. Depending on sources

With regard to the source which determines the existence of the term and its length, legal theory and case law differentiate between several types of terms.

- First, there are terms stipulated freely between counterparties – the time clauses mentioned above as part of a bilateral or unilateral act. In contrast, there are also terms laid down by laws or by-laws.

Example 1: According to Article 303 of the Bulgarian Commerce Act, where a contract does not specify a term for the performance of an obligation, provided the nature of the transaction or commercial customs do not require otherwise, the performance may be requested and may be provided anytime during working hours at the place of performance.

In comparison, Article 303a lays down that parties to a business transaction may agree to a time limit for a monetary obligation of a maximum of 60 days. By way of exception, a longer time limit may be agreed upon where required by the nature of the goods or services or another important reason and provided that this extension is not grossly unfair to the creditor or inconsistent with good morals.

It is also possible for a court ruling to impose certain time limits for the performance of obligations based on a court decision. These time limits are usually called judicial.

Example 2: Article 390 of the Civil Procedure Code provides that in cases of securing future claims, the court will determine a term for lodging the claim, which cannot be longer than one month. If evidence for the submission of the claim within the determined term is not presented, the court will cancel the security ex officio.

2.1.2. Legal Effects of Time Limits

Time limits are categorized as suspensive or resolute based on the legal consequences they entail.⁵ A suspensive time limit refers to a period that marks the commencement of the legal effects of a transaction or obligation.⁶ On the other hand, a resolute time limit specifies a future point in time that terminates the legal effects of a contract. In some cases, the time limit may not only determine the creation of an obligation but also its performance. In such situations, the time limit defines the maturity of the obligation, which is the point from which it becomes due. While in the first case, the obligation does not occur until the time limit expires, in the second case, the obligation exists but cannot be enforced until the time limit expires. A suspensive term may be imposed by law or may be included in a contract as a time clause.

Example 1: Under a rent contract A can start residing in the rented flat 3 months after paying the first rental payment.

⁵ See Василев, Л. Цит. съч., с. 407.

⁶ See Решение № 182 от 13.07.2017 г. по гр. д. № 4460/2015 г., г. к., IV г. о. на ВКС.

In contrast, the resolutory time limit (time-clause) is the time limit added to the transaction that terminates its legal effects *ex nunc* and extinguishes the effectiveness of a contract depending on a future but definite⁷ point in time.

Example 2: A agrees to rent his flat to B for a low rental fee provided that the rent contract will be terminated 6 months after it was concluded.

1.1.3. With view of their determinacy

Time limits are classified as absolutely and relatively determined based on their level of certainty.⁸ An absolutely determined time limit refers to a specific date or event that takes place on a fixed date.

Example 1: A requires from B to pay him back the money he received under a loan contract by Christmas 2023.

Example 2: Under a building contract, A is obliged to pay the first instalment of the negotiated price on April 1, 2024.

On the other hand, a relatively determined time limit refers to an event that is certain but the date of its occurrence is uncertain.

Example 3: A agrees to start selling shares of his company to B after the death of B's grandmother.

Example 4: Under a building contract, A agrees to pay the relevant price when the building licence allowing the land to be built up is granted.

⁷ Unlike pure obligations, conditional obligations are those whose effectiveness depends on the occurrence of a future and uncertain event. The uncertainty of the event is the essence of the conditional obligation.

⁸ Диков, Л. Курс по българско гражданско право. Том III. Облигационно право. Обща част. София, УИ „Св. Кл. Охридски“, 2015, 89–95.

2.2. Calculating time limits and computation of time in civil law

With relative certainty, we can state that ‘civil’ time relies on months and days as units to delineate time, unlike the natural time that consists of computing time *a momento ad momentum*. This is why a special law provision is necessary when calculating time limits in law so that there is no uncertainty and arbitrary interpretation by the interested parties.⁹ In Bulgaria, pursuant to Article 72 OCA, the period set in months expires on the respective date of the final month; if that month has no respective date, the period expires on its last day.¹⁰

Example 1: In their contract, the parties A and B have agreed (Article 2(4)) that A will deliver the equipment within one month of receipt of a written order from B. B received the written order on April 23rd, 2013, therefore, and with view of the provision of Article 72, clause 1 OCA, the time limit for performance expires at the end of 23.05.2013 (the corresponding day of receipt of the order on the last month of the term), which is an attendance (working) day.

A period set in weeks expires on the respective day of the final week. Where the period is set in days, the day of the event or moment that the period runs from is not counted. The period expires at the close of the final day.

If the final day is not a working (business) day, the period will expire on the first working day which follows.

Example 2: If a contract stipulates a 6-month probationary period which commenced on February 19th, 2001 and expired on August 19th, 2001, given that August 19th, 2001 is a non-working day (Sunday), by operation of law the period is deemed to have expired on the following working day, i.e., August 20th, 2001 (Monday).

⁹ For remarks on this problem in international private law, see Deák, F. (1926). Computation of Time in International Law. American Journal of International Law, 20(3), 502–515.

¹⁰ Решение № 66 от 18.08.2020 г. по т. д. № 396/2019 г. на Върховен касационен съд, 2-ро търг. отделение.

Of course, the parties may, in departure from the dispositive rule of Article 72, clause 2 OCA, agree that the period within which the obligation is to be performed will expire on its last day, notwithstanding that this day is a non-working day or that the maturity of the obligation will occur on a non-working day.¹¹ This is possible as long as it follows from their actual intention and the performance of the specific obligation is objectively possible within the agreed period, respectively on the agreed maturity date.

If the period expires a certain number of days before a certain day, the latter will not be counted, neither will the day on which the term expires.

Written statements and notices of any nature will be deemed concluded within the relevant period if they have been sent by mail, telegraph or radiogram before expiry of the twenty-fourth hour of the period's final day.

The beginning of the month will mean the first day of the month, the middle of the month will mean the fifteenth day of the month, and the end of the month will mean the last day of the month.

2.2.1 Beginning and end of period (term)

Usually, the term begins running from the day following the occurrence of the event, which constitutes its starting point. Of course, the way the starting point is defined depends on whether the term is established freely between counterparties or is imposed by law or court rulings.

Example 1: On July 7, 2022, A loaned 1,500 euros to B for one year. The period of one year begins to run on the 8th of July.

Example 2: In the case of a claim under Article 19(3) OCA, if under the preliminary contract the claimant is required to fulfil its counter-obligation upon conclusion of the final contract, the court will rule with a decision, which will replace the final contract, with the condition that the claimant has to fulfil its obligation. In this case, the claimant must fulfil its obligation within a term of two weeks from entry of the decision into force, including by compensation of the liabilities paid by it to the state on account of the defendant.

¹¹ Решение № 220 от 30.01.2018 г. по т. д. № 72/2017 г. на Върховен касационен съд, 2-ро търг. отделение.

The period ends at the expiration of the entire last day of the term. As stipulated in Article 72 OCA, if the last day of the period is not a working day, then the period ends at the expiration of the entire next working day.

2. Terms as a period for the extinction of a right or for its acquisition.

Almost all European legal jurisdictions recognise that rights and obligations can be affected by the lapse of time. In traditional civil terminology the term ‘prescription’ entails (i) the acquisition of title to property as a result of the lapse of time (‘acquisitive prescription’) and (ii) the loss of a right as a result of the lapse of time (‘extinctive prescription’).¹² Nevertheless, it is no longer considered helpful to place both types of prescription under a common legal framework as they are governed by very different rules, which makes the unified regime notoriously defective. Besides the fact that they share the same noun modified only by an adjective, and that many rules, especially those on the running of time (suspension, interruption, calculation), are common for the two, and that both consolidate facts that have existed during a certain time without being disputed, acquisitive and extinctive prescription are essentially different in their application, effects and mechanism.¹³ This explains why under Bulgarian civil law there are specific rules dedicated to extinctive prescription (Articles 110–120 OCA), while the regulation of acquisitive prescription is set out in the Property Act, Articles 79–86. Yet Article 84 of the Property Act provides that, concerning prescription, in addition to the above rules, the provisions of Articles 113, 115, 116, 117 and 120

¹² See Principles, Definitions and Model Rules of European Private Law – Draft Common Frame of Reference (DCFR). Prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group), Edited by Christian von Bar, Eric Clive and Hans Schulte-Nölke and Hugh Beale, Johnny Herre, Jérôme Huet, Matthias Storme, Stephen Swann, Paul Varul, Anna Veneziano and Fryderyk Zoll (available at: https://www.law.kuleuven.be/personal/mstorme/european-private-law_en.pdf), p. 1164.

¹³ **Voorde, J.** On the Unity or Disunity of Acquisitive and Extinctive Prescription. Or How Daring Reinterpretations are not Always Right. In: **Dorothy G., Eveline Ramaekers, and Luke Rostill (Eds.)** Property Law Perspectives IV (95–118). Intersentia, 2016.

OCA will apply *mutatis mutandis*, thus using the technique of respective reference for convenience.

This does not change the fact that although the differences are less pronounced as both types of prescription need the passing of a certain period of time and are calculated in the same manner, their legal effects are profoundly different. Extinctive prescription extinguishes a right¹⁴ solely because of the running of a certain period and concerns mainly receivables¹⁵ and as an exception – potestative rights. Usually, we say that a right to the performance of an obligation is subject to prescription by the expiry of a period prescribed by the law during which the creditor was inactive. In comparison, acquisitive prescription implies the original acquisition of a right *in rem* that necessitates a qualified and continuous possession during a certain time and concerns only real rights. Therefore, acquisitive prescription refers to a primary means of acquiring a right of ownership, or one of its dismemberments through the effect of possession. To claim possession and produce effects in law, the nature of the ownership must be peaceful (unfounded violence), continuous (without interruption), public (acknowledged), and unequivocal (absence of ambiguity). Finally, yet importantly, extinctive prescription is considered to require only the inaction of the creditor, while acquisitive prescription requires possession.

II. ACQUISITIVE PRESCRIPTION IN BRIEF

1. Defining acquisitive prescription

Acquisitive prescription is a civil law institute equivalent to adverse possession in the common law system and is widely recognised as one of the most important original ways of gaining ownership and other limited real rights. The majority of European legal systems, especially in civil law

¹⁴ As will be clarified further on, following expiry of the limitation period, the right is not extinguished. It continues to exist but the debtor is granted a right to refuse performance.

¹⁵ In addition, not only to contractual rights, but also to other rights to performance based on extra-contractual sources – wrongdoing, unjustified, benevolent interference in another's affairs.

countries, provide rules on the acquisition of ownership or limited rights *in rem* by continuous possession. Under this concept, the right of ownership can be acquired based on possession for a certain period¹⁶ and admittedly the main purpose of the institute is to protect the holder who has used the land for a long time, thus ‘punishing’ in a way the owner, who did not exercise his rights.¹⁷

In Bulgaria, the delay to acquire an immovable by acquisitive prescription is ten years in cases of ordinary (*mala fide*) possession and five years in cases of good-faith possession (*bona fide*).¹⁸

Example 1: If A possesses, as an owner, and uses a certain immovable (a plot of land for example, or a flat) for more than ten years in a peaceful, continuous, public and unequivocal manner, A could ask to be officially recognized as the sole owner of the immovable.

In comparison, the term of acquisitive prescription for movables is 5 years.

According to Bulgarian legislation, acquisitive prescription requires the existence of the following concurrent elements:

- the intention of the possessor to use the property as if it were his own also known as *animus habendi*. Under Article 69 of the Property Act the subjective element – *animus habendi* – is presumed for all cases when an individual asserts material possession. Thus, whoever contests the said ownership will bear the burden of proof

¹⁶ Тълкувателно решение № 10 от 05.12.2012 г. по тълк. д. № 10 / 2012 г. на Върховен касационен съд, ОСГК.

¹⁷ A decision of the European Court of Justice in 2002 in the case of JA Pye (Oxford) Ltd vs Graham sparked the dispute over the constitutionality of the institute of acquisitive prescription and its legal and moral justifications.

¹⁸ Possession in good faith (*bona fide possession*) is a possession based on a legal title that usually transfers ownership from one legal owner to another (such as a deed) in cases where the form of validity was not met, or the transferor was not the real owner. According to Article 70 of the Property Act, the possessor will be deemed to possess in good faith when he possesses the property on a legal basis fit to make him an owner, without knowing that the transferor is not an owner or that there is a defect in the form prescribed by the law. It is sufficient that the good faith exists at the time of arising of the legal basis. According to the law, good faith is presumed until proven otherwise.

and will need to establish the absence or the inadequacy of the two conditions.

- continuous possession comprising all the actions by which the possessor occupies the property manifesting his *animus*.¹⁹ Possession must be continuous, peaceful, public, unambiguous, uninterrupted and as owner. Possession is considered to be interrupted when lost for more than six months. In order not to interrupt possession, it is necessary to bring a possessory action within the prescribed period. When the period is interrupted, possession is also interrupted as per Article 81 of the Property Act. Proof of continuity of possession is facilitated by the presumption of Article 83 of the Property Act, according to which if the possessor proves that they were in possession during different periods, they supposedly were also in possession in between those periods. Hence, we conclude that it is sufficient to establish that possession existed at the start of the limitation period and at the end of the term.

Therefore, for a person to acquire through acquisitive prescription say, an apartment building in Sofia, they would have to act as its owner for ten years and would have had to be in physical possession of that apartment for that same period.²⁰ This will allow the possessor to request either a notary deed or a legal judgment from a court stipulating or confirming their rights as owner through the peaceful, continuous, public, and unequivocal possession of the building against the former owner.²¹

The possession of an item, whether in good or bad faith, comes with both rights and obligations. According to Article 73(1) of the Property Act, a person in bad-faith possession will owe the owner compensation for the profits they have deprived the owner of and for those they could have derived, as well as the benefits they have obtained less the expenses incurred in the process. However, a *mala fide* possessor has the right to seek the protection of their possession under Articles 75 and 76 of the

¹⁹ For some discussion, see **Боянова, Г.** Някой дискуссионни въпроси на придобивната давност. // Собственост и право, 2011, № 1.

²⁰ Решение № 50160 от 20.01.2023 г. по гр. д. № 504 / 2022 г. на Върховен касационен съд, 1-во гр. отделение.

²¹ Решение № 79 от 05.07.2019 г. по гр. д. № 3706 / 2018 г. на Върховен касационен съд, 2-ро гр. отделение.

Property Act. In comparison, a *mala fide* possessor can ask to be repaid for necessary expenses made for preservation of the property. In the case of improvements made by the bad-faith possessor, the latter may only receive the smaller sum between the total of all expenditures and the amount with which the value of the property has increased because of such improvements.

2. Good-faith possession

The legal position of the good faith possessor is quite different. In the case of good faith possession, the law imposes additional conditions beyond the ordinary possession.²² These include a valid title that is sufficient and capable of conveying rights *in rem*, along with good faith on the side of the possessor, meaning that the latter does not know that the form required by the law was not followed, or that the transferor was not the real owner.²³ However, there is a debate in case law as to whether the presumption of good faith is rebutted by a mere showing that the vendee has the means of obtaining knowledge of the defect in their title of ownership. The same problem arises when deciding whether the possessor must be charged with bad faith because a title examination in public registers would have disclosed the defects in the seller's title. The law simply requires that good faith exists at the time of arising of the legal basis.²⁴ Even if the possessor subsequently becomes aware of the defect, the person remains a *bona fide* possessor since factual ignorance was present at the time of legal entitlement.

Bona fide possession has several legally significant consequences in contrast to *mala fide* possession. Firstly, the prescription period for the acquisition of property is five years, and a *bona fide* possessor can use the property and enjoy the benefits derived from it until an action is filed

²² For more details, see **Орцов, Зл.** За фактическия състав на придобивната давност (по повод ТР N 4/2012 г. на ОСГК на ВКС). // Търговско право, 2013, № 2.

²³ As per Article 70 of the Property Law Act, the possessor is deemed to possess in good faith when they possess the property without knowing that the transferor is not the owner or that there is a defect in the form prescribed by the law.

²⁴ See Недев, Д. По някои въпроси на вписването, добросъвестното владение и придобивната давност, поставени в съдебната практика. // Собственост и право, 2016, № 7.

for its return. Secondly, a *bona fide* possessor can ask for the sum with which the value of the property has increased due to any improvements made. Moreover, a *bona fide* possessor may hold the property until they are reimbursed for such improvements and expenses.²⁵

The expiration of the acquisitive prescription (five years for possession in good faith and ten years for possession in bad faith) does not automatically transfer the ownership of the real estate. According to the case law of the Supreme Court of Cassation, the adverse possessor must explicitly manifest the expiration of the acquisitive prescription, although the manifestation is not considered an element of the acquisition of property rights using acquisitive prescription.

III. EXTINCTIVE PRESCRIPTION

The legal framework regulating extinctive prescription reflects, in a very curious way, the obscuring or obfuscating power of time. Most probably, this explains why all European legal systems subject the right to the performance of an obligation or the ability to pursue such a right in court to temporal limitations,²⁶ endangering the existence of the right with the lapse of time.

1. Policy considerations in forming the regulation of prescription

From a comparative point of view, there are at least four leading policy considerations²⁷ behind the legal regulation of extinctive prescription:

(1) Protection must be granted to a debtor who, given the obscuring power of time, finds it increasingly difficult to defend an action.

²⁵ See Решение № 95 от 10.06.2019 г. по гр. д. № 2609 / 2018 г. на Върховен касационен съд, 1-во гр. отделение.

²⁶ See **Zimmerman, R.** Prescription, available at <https://max-eup2012.mpipriv.de/index.php/Prescription>.

²⁷ However, numerous disparities exist among legal systems concerning the conceptual basis for extinctive prescription, which dooms to failure almost all attempts for generalization.

(2) Lapse of time demonstrates an indifference of the creditor towards the right, which, in turn, may create a reasonable reliance on the debtor that no lawsuit will initiate.

(3) Prescription prevents long drawn-out litigation about claims, which have become stale and thus the institute aims, although in a very special way, to achieve legal certainty.

(4) Last but not least, most legal systems limit or prescribe a claim from being asserted after the lapse of a specified period to prevent the institution of legal proceedings at such a late date that the evidence relating to the claim is likely to be unreliable or lost. Thus, the rules governing prescription also aim to protect against the uncertainty that would result if a party were to remain exposed to unasserted claims for an extensive period.

2. Notes on the origin of extinctive prescription from a historical and comparative perspective

According to most scholars, Classical Roman law did not recognise any relationship between the word ‘prescription’ and the concept of losing right with the lapse of time. In the wording of Roman sources, the concept of prescription was initially conceived within the realm of a very elaborate division aiming to distinguish perpetual actions from temporary actions. In the late Roman Empire, things started to change: in the system of *cognitio extra ordinem*, the word ‘*praescriptio*’ is meant to be a ‘defence’, set up by the defendant but mostly against *rei vindicatio* due to the plaintiff’s guilty behaviour. One century later, more or less, Emperor Constantinus set up a *lex*, which mentioned a brand-new kind of *praescriptio*, the so-called *longissimi temporis praescriptio*, protecting through an exception a possession lasting at least forty years.²⁸

Genuine extinctive prescription, as we today intend it – referring to actions – first appeared in Roman legal experience only under Theodosius II, in 424 A.D. The emperor aimed to shorten the terms of all civil litigations,

²⁸ This is the concept supported by **Bianchi, P.** *Sulla praescriptio constantiniana*. P. Col. VII 175: ricostruzione di una vicenda processuale. In AARC, XVII 707 ff. (Atti Accademia Romanistica Costantiniana). Rome, 2010.

setting up a *certum tempus in protrahendis litibus* and expressly made mention of safety and fairness in legal affairs in his *Lex Theodosiana* which introduced extinctive prescription. The *Lex Theodosiana* was contained in Justinian's Code as well, but Byzantine jurists – as it often happened – made in it some textual changes. According to Justinian, extinctive prescription had a 30-year lasting period. But, overall, if we take a look at C. 7.31.1, 23 we realise that, under Justinian, prescription had an ambiguous appearance,²⁹ referring both to extinctive and acquisitive effects.³⁰ Besides, in answering the question of how long should prescription periods run, we can appreciate the great effort of Roman Emperors in making rules to put a limit to the length of litigations.

The old articles of the French Code Civil, going back to the year 1804 (Articles 2219–2281), and the articles of Italian *Codice Civile* in its version from 1865 (Articles 2105–2147) were faithfully inspired by Roman rules. Despite that, the contemporary trend, in modern legislation, has been to shorten the periods of extinctive prescription. Recent codes have shortened general prescription periods to fifteen years, ten years,³¹ or even three years.³² Thus, comparatively recently, Germany and France have changed the asset of prescription in their codes, focusing, peculiarly, on shortening limitation periods. The so-called German *Schuldrechtsmodernisierung*, or 'Modernization of the Law of Obligations', finally took place in 2002, and its most relevant provision is, in §195 BGB, a general limitation period of three years. An even more relevant and eloquent example is what happened in France. The growing dissatisfaction towards the law of liberative prescription urged, in 2008, the French legislature to take the necessary step and drastically reform prescription. The general period is now shorter

²⁹ See **Zimmerman, R.** *Comparative Foundations of a European Law of Set-Off and Prescription*. Cambridge University Press, 2002.

³⁰ To trace some short remarks on historical roots of prescription, see **Triggiano, A.** Short remarks on extinctive prescription in legal history. *US-China Law Review*, 2013, 35–45.

³¹ Article 2934 of the *Codice Civile* (Italy), Article 1159 of the *Código Civil* (Mexico), Article 2922 of the *Code Civil* (Québec), Article 127 of the *Obligationenrecht* (Switzerland).

³² Law Reform (Limitation of Actions, Etc.) Act 1954 (England), Latent Damage Act 1986, Administration of Justice Act 1985, Consumer Protection Act 1987.

and unified – five years; there are new grounds for suspension (including codified *contra non valentem*), and a long-stop period is introduced.

IV. CONTEMPORARY RULES ON PRESCRIPTION IN BULGARIAN CIVIL LAW

In Bulgaria, extinctive prescription is the loss of the right due to the lapse of time combined with the creditor's inaction.³³ The rules governing the limitation of actions and prescription of claims are mandatory³⁴ and they are located in Part V of the Obligations and Contracts Act, which is dedicated to different means of extinguishing obligations. It is essential to note that following expiry of the limitation period, the right does not cease to exist, and the obligation is not extinguished. Instead, the obligation continues to exist, but the debtor is granted a right to refuse performance.³⁵ Therefore, some recent research suggests that the term 'liberative prescription' is more appropriate.³⁶

According to the general rule of Article 110 OCA, all claims are extinguished upon the expiration of a five-year limitation period, unless the law provides otherwise. This means that extinctive prescription requires only the inaction of the creditor concerning his rights within a specific period.

Example 1: If A forgets or neglects to claim back the amount of 10,000 euros – the price for the transfer of an immovable to B that was due the day after the contract was concluded – December 15th, 2015, then if A raises a claim in court demanding his money on December 15th, 2021, respondent B has the right to refuse to pay back, due to expiry of the limitation period.

³³ For a brief overview, see Велинов, Л. Погасителна давност по българското частно право. София, Феня, 2007.

³⁴ Решение № 30 от 18.03.2021 г. по гр. д. № 1555 / 2020 г. на Върховен касационен съд, 3-то гр. отделение.

³⁵ Решение № 172 от 06.02.2018 г. по т. д. № 153 / 2015 г. на Върховен касационен съд, 1-во търг. отделение.

³⁶ See **Zimmerman, R.** Op. cit. p. 112 et seq.

1. Types of rights subjected to extinctive prescription. Range of application.

We can freely state that the lapse of time is intended to affect mostly receivables. Prescription is thus conceived as an institution of substantive law: because of the lapse of time the debtor is entitled to refuse performance. Under the rules governing extinctive prescription the creditor's right to claim performance is lost by failing to assert it within a certain period, prescribed by the law, though the right continues to exist. This explains why the voluntary performance by the debtor after the lapse of the extinction period does not deem the performance undue. The fact that the creditor's right to claim the performance of an obligation is time-barred does not deny its enduring existence since prescription only affects its enforceability. Hence, what a creditor obtains as a result of the debtor's voluntary performance of a time-barred claim is therefore justified and does not constitute unjustified enrichment. Moreover, this is easy to understand given that there is no reason for a legal system to ensure protection for a debtor who is willing to perform and who may thus be taken to acknowledge the obligation to do so. For the same reasons, Article 118 OCA provides that whatever has been performed to discharge a claim may not be reclaimed merely because the period of prescription has expired.

The institution of prescription is centred around the idea of the right to performance of an obligation. It is not surprising that limitation periods generally do not affect rights that can be exercised without the assistance of the debtor, such as rights *in rem* and potestative rights.³⁷ (also known as condition-changing) rights. This group also includes many defences, such as *exceptio non adimpleti contracto*.³⁸ However, the prescription

³⁷ In Bulgarian civil doctrine an ongoing dispute exists on whether potestative rights are subject to prescription or not. On this problem, see **Таджер, В.** Гражданско право на НРБ. Обща част. Дял 2. София, Наука и изкуство, 2001, стр. 390, 694–695; **Павлова, М.** Гражданско право. Обща част. София, Софи-Р, 2002, 652–653; **Василев, Л.** За преобразуващите субективни граждански права. // Правна мисъл, 1958, № 2, с. 22; **Голева, П., Силви Чернев.** За квалификацията на давностните и преклузивните срокове. // Правна мисъл, 1987, № 1.

³⁸ This is a defence, which allows each party to a reciprocal contract to refuse the performance of an obligation under the contract, although such an obligation is enforceable, if the other party has not performed their respective reciprocal obligation.

of defences raises difficult doctrinal problems. Under the *ius commune*, defences were widely considered to be exempt from prescription. This principle is still accepted in several jurisdictions, although it remains controversial in Bulgaria.³⁹

It is important to note that means for protecting absolute rights, such as ownership, should not be subject to extinctive prescription. If they were, it would undermine the absolute nature of these rights, which would be unjustifiable. As a result, it can be argued that rights arising from absolute rights should only end when the absolute right itself ceases to exist. Specific rules relating to these rights require them to be exercised within a reasonable period.

2. What is the duration of different prescription periods?

It is widely accepted that a prescription regime should be simple, straightforward, and uniform. However, many prescriptive regimes face criticism due to the long delays involved. Some European legal systems have complex regimes with both general and shorter periods for special situations. In contrast, Bulgarian legislature has adopted a more moderate approach by delimiting between the general prescriptive term and special prescriptive terms. This normative approach aims to standardize prescription periods as much as possible. It is worth noting that the limitation period cannot be extended or narrowed based on free will, as it is a matter of public interest and can only be changed through relevant law provisions. The parties cannot modify the structure and content of the prescriptive regime by contract.

³⁹ Most legal systems do not have a general rule but some have specific provisions in terms of which defences may, under certain circumstances, survive prescription of the right on which they are based. See on this topic Principles, Definitions and Model Rules of European Private Law – Draft Common Frame of Reference (DCFR). Prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group), Edited by Christian von Bar, Eric Clive and Hans Schulte-Nölke and Hugh Beale, Johnny Herre, Jérôme Huet, Matthias Storme, Stephen Swann, Paul Varul, Anna Veneziano and Fryderyk Zoll (available at: https://www.law.kuleuven.be/personal/mstorme/european-private-law_en.pdf), p. 1167 et seq.

2.1. General versus particular or ‘special’ prescriptive periods

In Bulgaria, the general statute of limitations is five years according to Article 110 OCA. Simultaneously, the law enforces certain ‘particular’ or special prescriptive periods confining the scope of applicability of the general one. Thus, the general delay of five years applies only where no other period is provided for in the law.⁴⁰

Example 1: The relationship between two co-owners is not one of tenancy, and the calculation of compensation based on rent to be paid does not alter its nature. It remains an obligation to pay compensation on account of the unlawful exclusive use of the common building, and that obligation is neither one to pay rent nor any other periodic obligation. It is therefore not extinguished by the expiry of the three years under Article 111(c) OCA, but five years after its occurrence pursuant to Article 110 OCA (Judgment No. 2254 of 22.09.1972 in Case No. 1602/72, 1st civil department of the Supreme Court of Cassation).

It can be viewed as a positive aspect of our legal system that there aren’t many specific time limits. This helps prevent the possibility of limiting the scope of the general 5-year rule. Moreover, by limiting the number of specific exceptions, the risk of confusion and arbitrary differentiation that previously caused problems is also eliminated.⁴¹

2.1.1 Special limitation periods

According to Bulgarian civil law, only certain claims are subject to special limitation periods that are explicitly established. Any other claims and rights that do not fall under a special limitation are subject to the general limitation period of five years. The criteria for determining the

⁴⁰ Решение № 845 от 02.06.2003 г. по гр. д. № 2471/2002 г., V гр. о. на ВКС.

⁴¹ And while modern European legal systems still recognise a large variety of periods, ranging from six months to thirty years, more and more rights in more and more countries in new enactments and draft proposals are subject to a prescription period of between two and six years. And there is a growing conviction that the general period should be somewhere between these poles.

special limitation periods depend on the source of the subjective rights, the content of the right, and the personality of the creditor or debtor. The most common criterion for differentiated periods of prescription is the legal nature of the right. However, the legal consequences of the expiry of special limitation periods set by law are the same as those arising at the expiry of the general limitation period, because in both cases the claim to enforce subjective rights is extinguished.⁴²

Here are some examples of the most practically important special limitation periods:

- **Three-year statute of limitations:**

The provision of Article 111 OCA envisions that upon the expiration of a three-year limitation period, the following obligations will be extinguished:

a) labour remuneration claims that no other limitation period is provided for;

b) (amended, SG No. 12/1993) claims for damages and penalties resulting from non-performance of contracts;

c) claims for rent, interest and other debts payable annually or at shorter fixed intervals;

According to Article 195 OCA, claims for remuneration in the case of defective goods are subject to a three-year limitation period if the seller has knowingly concealed the defect. This same three-year limitation applies to claims against the issuer of a promissory note or its assignee under Article 531(1) of the Commerce Act, rather than the general five-year limitation under Article 110 OCA.

- **In some cases, a one-year extinctive prescription is laid down:**

- ◆ one year is set to prevent a transaction due to extreme necessity under Article 33 OCA.

- ◆ In addition, one year is provided for certain claims under the Commerce Act. This includes claims for damages under a

⁴² Тълкувателно решение № 103 от 11.IX.1961 г., ОСГК, докладчик Недю Ганчев.

forwarding contract (Article 366 CA), claims under a contract of carriage (Article 378 CA), and claims against the bearer, the grantees, and the issuer (Article 531(2) CA).

- ◆ Furthermore, a one-year period is also applicable to raise action under Article 195 OCA in the case of the sale of immovable property with defects, where the defect was not knowingly concealed by the seller (Article 197 OCA).
- **Six-month limitation periods apply to:**
 - ◆ Claims of the endorsees against each other in cases of bill debt – Article 531(3) CA
- **Limitation periods for actions in tort and in contract**

It must be pointed out that the law provides for separate regimes concerning the length of delays in contract and tort law. The general time limit applies to actions in tort, while actions for damages resulting from a breach of contract have a 3-year limitation period. However, this subject is widely debated and criticized. There are no convincing arguments in favour of separating the time limits in this manner, where the delay for tort actions is longer than the delay for breach of contract actions. Moreover, there are no clear and convincing criteria to justify such a differentiated prescription regime.

3. Commencement of the prescriptive period – point of departure of the delay

The legal regulations that govern the time limits for legal action are indisputably mandatory. The same holds for the rules that determine when the relevant time limit begins. The moment when a right becomes enforceable is used to initiate the prescription period. However, a right can only be pursued in court or before an arbitration tribunal when the debtor is required to perform. This concept of the debtor's obligation to perform is widely recognized and relevant in various situations. For example, according to Article 114(1) OCA, the limitation period generally begins when the debtor is obliged to perform. Thus, the point of departure for extinctive prescription is coupled with the due date and with the maturity of the receivable.

Example 1: The time for A's performance is determined by the contract: February 10th. The period of prescription against B starts to run on that day.

In cases where counterparties have agreed that a right will become due and enforceable after an invitation or notice, the situation is more complex. According to Article 114(2) OCA in conjunction with Article 69 OCA, the limitation period begins on the day the obligation is established. This means that if no due date was stipulated between the parties (which is the case with all extra-contractual obligations), the limitation period starts from the day when the obligation arises.

The reason for this rule is the reluctance of the legislator to allow the starting point of the limitation period to depend on the will of the holder of the subjective right. This is because the holder may decide to send an invitation, which would delay the starting point of the limitation period. The legislator aims to bind the beginning of the limitation period with objective criteria based on event-based accrual, rather than subjective criteria (also known as the discovery rule).

Example 2: The entitlement to receive monetary compensation under Article 59 OCA arises on the day when an unjustified transfer of goods occurs from the property of a person who is impoverished to that of a person who is enriched. This day also marks the beginning of the five-year limitation period for certain types of receivables as per Article 110 OCA.

The right to receive damages for harm caused by another is granted only when all requirements of the rule imposing liability have been met. This means that the right to claim damages arises only when the identity of the perpetrator as a wrongdoer is revealed (as per Article 114(3) OCA). Where the wrongdoer is known, the claim becomes enforceable from the time the tort was committed. Otherwise, the claim becomes enforceable only when the tortfeasor is discovered. The logic behind this rule is that no limitation period may start to run against those who cannot defend themselves.

If new damages occur resulting directly from the same wrongful act, such as worsening of the victim's health, then a new limitation period

will start running, and the starting point of the limitation period for the new damages will be their occurrence and not the commission of the wrongful act.

Furthermore, claims for liquidated damages will begin to run from the last day for which the liquidated damages are assessed, according to Article 114(4) OCA.

3.1. Some cases of special commencement dates

- In case of contracts concluded under suspensive conditions, the limitation period will start running only when the condition is fulfilled and not when the transaction is concluded.
- If it is agreed that the debtor will perform when it is possible to do so, the creditor can ask the court to set a sufficient period, after which the limitation period starts to run.
- When it comes to instances of unjust enrichment regulated under Article 55 OCA, there are different hypotheses to consider concerning the starting point of the limitation period. If the object of performance was received under a void transaction, the limitation period for the action of recovery begins from the moment when the object was delivered to the creditor. Meanwhile, in cases of lapsed ground, the extinctive prescription runs from the emergence of the juridical fact that causes the lapsing of the ground. For instance, this could be the date of contract termination or the day of the entry into force of the decision for the annulment of the transaction, among other examples.
- Where a party is under a continuing obligation to refrain from doing something, the due date cannot be the appropriate moment to commence the limitation period since the creditor's right is due even before the debtor has infringed the obligation. Yet, before such infringement has occurred, the creditor does not normally have any reason to sue the debtor to stop the period of prescription from running. In this case it appears appropriate for the period of prescription to commence not once and for all with the first act of contravention, but with each new act of contravention.

- Only the party with vitiated will, in whose interest the law allows invalidation of a contract, may claim annulment in the case of voidable contract. The law lays down that the right to claim invalidation is limited to three years. The limitation period has different starting points depending on the defect affecting the contract:
 - in the case of incapacity – from the age of majority/termination of guardianship/appointed guardian
 - in case of error and fraud – from their discovery
 - in case of intimidation – from the termination thereof
 - in the remaining cases – from the commencement of the transaction.

3.2. Commencement of the limitation period and the discovery rule

Prescription can effectively amount to an act of expropriation: a right is an asset of the creditor, which loses its value if it can no longer be pursued in court. This is justifiable only if the creditor has previously had a fair chance of pursuing the claim. In Roman times the birth of the right to sue was also known as '*actio nodum natae non praescribitur*', meaning that while an action to sue does not exist, there is no way for prescription. Reflections from this Roman principle in the contemporary legal world can be found in the rule that the period of prescription should only run against a creditor who has the possibility of enforcing the right in court, or of starting arbitration proceedings. Therefore, in the first place, the creditor must know about such right or, at least, ought reasonably to have known about it. Not surprisingly, the rise of the discoverability criterion in different jurisdictions is closely related to the general tendency towards shorter prescription periods. More precisely, there has been a trend towards (i) taking account of the creditor's ignorance concerning a growing range of rights while (ii) reducing the inherent potential of this consideration for delaying the course of prescription by moving from lack of knowledge towards a test

of reasonable discoverability. Hence,⁴³ from a comparative perspective, there is a legislative tendency to recognise the advantages of the so-called subjective system to define when the limitation period will start running. For example, the reform of the law of obligations in Germany introduced a discoverability criterion for the general prescription period. Thus, according to German law prescription starts at the end of the year in which the right comes into existence and the creditor becomes aware or should become aware of the facts giving rise to the right and the identity of the debtor. In contrast, in France, the law on prescription (June 17, 2008) states that for all ‘personal or movable property actions’ (except as otherwise expressly provided for by the legislator), the starting point is the date on which the creditor became aware or should have become aware of the facts that gave rise to the rights (CC Article 2224).

Unfortunately, in Bulgarian legislature the uncertainty associated with a discoverability criterion is regarded as sufficiently serious to make the running of prescription dependent merely on objective criteria.⁴⁴ Yet there are some attempts in case law to correct the often-unfair results following the application of the event-based system to commence the limitation period. Thus, a peculiar example of a subjective starting point for the limitation period is provided through the interpretation of Article 30 of the Inheritance Act.⁴⁵ Notwithstanding the silence of the law

⁴³ See Principles, Definitions and Model Rules of European Private Law – Draft Common Frame of Reference (DCFR). Prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group), Edited by Christian von Bar, Eric Clive and Hans Schulte-Nölke and Hugh Beale, Johnny Herre, Jérôme Huet, Matthias Storme, Stephen Swann, Paul Varul, Anna Veneziano and Fryderyk Zoll (available at: https://www.law.kuleuven.be/personal/mstorme/european-private-law_en.pdf), 1889–1890.

⁴⁴ As a general trend from a comparative perspective, the inclination is towards abandonment of the objective system. It is considered that a relatively short general period of prescription (between 3 and 5 years) should not be tied to an objective criterion (due date; accrual of the claim; delivery; acceptance; completion (of a building); etc). It should depend on whether the creditor knew (or ought reasonably to have known) of the identity of his debtor and of the facts giving rise to his claim (subjective system).

⁴⁵ Delays that are counted ‘from the date the holder of the right knew or should have known the facts to enable it to exercise it’ are regarded as having a subjective starting point.

on the matter, there is no doubt in theory and case law that the right to recover the reserved portion is time-barred. It is extinguished by the expiry of the general five-year limitation period – Article 110 OCA. Concerning testamentary dispositions impairing the reserved portion, the Plenum of the Supreme Court of Justice, in its Resolution No. 7-73, held that the limitation period begins to run from the moment when the person in whose favour the disposition is made ‘exercises his right under the will’. In addition to this example, the prescription of non-contractual rights to compensation for damages caused by another must *de lege ferenda* also depend on knowledge (or reasonable possibility to acquire knowledge). Most probably, the same holds for rights to reversal of unjustified enrichment based on unauthorised use of a person’s assets. For now, however, our legal system is not ready to swallow the subjective criterion and to take the knowledge and discoverability test.

4. Suspension of Prescription

The legal principle of suspension of prescription, *contra non valentem agere non currit praescriptio*, derived from Roman law, is widely used in Europe. It means that prescription does not run against individuals who are unable to act. This rule was developed by the jurist Bartolo de Sassoferrato in the 14th century to benefit individuals such as minors, disabled people, people in absence due to wars or other reasons, and more. The principle reflects the legal policy underlying the legal rules governing all grounds of suspension and interruption of the limitation period. It recognizes that time does not have the same value for everyone and that interruption and suspension serve to temper the blind and objective periods of prescription.

4.1. Differences between suspension and interruption of prescription

Civil law systems traditionally distinguish between ‘interruption’ and ‘suspension’ of a period of prescription. If the period of prescription is interrupted, the time elapsed prior to the interrupting event is not taken into account: the period of prescription begins to run afresh. In the event of suspension, on the other hand, the period during which the prescription is suspended does not count towards the total prescriptive period: when

the cause of suspension ends, it is, therefore, the old prescription period that continues to run its course. Of course, this is so unless the period of prescription had not commenced, in which case it will start to run only after the cause of suspension has ended.

4.2. Suspension of the prescriptive period

According to Article 115 OCA, certain events and circumstances can suspend the extinctive prescription. Once the suspensive event ceases to exist, the old prescription will continue to run from the point it was suspended.

The list of suspensive grounds is exhaustive⁴⁶ and includes various impediments that are beyond the creditor's control and prevent them from pursuing their right in court. This means that the suspension of prescription leads to an extension of the extinctive period, as long as the period during which the prescription is suspended is not counted in calculating the period of prescription. However, our legislation has a limitation in this regard, as the narrowly limited grounds for suspension, regulated through Article 115 OCA, make it impossible to rely on the principle of *contra non valentem*.⁴⁷ As a result, the prescription still runs and will not be suspended in many cases where the creditor is unable to act due to an impediment resulting from the law, agreement, or force majeure.

⁴⁶ See Тълкувателно решение № 3 от 22.04.2019 г. по тълк. д. № 3 / 2016 г. на Върховен касационен съд, ОСГТК; Решение № 153 от 09.10.2015 г. по т. д. № 2304/2014 г. на Върховен касационен съд, 1-во търг. Отделение.

⁴⁷ Some codes have rules suspending prescription where it is factually impossible for the creditor to pursue the claim. In Germany, the creditor must have been prevented from exercising the right as a result of *vis major* (höhere Gewalt) (CC § 206), 'cessation of the administration of justice' being an example. The same is valid for Slovenian law (LOA Article 360). Greek law (CC Article 255, 1) is virtually identical and so is Portuguese law (CC Article 321). Also Articles 121–15 of the First Law of the Catalan Civil Code upholds the suspension of the prescription period due to force majeure. For more details, see Principles, Definitions and Model Rules of European Private Law – Draft Common Frame of Reference (DCFR). Prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group), Edited by Christian von Bar, Eric Clive and Hans Schulte-Nölke and Hugh Beale, Johnny Herre, Jérôme Huet, Matthias Storme, Stephen Swann, Paul Varul, Anna Veneziano and Fryderyk Zoll (available at: https://www.law.kuleuven.be/personal/mstorme/european-private-law_en.pdf), p. 1164.

According to the mandatory rule formulated in Article 115 OCA, the limitation period will not run:

- between children and parents as long as the parental authority continues;
- between persons under guardianship or custody and their guardians or custodians as long as the guardianship or custody lasts;
- for claims of one spouse against the other – while the marriage lasts;
- for claims of persons not possessing full capacity for legal acts against persons performing guardianship or curatorship while such persons are guardians or curators;
- for claims for damages to legal entities against their managers as long as the latter are in office;
- for claims of minors and persons under interdiction for the period when they have no legitimate representative or custodian appointed, and six months after such a person is appointed or after the legal incapacity is terminated;
- for the duration of the trial on the claim. A creditor who institutes an action to assert the right does what the law of prescription expects: the creditor takes the initiative to bring about an authoritative resolution of the dispute. It would be manifestly unfair if the period of prescription were to continue to run while judicial proceedings are pending.⁴⁸ In this case, if these proceedings lead to a judgment on the merits of the claim, there are two possibilities. Either the claimant succeeds, in which case the right is established by legal proceedings and thus subject to new prescription (as per Article 116 OCA); alternatively, if the action is dismissed, then it is authoritatively settled that there is no right that could be subject to prescription. Where the proceedings end without a decision on the merits (because the action is procedurally defective, or because it has subsequently been withdrawn), the creditor has what remains of the old period of prescription to bring a new action.

⁴⁸ Решение № 62 от 31.07.2019 г. по т. д. № 1824 / 2018 г. на Върховен касационен съд, 1-во търг. отделение.

If the limitation period expires while the creditor or the debtor is mobilised in the military forces, the action may be brought within six months after their demobilisation.

5. Interruption of the prescriptive period

Compared to suspension, the interruption of a limitation period usually occurs due to a more radical event that leads to the renewal of the limitation period. Once there is a cause for interrupting the limitation period, the prescription starts again. Renewal is a significant change to the period of prescription, as opposed to its suspension. In Bulgaria, the interruption or renewal of a prescriptive period is regulated through Article 116 OCA. This Article exhaustively lists the grounds leading to interruption following the legislative idea that the law should only interfere with the running of the prescriptive period to the extent that it is essentially necessary for the protection of the creditor. According to Article 116 OCA, the limitation period will be interrupted upon acknowledgement of the debt by the debtor, upon lodging of a claim or objection or of an application for conciliation. However, if the claim, or objection, or application for conciliation is not upheld, the limitation will not be deemed interrupted. Lastly, the limitation period will be interrupted upon undertaking of enforcement action. However, inconsistent interpretations of the wording of Article 116 OCA have caused significant difficulties in both doctrine and legal practice regarding the application of all these grounds for interruption of the prescriptive period. This requires a separate examination of each cause for interruption of the limitation period.

5.1. Acknowledgement of the debt

In the first place, the limitation period will be interrupted upon acknowledgement of the debt by the debtor or the person respectively entitled to do so, such as a representative either under law or a voluntary representative. Furthermore, the person who allegedly recognizes the opposing party's right must have the capacity to bind the party on behalf of whom he purports to act.

Acknowledgement of the claim within the meaning of Article 116(a) OCA by its nature constitutes a unilateral expression of the debtor, by which the latter acknowledges the existence of the creditor's right and his counter-obligation, and not only the factual composition from which they arise. Whether an acknowledgement should have the effect of interrupting prescription was disputed under the *ius commune* but is generally accepted today. Some legal systems require the acknowledgement to be in writing. The argument is that this format promotes legal certainty. In Bulgaria, however, an informal acknowledgement (which may be either express or implied) is regarded as sufficient. To legally prove that a prescription has been interrupted, the creditor who would benefit from it, must provide evidence to the court of the debtor's clear and unambiguous intention to acknowledge their right and, therefore, relinquish the advantage of the time that has already passed.

Example 1: A owes B 400 euro. B's obligation to pay that sum is due on October 10th, 2005. On October 5th, 2008, B paid part of the sum and confirmed that he would pay the remainder as soon as he could. As a result, on October 5th, 2008, a new three-year period starts to run for the remaining debt.

Of course, it may sometimes be difficult to interpret the debtor's conduct but these difficulties can be resolved, as with all declarations or other conduct which may have legal relevance, by having recourse to the general rules of interpretation. Thus, according to case law, the mere acknowledgement of the factual constituent is not equivalent to the acknowledgement of the consequences arising therefrom.⁴⁹ As the Court stated, an offer to settle a debt, in and of itself, is not sufficient to interrupt prescription.

A debtor who acknowledges the right does not require the protection granted by prescription. Protection must, on the other hand, be granted to the creditor who may rely on the debtor's acknowledgement and refrain from instituting an action. This poses the question of whether the acknowledgement should be directed towards the creditor or this is not

⁴⁹ See Решение № 200 от 23.12.2019 по дело № 3779/2018 на Върховен касационен съд, 4-то търг. отделение.

necessary. In my opinion, legal certainty is safeguarded sufficiently if the law is interpreted as requiring acknowledgement of the right to the creditor. The latter cannot reasonably rely on an acknowledgement to a third party. This might well be based on considerations arising from the relationship between the debtor and such third party and is not sufficient evidence of any clear recognition of obligation towards the creditor. In general, this is the position shared by the majority of Supreme Court Judges in Interpretative Decision No. 4/2019 of 14.10.2022 which holds as follows: For the limitation period under Article 116(a) OCA to be interrupted, ‘the statement or act of the debtor in which the acknowledgement of the claim is contained must be addressed to the creditor or to his representative in such a way that, in the circumstances given, it is normal for the acknowledgement to reach to the creditor’s knowledge.’

5.2. Lodging a claim or objection to assert the right subject to prescription

According to Article 116 OCA, lodging a claim or objection⁵⁰ will secure interruption of the limitation period. The same effect can be achieved by applying a conciliation procedure. This means that in all these cases, the period of prescription stops running and is interrupted.

However, it is odd that the act of bringing action should renew rather than suspend the prescription period. By initiating legal action, the creditor sets in motion court proceedings that last until a decision is made or the case is otherwise resolved. It’s not a momentary event that could sensibly extend the original prescription period, but a continuing process. After the legal proceedings, there is usually clarity about the merits of the claim. If there’s no decision made, there is no reason to renew the entire period of prescription. For this reason, Article 116 OCA states that if the legal proceedings end without a binding decision, it is presumed that the limitation period will continue to run during the proceedings. On the other hand, if the claimant wins, the right will be

⁵⁰ See **Богданова, И.** Предявяването на иск и възражение като основания за прекъсване на погасителната давност по чл. 116 ЗЗД. // Търговско и облигационно право, 2022, № 2.

established through legal proceedings and thus subject to a new five-year prescription period, as per Article 117 OCA.

Article 116a OCA (State Gazette No. 42/2018) introduces a new provision which states that if a claim is asserted in part, the limitation period will only be suspended or interrupted for the part asserted. Therefore, in the case of a partial claim, the limitation period will only be interrupted for the part of the claim that was asserted and upheld. The part of the claim that was not asserted remains outside the subject matter of the action and the limitation period for that part will continue to run. This also applies when the partial claim is increased under Article 214(1) of the Civil Procedure Code. By increasing the claim, the claimant asserts the remaining part of the claim that has not been the subject of the proceedings up to that time. When the claim is increased, the limitation period is suspended and interrupted by the filing of the application under Article 214(1) and (2) of the Civil Procedure code.

5.3. Renewal of prescription because of enforcement

Lastly, according to Article 116 (3) OCA interruption of extinctive prescription will occur as a consequence of acts of execution taking place within the enforcement proceedings. This is possible when the creditor has obtained a judgment that has become enforceable, or any other instrument, which is enforceable under the law under which it was made. Normally, the attempt at execution will be effected by the application of the creditor by a court or public official. It is then sufficient that the creditor has made the application, as long as such application is not invalid or is not withdrawn before the act of execution has been attempted. After the commencement of enforcement proceedings, it is considered that by undertaking a single executive action the prescription is interrupted. However, not all actions directed against the debtor during executive proceedings result in the renewal of the limitation period. The interruption of the extinctive prescription occurs as a result of valid executive methods such as public sale, imposing foreclosure, distraint (attachment) of earnings and debts and so on. Hence in case law, it is commonly accepted that. Hence in case law, it is commonly accepted that the commencement of enforcement proceedings, the sending of notice for voluntary performance, the

investigation of the debtor's assets and so on are not enforcement actions and consequently do not interrupt the limitation period.

Where the claimant, i.e., the creditor, has not requested enforcement actions for two years, the executive proceedings are deemed terminated automatically (*ex lege*). In this case, it is arguable whether the new limitation period will start running from the execution of the last enforcement method, or with the peremption of the proceedings all executive actions should be considered invalid with retrospective effect.⁵¹

5.4. Duration of the limitation period after the interruption

When a limitation period is interrupted, a new period starts. The duration of the new period is the same as the previous one. However, if the claim was established by a court, the new limitation period is always five years. The reason for this is that a right established by a court decision is considered to be firmly established and less likely to be affected by time. Furthermore, it shows that the creditor is serious about pursuing the claim and the debtor knows that payment is still required. A legal dispute between the parties has been resolved and there is no uncertainty or danger to the public interest. A declaratory judgment is sufficient, as long as it establishes the right and not just one of its prerequisites. The new prescriptive period starts at the moment when *res judicata* is obtained.

6. Effects of extinctive prescription.

6.1. Prescription – a substantive or material institute?

One of the most debated issues in Bulgarian civil doctrine is the effect of extinctive prescription on subjective rights. There are two conflicting theories – the substantive and the procedural theory.⁵² These theories offer different answers to the question of what happens when a subjective

⁵¹ See Тълкувателно решение № 2/2013 от 26.06.2015 г. на Върховен касационен съд.

⁵² See Таджер, В., Цит. съч., с. 349 и сл.; Яновски, Б. – В: Лекции за следдипломна специализация на юристи от Софийски университет, Юридически факултет, София, 1971, № 5, с. 167.

right is extinguished by prescription. According to the substantive theory, the right is affected by the lapse of time and is eventually extinguished. However, the procedural theory suggests that limitation does not affect the right itself, but only the ability to pursue it in court. In other words, the object of temporal limitation is the action, making prescription a matter of 'limitation of actions'. This procedural understanding is not new and until the 19th century, *longi temporis praescriptio* was usually related to the right to sue in the civilian tradition.

Agreeing with the first theory concerning the effect of the limitation period will mean that the substantive law has provided a special prerequisite for the admission of action regulated by the Procedural Code. This will also result in the absurd situation where the expiration of the statute of limitations and the invocation of the statute of limitations terminates the procedural right of action, but not the substantive right of action. Because there is no such right, any claim brought in this context must be dismissed as unfounded.

To avoid contradictions in defining the effect of the limitation period, it is helpful to consider it from the debtor's perspective rather than the creditor's. The lapse of time does not affect the creditor's subjective right but creates a relative right. This right allows the debtor to lawfully deny performance. However, after the prescription has occurred, what remains of the obligation is often called a *naturalis obligatio*. This term is used in legal systems that assume that the obligation is extinguished, as well as those that believe the obligation continues to exist.

This paper argues that following expiry of the period of prescription, the debtor can refuse performance unless they have waived the right to rely on the prescription. This means that prescription serves as a defence on the level of substantive law. The application of the statute of limitations is on the merits of the case and, therefore, is an institute of substantive, not procedural law. This explains why if the debtor invokes it, it is their responsibility to establish the requirements of that defence, and the central requirement is that the period of prescription applicable to the right has elapsed, which depends on the date of commencement. Moreover, prescription does not operate automatically and the rules of

extinctive prescription are not applied *ex officio* by the court, as stated in Article 120 OCA. The bona fide requirement is the purported basis on which the prescription is to be alleged by the party who wants to benefit from it.⁵³ As a result, a judge cannot award a prescription without this previous allegation. Therefore, if a party does not invoke it, there is no prescription.

Another effect of extinctive prescription is that a debtor who has paid despite the prescription having occurred, has paid on legal grounds and should be unable to recover. Whether the debtor was aware of the fact that the prescription had occurred or not is irrelevant. The debtor who did not know that the prescription had occurred still cannot recover what has been paid. There is no reason for a legal system to protect a debtor who is willing to pay and who can thus be taken to acknowledge the obligation to do so, and the public interest (*ut sit finis litium*) is not adversely affected if a debtor is allowed to pay even after the period of prescription has run out. On the contrary, it would be detrimental to public peace if the debtor were allowed to reclaim the payment made. Once payment has been made, even after prescription has occurred, the matter must be regarded as settled.

6.2. Effect on ancillary rights

According to Article 119 OCA, the period for claiming interest or any other related rights expires at the same time as the period for the principal claim. This is because the purpose of prescription is to prevent litigation over old claims, both for the benefit of the public and to protect the debtor. Allowing the creditor to sue the debtor for interest on an expired claim would go against this policy. This rule also applies to other ancillary rights, such as emoluments and costs. Therefore, it is necessary to have a rule that these rights expire with the principal claim, even if their prescription period has not yet run out.

⁵³ See Решение № 40 от 20.07.2017 г. по гр. д. № 2874 / 2016 г. на Върховен касационен съд, 1-во гр. отделение.

6.3. Effects of extinctive prescription on set-off

A right concerning which the period of prescription has expired may nonetheless be set off. This is regulated through the provision of Article 103(2) OCA. A right that is prescribed can no longer be enforced. But it may still provide a valid basis for a right of set-off. Several codifications contain rules to the effect that the right of set-off is not excluded by the prescription of the cross-claim, provided it could have been set off against the principal right prior to expiry of the limitation period. The policy of these rules is to preserve a right of set-off that has once accrued, even though set-off has not been declared at that stage.

CHAPTER 7:

GENERAL REMARKS ON AGENCY IN CIVIL AND COMMERCIAL LAW

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ABSTRACT	KEY WORDS
This chapter aims to present the main features of agency as a legal mechanism and the ‘authority’ of one person – the representative – to affect the principal’s legal position. After a brief historical review, the term of ‘agency’ is defined as the ability of one person to perform legal acts on behalf of another person with a direct effect on the represented person, i.e., the principal. The topic of representative authority and the different types of agency is addressed, with a particular focus on voluntary representation and the legal effects of the power of attorney. Additionally, the issues that arise from self-contracting, acting to the detriment of the principal, and delegation of authority are also discussed.	agency, voluntary representation, letter of attorney, self-contracting, misrepresentation, ratification

I. HISTORICAL OVERVIEW

Surprisingly, agency is among the few legal figures where the civil law tradition does not rely on the inspiring foundations of Roman law. Indeed, the modern law of agency developed largely in opposition to the situation in Roman law and the famous principle ‘*Alteri stipulari nemo potest*’. Roman law did not recognise direct representation or in general the ability to stipulate on another’s behalf. This might be attributed partly to the formal character and nature of legal proceedings and transactions in Roman law. In early Roman law, legal acts were a strictly material and exclusively personal connection (obligation) between the contracting

parties participating in the special conclusion ritual, generating legal effects only on them.

Later on, economic development and diversification of commercial activity combined with the need to facilitate the conclusion of contracts required reconsideration of the principle '*alteri stipulari nemo potest*'. Gradually certain situations were recognised in which one person could act through a middleman. Nevertheless, the comprehensive legal institute of agency was never developed in Roman law.¹

2. Evolution of the modern concept of agency

The need to expand commerce has been among the most important factors for the recognition of agency in modern times since the Middle Ages. Gradually the prohibition to contract on another's behalf was abandoned – first in upper Italian city-states and the Dutch jurisprudence. Thus, it is not surprising that natural lawyers were those who broke away decisively from the principle *alteri stipulari nemo potest* and laid the essential cornerstones for the future. It took scholars and legal practice some more decades to distinguish the mandate as a separate figure from representation. Following the Roman tradition of mandate, older European codifications do not distinguish between the internal relationship between representative and principal on the one hand, and the external relationship between principal and third party on the other hand. This separation has, however, been developed in these countries by legal writers. This happened firstly in Germany thanks to the effort of some eminent scholars belonging to the Pandectist school of law. This is how the distinction between the external and the internal relationship has come into place since the start of the 20th century. The rules on representation govern the relationship between principal and third party whereas the internal relationship between principal and representative is regulated by contract law in general.²

¹ For more details on the historical development of the institute of agency, see **Zimmerman, R.** *The Law of Obligations. Roman Foundations of the Civilian Tradition*. Cape Town, Wetton, Johannesburg, Juta & Co Ltd., 1992, 45–58.

² For more comparative issues on agency, see *Principles, Definitions and Model Rules of European Private Law - Draft Common Frame of Reference (DCFR)*. Prepared by the Study Group on a European Civil Code and the Research Group on EC Private

In Bulgarian, it is the Obligations and Contracts Act (OCA) that governs representation as an institute, specifically Articles 36 to 42. These rules mainly address the impact of actions taken by a representative or purported a representative, on the legal position of the principal or purported principal with regard to third parties. However, some of these articles also cover the impact of an act of representation or purported representation on the legal position of the representative or purported representative with a third party.

II. DEFINING AGENCY IN BRIEF

Agency, as we see it today, refers to a situation where one person (the agent) authorised by a third party (the principal) concludes a transaction on behalf of the latter with another person, with the result that such transaction takes effect between the principal and this other person.³ Hence agency or representation is the ability of one person to perform legal acts on behalf of another person with a direct effect on the represented person (the principal).⁴ Where an authorised agent enters into a contract with a third party on behalf of the principal, the contract is enforceable by both the principal and the third party against each other. The ‘authority’ of the representative is the power to affect the principal’s legal position. The ‘authorisation’ of the representative is the granting or maintaining of such authority. It is important to note that the agent does not become party to the contract.

Example 1: A, who acts as the representative of B, buys a car from C on behalf of B.

Law (Acquis Group), Edited by Christian von Bar, Eric Clive and Hans Schulte-Nölke and Hugh Beale, Johnny Herre, Jérôme Huet, Matthias Storme, Stephen Swann, Paul Varul, Anna Veneziano and Fryderyk Zoll (available at: https://www.law.kuleuven.be/personal/mstorme/european-private-law_en.pdf), p. 438 et seq.

³ Beyond the scope of the present chapter are the problems, arising from the internal relationship between principal and representative.

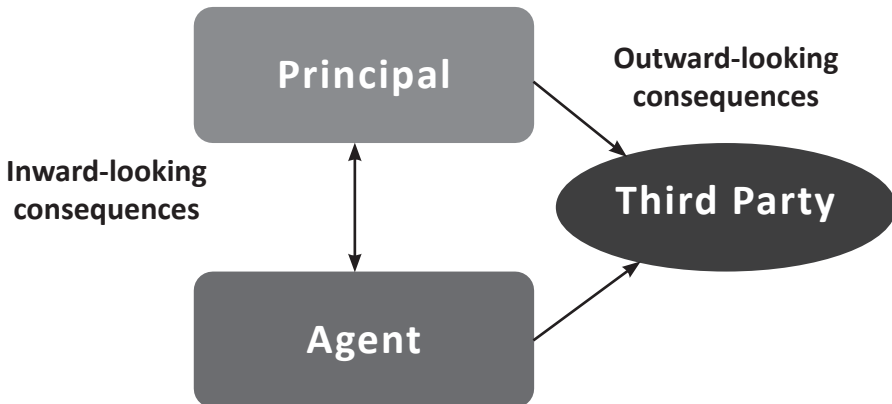
⁴ For profound research on agency, see **Таков, Кр.** Доброволно представителство. София, Сиби, 2023, с. 560.

Example 2: B who is a shareholder in Agrica will represent C who is also a member of the company but is currently on vacation with his family.

Example 3: Between A and B there is a legal dispute concerning their shares in an existing co-ownership. A entitles C, who is a lawyer, to act on his behalf during court proceedings.

1. Types of relations in terms of representation

Agency: A Tripartite Relationship



Within representation as a legal mechanism, we have at least three participants – principal, representative and third party where: ‘representative’ or ‘agent’ is a person who has been granted the authority to affect the legal position of another person, i.e., the principal, concerning a third party by acting on behalf of the principal. The ‘principal’ is the person on whose behalf and in whose name the representative acts, and the ‘third party’ is a legal entity or natural person other than the principal and the representative. In certain situations, however, known in the law of agency as ‘self-contracting’, the third party might be the representative itself when the latter, while acting for the principal, also acts in a personal capacity as the other party to the transaction.

- Agency may arise from express or implied contract or unilateral act, by operation of law or by judicial act. This act is usually referred to as an internal relationship. The present chapter does not deal with how a principal may grant authority.
- Under representation we mean the external relationships created by acts of representation – that is to say, the relationship between the principal and the third party.
- No relation is created between the third party and the representative.

2. Restrictions on the scope of application: acts unsusceptible to representation

- Rules on representation only apply to legal acts and not factual (*de facto*) actions. For example, no one can act on another's behalf when exercising possession over movable or immovable property. Representation also does not apply to wrongful acts.
- Moreover, there are certain legal acts where the law permits only personal acts and does not allow representation. One such is marriage, the drawing up of a will, concluding a marriage contract, adoption, the father's voluntary acknowledgement of a child born out of wedlock as his own, the conclusion of a divorce agreement and so on. If these juridical acts are concluded via a representative, they are null and void.
- The rules on the authority of representatives in OCA are not intended to be used, or used without modification or supplementation, regarding representatives appointed by public or judicial authorities to perform public law functions.
- There is no representation when another person simply communicates to another a message sent by a third party. A representative makes a declaration of will and concludes a transaction on behalf of another person; a messenger, just like a 'live letter,' conveys someone else's declaration of will.

III. FORMATION OF REPRESENTATIVE AUTHORITY

According to Article 36 OCA a person may represent another by virtue of law or by the will of the principal. This essentially means that authority may be derived from the will of the principal⁵ (express or implied) or the law. In the first case, the formation of representative authority usually relies on the existence of a power of attorney as a unilateral act, while in the second case, representative power is obtained by virtue of law.

1. Representation by virtue of law

The representative may derive authority from a rule of law. Under Bulgarian civil law representation by law applies to minors and persons under full interdiction, as well as to legal entities. ‘Compulsory’ representation or representation by operation of law occurs also when a person is empowered to represent another person by a judicial act. In this respect, the representative authority granted to the guardian or the liquidator is based upon the law or a judicial act for appointment.

If a representative is granted authority by a special provision of law, the extent of their authority concerning third parties is also determined by law. In such cases, there is no need to assess validity or obtain any further authorisation.

1.1. Representation of companies⁶

The authority of company representatives in dealings with the outside world is one of the most important practical applications of the rules on representative authority. This is because companies can engage in juridical acts only through representatives.

Representation of companies in Bulgaria is also sometimes referred to as a special type of representation by law, i.e., representation through management and control bodies of the company. The company’s

⁵ Решение № 48 от 10.06.2021 г. по гр. д. № 3001 / 2020 г. на Върховен касационен съд, 2-ро гр. отделение.

⁶ The authority of directors and other company officers in the internal affairs of a company is not intended to be covered by the present chapter.

representatives are certain corporate bodies authorised to acquire rights and make commitments in the company's name that are binding on the company, as well as to act before courts and other authorities on behalf of the company. For example, the directors of a company may have authority by law to bind the company or otherwise affect its legal relations. Partners may have a similar authority to act as representatives of the partnership. In all these cases representative power usually arises from the mixed composition of facts including the election of a person (being nominated and elected by the General Meeting) combined with the entry of this fact in a special register, i.e., the Commercial Register; such entry has constitutive effect as to the creation of representative power concerning third parties. Registration in the Commercial Register requires notary certified consent along with a signature specimen.

It must be pointed out that according to the Supreme Court of Cassation⁷ and legal practice, corporate bodies form and express the will of the corporation concerning third parties. Corporate bodies coincide with the legal entity itself. Therefore, the will of corporate bodies can be regarded as the will of the legal entity and their acts are deemed to be acts of the legal entity. In the case of legal persons, the processes of will formation and will expression are separate and fall within the competence of different bodies. Corporate bodies are not an independent subjects of law and act in accordance with statutory competence, exercising representative functions as part of their powers as a body of the company. That is why when a person acts as a corporate body of a company, they are considered to express the will of the legal entity itself.

Example 1: A is the appointed manager in the limited liability company X. The relationship between the manager and the company is regulated by a contract which is the internal relation. If A, acting as the manager of X (limited liability company), concludes a purchase contract with B, then the contract will be binding directly for the company.

⁷ See Тълкувателно решение 3/2013 от 15 ноември 2013 г. по тълк. дело № 3/213 на Върховен касационен съд.

Example 2: In a joint-stock company, we have two possible management structures: the board of directors, resp. management and the supervisory board (all permanent bodies of the joint stock company) who are entrusted with the management of the company. General rules concerning the two management systems are contained in Articles 233 to 240 of the Commerce Act. The term of office is limited to 5 years, but there is no regulation regarding the number of mandates. Regarding decisions, a quorum of half of the participants is required; a smaller quorum is not permitted. Resolutions are made by a simple majority of the directors present. These bodies are collective; natural persons as well as legal entities may participate. Each management body has a defined number of participants. The relationship between the company and the members of company bodies are regulated by a management contract.

1.2. Voluntary representation. Letter of attorney.

The principal may grant representative authority expressly or impliedly. Implied authority refers to an agent's power to act on behalf of a principal without express authorisation from that principal. In such cases, the granting of authority must be implied from the circumstances. This manner of granting authority plays an important role in practice. Usage and practices are often very important in deciding whether a principal has impliedly granted authority to a representative. The appointment of a person as an agent of a certain type may, by usage, or by practices established between the parties, confer on that agent authority to act as the principal's representative concerning certain types of legal transactions.

Example 1: A bank that employs X in its sales department impliedly authorises X to transact any business relating to the bank sales department and to bind the bank by any such transaction.

Besides implied, representative authority may be granted expressly through a unilateral expression of will, known as a 'power of attorney'. The general rules on contracts and other juridical acts apply to powers of attorney, including the rules on formation, interpretation and grounds of invalidity. These general rules are also relevant to contracts concluded, or

acts performed, by the representative on behalf of the principal when the authorisation is granted through a power of attorney.

V. DEFINING POWER OF ATTORNEY AND ITS LEGAL EFFECTS

1. What is power of attorney?

In the heart of voluntary representation is the power of attorney (POA) where the term refers to a unilateral legal act creating authorisation that gives a designated person the power to act on behalf of someone else. As such, a POA gives the agent the authority to act on behalf of the principal. The agent may be given broad or limited authority. The power of attorney is a unilateral legal act where only the principal expresses his will (only the principal signs the power of attorney). The representative is not obliged to execute the powers granted thereto unless there is a contract between the principal and the attorney (for example a mandate). That is why the power of attorney might be (and often is) accompanied by a contract governing the internal relationship between the principal and the representative.

As a document, the power of attorney grants and confirms the right of the person named in it (agent, representative) to perform, in the name and on behalf of the principal (the person who issued the document), specific legal actions, including dispositive ones, representing the authoriser before persons, organisations and institutions.

1.1. Essential elements of the power of attorney

- **Declaration of will**

A power of attorney is a legal document that allows someone to act on behalf of another person or legal entity. To create a power of attorney, the grantor must make a clear declaration of their intention to be represented. The document must include details such as explicitly granted powers, the identity of the principal and the representative, and the relevant date and signature. The extent of the representative's powers depends on the grantor's expressed will. In general, a representative has the power to enter

into contracts with third parties on behalf of the principal. However, there may be classes where representative authority is more limited. The scope of the agent's authority concerning third parties is determined by what the principal has expressed in the power of attorney. If several people are authorised to perform a certain act, each one of them may perform the act alone unless the authorisation specifies otherwise. A standard form listing the powers of a representative of a certain type may be used to grant express authority. The use of such standard forms has many advantages for all parties involved. The power of attorney may be valid for a certain period or be issued without a fixed term and may apply to certain acts or be more general.

- **Declaration of will susceptible to representation**

In principle, all rightful juridical acts may be concluded through representation. However, there is a certain group of activities, as mentioned above, where representation is not applicable. For instance, there can be no representation in civil offence (tort/delict). For example, A cannot appoint B as his representative to burn down C's house or to murder. Moreover, certain rightful acts are also not susceptible to representation because the law permits and requires only personal acts. Some such examples are declarations of future spouses regarding their intention of getting married, the father's voluntary acknowledgement of a child born out of wedlock as his own, declaration of adoption, and the drawing up of a will. If those juridical acts were concluded via a representative, they would be void.

2. Formal versus informal power of attorney

In giving express authority to the representative, no particular form needs to be observed unless otherwise provided by law. Exception in most national jurisdictions are cases where the granting of authority must fulfil the formal requirements prescribed for the authorised act. For example, in Bulgaria, according to Article 36 OCA authorisation for the conclusion of contracts, for which the law requires a specific form, needs to be made in that particular form. However, if the contract must be concluded in the form of a notary deed, the authorisation may be in writing with a notarized signature and notarized content of the document (Article 37 OCA). Failure

to comply with the mandatory form of power of attorney results in its nullity as a unilateral act whereby no valid representative power will be created.⁸ In contrast, the case law of the Supreme Court of Cassation clarifies that when Bulgarian law requires the transaction to be by notary deed, and the power of attorney for the sale of immovable property is issued abroad, it is not necessary for the authorisation to be performed by notarized signature and content, executed simultaneously, according to the requirements of Article 37 OCA, provided that the form of authorisation with such powers in the respective country is complied with.⁹

Example 1. If you want to buy or sell a car in Bulgaria but are unable to personally conclude the purchase contract (which contract needs to be in writing with notarized signatures of the parties) you have to sign a power of attorney before a notary – with notarized signature.

Example 2: If you want to buy or sell a house in Bulgaria but are unable to personally conclude the purchase contract (which contract needs to be in the form of a notary deed), you have to sign a power of attorney before a notary – with notarized signature and notarized content.

3. Legal effect of the power of attorney. Exercising representative power.

Where valid representative power is established (granted by the sole will of the principal or by law) then the effects of the legal acts performed by the agent will arise directly for the principal (represented person) thus altering the legal position of the latter.¹⁰ This means that the representative's acts directly affect the legal relationship between the principal and the third party but do not give rise to any legal relation between the representative and the third party. Nevertheless, this legal effect occurs only if the agent

⁸ Решение № 50021 от 22.06.2023 г. по гр. д. № 443 / 2022 г. на Върховен касационен съд, 3-то гр. отделение.

⁹ See Решение № 67 от 06.04.2020 г. по гр. д. № 2151 / 2019 г. на Върховен касационен съд, 4-то гр. отделение.

¹⁰ Решение № 108 от 05.12.2019 г. по т. д. № 2862 / 2018 г. на Върховен касационен съд, 1-во търг. отделение.

makes a declaration of will in the name and on behalf of another person, i.e., the principal.

It should be clear that the juridical act concluded by the representative is another person's transaction¹¹ i.e., the principal's. In some jurisdictions, this is referred to as the 'intention of representation', which is crucial when estimating the binding effects of the representative's acts on behalf of the principal.

The fact that the representative concludes the transaction in the name of the principal is sometimes expressly stated and other times is inferred from the circumstances.¹² To estimate the existence of this element we use the test of what the third party knew or was supposed to know.

Example 1: The employees in an auto repair shop conclude agreements with the customers regarding car repairs act in the name of their respective employers (the businessman operating the store or the owner of the car repair shop) even though no special mention of this is made to the customers during the respective transactions (tacit or implied representation).

Moreover, the declaration of will made by the representative affects the principal's legal position only when made within the bounds of the authority of representation conferred. As mentioned above, in the case of legal representation, the scope of representative authority is determined directly by the law, whereas in the case of voluntary representation – by the power of attorney or the underlying legal relationship between the representative and the principal. If the exercise of representative authority exceeds the above-mentioned boundaries, the provisions of the law regarding false representation will apply.

¹¹ Meaning that the representative has openly acted as such.

¹² Решение № 108 от 05.12.2019 г. по т. д. № 2862 / 2018 г. на Върховен касационен съд, 1-во търг. отделение.

4. Types of powers of attorney

The type of power of attorney determines the scope and limitations of the powers awarded. The POA could refer to healthcare decisions in the future, managing of real estate transactions, or assigning financial responsibilities. This is why legal theory and practice recognises different categories of powers of attorney.

- ***General and Specific Power of Attorney***

Generally, the scope of a representative's authority is defined by the principal's statement and its interpretation. Depending on the extent of representative authority, the power of attorney may be general or specific.

- a. The power of attorney is **general** when it refers either to all or a group of the principal's transactions. It must be pointed out that for some transactions (e.g. sales contracts, loans, donations, mortgages) a general authorisation is not enough unless the type of transaction is specifically defined in the grant of authorisation or at least there is a general authority for concluding acts of dispositions as well as acts of administration.

Example 1: I hereby authorise A to represent me before all state and municipal bodies, banks, natural persons and legal entities concerning the establishment of a limited liability company on my behalf.

Example 2: I hereby authorise A to represent me before the traffic police to register my car.

- b. A power of attorney is considered specific when it refers to a particular juridical act of the principal, a certain type of transaction, or a specific kind of act. For example, a power of attorney may authorise X to vote in the General Meeting of Shareholders to be held on January 3rd, 2023.

- ***Individual and Collective Powers of Attorney***

A power of attorney can be individual or collective, depending on whether one or more representatives have been appointed.

- a. The power of attorney is individual when only one ‘attorney’ is appointed.
- b. The power of attorney is collective when more persons are appointed as ‘attorneys,’ acting either separately or jointly.

- ***Active and Passive representative power***

- a. Representation is active when the representative makes a declaration of will in the name and on behalf of the represented (principal).

Example 1: A, as the representative of B, declares to C that he will sell B’s car.

- b. Representation is passive when the representative only receives declarations of will addressed to the represented (principal).

- **Time-limited power of attorney**

The power of attorney may be time-limited or without a set term. For example, it can be valid until a certain date, such as the end of 2019.

VI. SELF-CONTRACTING AND DUAL REPRESENTATION (ARTICLE 38 OCA)

Both self-contracting and dual representation can lead to the abuse of representative power. This is because in both cases, there is only one subject's will, which results in two legal manifestations that are economically opposed. Self-contracting occurs when a representative acts as a party on their own behalf and on behalf of the principal at the same time. Dual representation occurs when a contract is signed between two distinct parties, and both parties are represented by the same person after the contract. This is also known as multiple representation.

In Bulgaria, attorneys and representatives are generally not allowed to represent themselves or two conflicting parties unless there is an explicit clause in the power of attorney that allows such representation. Article 38 OCA states that an attorney cannot negotiate on behalf of the principal with themselves or with another person who is also represented by the same attorney unless the principal has given prior approval for this.¹³ Alternatively, the authorisation for self-contracting may be obtained from the principal through subsequent approval.¹⁴

The main purpose of this restrictive legal regime is to prevent any conflicts of interest between the representative and the represented parties. Therefore, if the principal explicitly authorises the attorney to negotiate on behalf of both parties, there will be no conflict of interest. In addition, this prohibition prevents the authorised person from gaining an unfair advantage at the expense of the principal.

Example 1: If A who is a real estate agent represents both the buyer and the seller in a real estate transaction there is dual representation. It can also occur when an agent represents both the landlord and the tenant, or when the same real estate company represents both parties in a purchase and sale or rental transaction.

¹³ Решение № 60149 от 19.07.2021 г. по т. д. № 2376 / 2019 г. на Върховен касационен съд, 1-во търг. отделение.

¹⁴ Решение № 99 от 30.06.2022 г. по гр. д. № 1773 / 2021 г. на Върховен касационен съд, 4-то гр. отделение.

Example 2: If A represents B who wishes to buy a car and A also represents C who wishes to sell his car, A could not agree with B and C without their consent.

Example 3: If A represents B who wishes to buy a car, A could not sell his car to B acting as his attorney without the consent of B.

VII. ACTING TO THE DETRIMENT OF THE PRINCIPAL

In the triangular situation of representation, the representative has the responsibility to promote and preserve the interests of the principal. However, things can get complicated if a third party approaches the representative with different interests. The representative may be tempted to prioritize their own interests over those of the principal, which can be dangerous for the principal. While not all laws provide a solution, it is important to have a legal mechanism in place to guarantee the principal's interests. That is why, according to Article 40 OCA, if an agent and the person they negotiate with reach an agreement that harms the principal's interests, the contract will not be binding on the principal.¹⁵ This rule aims to protect the principal from various forms of abuse of representative power by voiding any legal act that harms their assets. However, the third party's interest in upholding the act is safeguarded by requiring them to have knowledge or be reasonably expected to have known about the conflict of interests.

When assessing whether a contract has harmed the principal's interests, all circumstances concerning the interests of the principal and the agent's motives for concluding the contract should be taken into consideration. The harm to the principal's interests can take various forms, such as a contract being concluded on unfavourable terms, the principal's property being unduly burdened with agreed-upon obligations, or the contract creating additional future and/or contingent

¹⁵ See **Конов, Тр.** Недействителност на сделка по чл. 40 ЗЗД. Доклад, изнесен през 1988 г. – В: Подбрани съчинения. София, Сиела, 2008, с. 452.

obligations (under modality) that are unusual for the particular type of contract. The rights granted to the agent may also be exercised in a harmful way, even if within their representative power. In all cases, there is objective damage to the interests of the principal, which is not insignificant. Damage doesn't need to have occurred, but it is enough that there is certainty of its occurrence, especially in the case of contracts with prolonged performance. According to case law, Article 40 OCA requires two elements to prove that the transaction is concluded to the detriment of the principal. The first element contains an objective aspect: the contract concluded by the representative and the counterparty, and a subjective aspect: the 'agreement' between the representative and the third party to the detriment of the principal. The assessment as to the existence of detriment is made in the light of the particular circumstances of each case, but in any event at the time the contract is concluded. The second element of the factual constitution consists in the bad faith of the representative and the other party – that is to say, both know that the contract objectively harms the represented party.¹⁶

Example 1: If an attorney (A) and a person (B) reach an agreement for A to sell a car on behalf of the principal (C) for 6,000 BGN, but in the contract, they write the car's price as 2,500 BGN and agree that 3,500 BGN will be paid to the attorney, not C, to the detriment of C, this agreement will not be valid for C.

VIII. DELEGATION OF AUTHORITY

It is undoubtedly clear that granting representative power to an individual is based on trust and belief. However, there may be situations where the representative cannot perform all the necessary acts, either due to lack of competence or distance from the place where the acts have to be performed. In such cases, it may be reasonable for the representative to delegate authority to another person. As per Article 43 OCA, the agent can authorise another person if the former

¹⁶ Решение № 95 от 27.06.2017 г. по гр. д. № 5523 / 2015 г. на Върховен касационен съд, 4-то гр. отделение.

authorised to do so or if this becomes necessary to protect the interests of the principal.

For a valid delegation of representative power there must either be an express permission clause for reauthorisation in the power of attorney,¹⁷ or a situation that requires reauthorisation to safeguard the principal's interests.¹⁸ In both cases, the agent must immediately notify the principal and provide the necessary information about the other agent authorised by them. If the agent fails to perform this obligation, they will bear responsibility for the actions of that other agent as if they were their own.

The delegate acts on behalf of the principal, and their authority is derived directly from the principal. However, the representative cannot delegate more authority than they already have. Therefore, for the delegate to achieve the same consequences as the representative's acts, their acts must be within the delegated authority and that of the representative. If the delegate's acts are to affect the legal position of the principal directly, the delegate must act in the name of the principal or in such a way as to indicate an intention to affect directly the legal position of the principal. If these conditions are met, then the delegate's acts have the same effects as if the representative had done these acts. They bind the principal and the third party directly, while the representative is not bound.¹⁹

Example 1: An old woman P living in a small European town has issued a general power of attorney containing a clause for delegating authority to her representative A living in the same town. She directs A to invest a substantial sum of money by acquiring an apartment house in New York. A authorises B who is a professional real estate agent to conclude the transaction.

¹⁷ Решение № 65 от 08.06.2017 г. по гр. д. № 643 / 2016 г. на Върховен касационен съд, 3-то гр. отделение.

¹⁸ See **Таджер, В.** Гражданско право на НРБ. Обща част. Дял 2. София, Наука и изкуство, 2001, с. 659.

¹⁹ For more details, see **Ставру, Ст.** Преупълномощаването, available at <https://www.challengingthelaw.com/grajdansko-pravo/preupalnomohtavaneto/>.

IX. TERMINATION OF AGENCY

Termination of agency refers to the situation when an authorised person (agent) is given power of attorney, but then certain legal events occur that lead to the end of the agency. The legal grounds for ending or restricting the agent's authorisation are part of the agreement between the agent and the principal. The legal doctrine usually classifies the reasons for termination of the representative power into general and special ones.

General Reasons:

The reasons for terminating a power of attorney are the same as in any legal relationship. These include:

- Expiry of the term for which the power of attorney was granted. For example, if A granted power of attorney to B for two years, the power of attorney is terminated at the end of the two years.
- Fulfilment of the resolutive condition upon which the power of attorney depended. For example, if A gave B power of attorney on the condition that B would be a permanent resident of Greece, and B settled abroad, the power of attorney ceases.
- Conclusion of the transaction for which the power of attorney was granted. For instance, if A gave B power of attorney to purchase an immovable property, and the purchase was concluded, the power of attorney ceases.

Special Reasons:

Some of the special reasons why the authorisation may be terminated are as follows:

- Revocation of the power of attorney: The power of attorney is based on a trust relationship between the principal and the representative. If this relationship breaks down, the principal is free to revoke the power of attorney. The power of attorney is freely revocable at any time and can be revoked by a simple declaration of the principal. If the power of attorney was granted by notary deed, it may be revoked by notary deed in the name of legal certainty. The revocation of the

power of attorney is made by way of a declaration addressed to the representative or the third party.

- Death of the principal or the attorney: Upon the death of the principal or the attorney, the authorisation is terminated. If the principal or the agent are legal entities, the authorisation will be terminated upon their dissolution.
- Incapacity of the principal or the attorney to conclude juridical acts: Assuming that the incapacity occurred after the power of attorney was granted, the power of attorney ceases. For example, if either principal B or attorney A is placed under privative judicial assistance in whole, on account of psychological disturbance, the power of attorney given to A by B ceases.
- Renunciation of the power of attorney given: If an attorney appointed to act on behalf of an individual wishes to resign from their position, they can do so by making a declaration to the principal. This is known as the renunciation or resignation of the attorney.

X. EFFECTS OF MISREPRESENTATION. RATIFICATION.

Misrepresentation or acting without authority can arise from various situations such as lack of initial authorisation (e.g., when the power of attorney is null), acting beyond the granted power of authorisation, acting after termination of the representative empowerment (e.g., after the death of the principal), or avoidance of the act granting the authority.²⁰ The common aspect in all of these situations is that, as a rule, the acts done by a person purporting to act as a representative but acting without authority do not bind the principal unless they are ratified by the latter.

1. Ratification

Where a person purports to act as a representative but acts without authority, the purported principal may ratify the act. According to Article 42(2) OCA a person on whose behalf a contract has been concluded

²⁰ See **Йосифова, Т.** Мнимо представителство. Второ преработено и допълнено издание. София, Сиби, 2008, 29–34.

without authorisation may ratify it. Usually, this will happen when the legal act concluded without authorisation or in excess of empowerment is of interest to the ‘represented’. By ratification, a purported principal may overcome any lack of authority on the part of the person who has purported to act as his or her representative.

Ratification has a retroactive effect, which means that if the acts are ratified, they are considered to have been done with authority and other people’s rights are not affected. The purported principal is granted the possibility *post factum* to ratify the legal act in question (*ratihabitio mandato aequiparatur*). Ratification should be made within a reasonable time limit, although there is no provision in Bulgarian law entitling the third party to invite the misrepresented principal to ratify the legal transaction.

Ratification requires the same form as the one provided for granting the authorisation for contract conclusion. As a result, where no formal authorisation is necessary, then ratification may also be implied from acts of the purported principal which unambiguously demonstrate the intention to accept the contract concluded or act done.

However, if there is no ratification, the person who acted as a representative without authority is responsible for any damages incurred to a third-party contractor who relied on the validity of the contract in good faith.

1.1. Ratification is not required when termination of the power of attorney is not enforced against a third party

There are some exceptions where ratification is not necessary and a representative’s authority continues in relation to a third party, even though the authorisation has been ended or restricted. This happens until the third party has information or could reasonably be expected to know about the end or limitation of the empowerment granted. Article 41(2) OCA states that the revocation of authorisation does not affect the rights of third parties who have dealt with the representative in good faith unless the revocation has been registered. Essentially, the authority continues until the third party is aware or should be aware of the revocation. This rule is intended to protect third parties who in good faith have relied on the

belief that the principal had granted authorisation. This means that if, for example, a representative fails to inform third parties of the revocation of the empowerment, any contract made on behalf of the principal will still hold them accountable for their duties. However, the principal can defend themselves by proving that the third party was already aware or could have known about the revocation of the empowerment before the contract was formed.

CHAPTER: 8

SOME ISSUES OF CONTEMPORARY COMPANY LAW IN BULGARIA

Savina Mihaylova-Goleminova

ABSTRACT	KEY WORDS
This chapter presents in a nutshell some issues related to contemporary company law and corporate governance in Bulgaria, different types of companies according to current Bulgarian legislation, including the establishment and the closure of companies, their status and corporate functioning, bankruptcy, liquidation, investment legislation, and other issues.	Company Law, public enterprises, investment legislation.

I. INTRODUCTION

Contemporary company law provides that companies established and/or operating in any of the Member states of the EU are regulated by the company law of the relevant Member State. Member States must ensure that the right of establishment of EU national and legal persons in any Member State and the freedom to provide cross-border services is not hampered by national legislation, subject to the exceptions set out in the Treaty. However, on the one hand, company laws of the Member States must comply with some rules and principles which constitute the body of supranational set of laws delivered by EU institutions, binding **as either hard or soft law**. According to the Oxford University Press Business English Dictionary¹ **‘corporate governance’** means: *The processes, both formal and informal, through which a corporation is administered and managed. Corporate governance involves the legal requirements imposed upon the corporation, the policies adopted by the corporation,*

¹ <https://www.oxfordreference.com/display/10.1093/oi/authority.20110803095640449> [Accessed on 15 January 2024].

and the informal customs within the corporation. The concept of corporate governance also embodies the interactions between the many parties that can be viewed as stakeholders in the corporation: directors, managers, shareholders, employees, customers, banks, and regulators. Currently, **responsible, sustainable² and sound corporate governance is a must,³** based on the requirements of EU and national legislation, including international law in specific fields. Some voluntary standards are at the disposal of the management of companies.⁴

II. LEGAL FRAMEWORK

1. European Union law

The legal framework of company law covers EU⁵ and national legislation⁶ (with regard to the hierarchy, correlation and relations between them, see Chapters 1, 16, 17 and 18). In the first place, Article 26 TFEU is applicable: *the Union shall adopt measures with the aim of establishing or ensuring the functioning of the internal market,⁷ in accordance with the relevant provisions of the Treaties. The internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions*

² Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, with regard to corporate sustainability reporting (OJ L 322, 16.12.2022, p. 15–80).

³ See Defining the ‘G’ in ESG Governance Factors at the Heart of Sustainable Business: https://www3.weforum.org/docs/WEF_Defining_the_G_in_ESG_2022.pdf [Accessed on 15 January 2024].

⁴ See <https://bulgariancp.bg/> [Accessed on 15 January 2024].

⁵ See **Craig, P., Gráinne de Búrca**. EU Law. Text, Cases, and Materials. 7th edition. Oxford University Press, 2021

⁶ See also: Източниците на правото – съвременни национални и международноправни перспективи, available at: https://www.uni-sofia.bg/index.php/bul/universitet_t/fakulteti/stopanski_fakultet/novini_ot_fakulteta/doc_d_r_savina_mihajlova_goleminova_uchastva_s_s_studiya_v_sbornika_iztochnicite_na_pravoto_s_vremenni_nacionalno_i_mezhdunarodnopravni_perspektivi [Accessed on 15 January 2024].

⁷ See **Христов, Х.** Вътрешен пазар и основни свободи на движение в правото на Европейския съюз. София, Сиела, 2018.

of the Treaties. Fundamental freedoms are protected: free movement of **goods** (Articles 28 et seq.); free movement of **persons** (differentiating between economically active and inactive individuals (Articles 45 et seq. and Article 21); freedom of **establishment** (Articles 49 et seq.); freedom to provide **services** (Articles 56 et seq.); free movement of **capital** (and payments) (Articles 63 et seq.).

European company law is partially codified in the Directives, and Member States continue to operate separate company acts, which are amended from time to time to comply with EU directives and regulations.⁸ There is a tremendous need for establishing a stable and effective contemporary company law and corporate governance framework for European undertakings, investors and employees, including non-governmental organisations.

The measures are taken at EU level using the directives as a tool based on the rules of the TFEU and the Charter of Fundamental Rights of the EU.⁹ The following Directives are applicable: Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law (codifies a large part of EU company law);¹⁰ Directive (EU) 2019/1151 of the European Parliament and of the Council of 20 June 2019 amending Directive (EU) 2017/1132 as regards the use of digital tools and processes in company law;¹¹ Directive (EU) 2019/2121 of the European Parliament and of the Council of 27 November 2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions;¹² Directive 2012/17/EU of the European Parliament and of the Council of 13 June 2012 amending Council

⁸ Negotiation Chapter 6: Company law provides: The company law *acquis* includes rules on the formation, registration, merger and division of companies. In the area of financial reporting, the *acquis* specifies rules for the presentation of annual and consolidated accounts, including simplified rules for small- and medium-sized enterprises. The application of International Accounting Standards is mandatory for some public interest entities. In addition, the *acquis* specifies rules for the approval, professional integrity and independence of statutory audits.

⁹ OJ C 326, 26.10.2012, 391–407.

¹⁰ OJ L 169, 30.6.2017, 46–127.

¹¹ OJ L 186, 11.7.2019, 80–104.

¹² OJ L 321, 12.12.2019, 1–44.

Directive 89/666/EEC and Directives 2005/56/EC and 2009/101/EC of the European Parliament and of the Council as regards the interconnection of central, commercial and companies registers;¹³ Commission Implementing Regulation (EU) 2021/1042 of 18 June 2021 laying down rules for the application of Directive (EU) 2017/1132 of the European Parliament and of the Council as regards technical specifications and procedures for the system of interconnection of registers and repealing Commission Implementing Regulation (EU) 2020/2244¹⁴; Directive 2009/102/EC of the European Parliament and of the Council of 16 September 2009 in the area of company law on single-member private limited liability companies; Council Regulation (EC) No 2157/2001 of 8 October 2001 on the Statute for a European company (SE); Council Regulation (EEC) No 2137/85 of 25 July 1985 on the European Economic Interest Grouping (EEIG),¹⁵ etc.

The G20/OECD Principles of Corporate Governance¹⁶ and OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition¹⁷ are also applicable. Chapter 1 – Fundamental Legal Notions and Concepts – serves as a base for the whole book, including company law. Some important and fundamental issues related to contemporary company law and corporate governance¹⁸ are also highlighted in the present book such as: contracts/commercial transactions (Chapters 2, 3, 4, 5, 10, 11); ESG standards (Chapter 9); Property law (Chapter 12); Competition law (Chapter 13); Intellectual Property (Chapter 14); Data protection (Chapter 15); Sustainable finance (Chapter 21); the Eurozone (Chapter

¹³ OJ L 156, 16.6.2012, 1–9.

¹⁴ OJ L 225, 25.6.2021, 7–51.

¹⁵ OJ L 199, 31.7.1985, 1–9.

¹⁶ OECD:<http://www.oecd.org/corporate/principles-corporate-governance/> [Accessed on 15 January 2024].

¹⁷ OECD:<http://www.oecd.org/publications/449ee0d5-bg.htm> [Accessed on 15 January 2024]. They are part of Bulgarian legislation according to §1 of the Supplementary Provisions to the Public Enterprises Act (PEA) prom. SG. 79/8 Oct 2019, last amend. and suppl. SG. 84/6 October 2023. ‘Standards for good corporate governance’ are the standards, included in the OECD Guidelines for corporate governance of state-owned enterprises.

¹⁸ In addition, Contemporary Project Management of companies is influenced by the requirements of the circular economy (Chapter 26) and United Nations 17 Sustainable Development Goals (SDGs) <https://sdgs.un.org/goals> [Accessed on 15 January 2024].

25), Greenwashing (Chapter 28); Public Procurement (Chapter 24); Anti-Money laundering regulation (Chapter 30); etc. A new approach related to the link between civil, commercial and company law is given in Chapters 6 and 7. In addition, the EU Act on Artificial Intelligence (AIA) will affect the behaviour of companies within and outside the EU (Chapter 31). AI also raises questions related to intellectual property rights, competition,¹⁹ data protection, human rights, national legal services and dispute resolution, etc. Last but not least, contemporary issues of company law are also linked to constitutional²⁰ and financial law issues (Chapters 16, 17, 18), including criminal law (Chapter 29). Recent trends and developments in the field of international tax law, including EU positive and negative tax integration also play an enormous role and influence the behaviour²¹ of companies, including governments and their tax policies.²²

¹⁹ See **Стойнев, И.** Правен режим за защита на конкуренцията в ЕС. Том I. Антикартелно право. София, Сиела, 2018.

²⁰ Regarding the constitutional dimension of property, see **Колев О.** Някои конституционноправни аспекти на понятието „собственост“ в практиката на Конституционния съд и на Европейския съд по правата на човека, Конституционни изследвания 2014–2015 г. 25 години демократична трансформация в Р България, УИ „Св. Климент Охридски“, София, 2017 г., стр. 418–431. For the above and other constitutional matters, see **Колев О.** Ръководство за държавен изпит по публичноправни науки. София, Сиела, 2024, 31–85, 95–183, 266–293.

²¹ See **Rita de la Feria**, Re-imagine Taxation (podcast) https://open.spotify.com/episode/5xky7xMeqdAeAAsMzP3yY7?si=6p8lMubES4eqSX1sSOSYJg%0A&nd=1&dls_i=4b11c291aff4462 [Accessed on 15 January 2024].

²² See: **Lang, M., Pasquale Pistone, Josef Schuch, Claus Staringer.** Introduction to European Tax Law on Direct Taxation. 7th Edition. Linde, 2022; **Lang, M. (ed.)** Introduction to the Law of Double Taxation Conventions. Linde, 2021; **Чилова Н., Таня Атанасова-Дренска, Александра Вълчева, Стойчо Дулевски, Тюркер Моллахасан, Станислав Джинсов.** Сравнителноправен анализ на данъка при източника през призмата на практиката на Съда на Европейския съюз. София, Издателски комплекс на УНСС, 2023; **Haase, F., Georg Kofler (ed.)**. The Oxford Handbook of International Tax Law. Oxford Handbooks series. OUP, 2023, etc.

2. National legislation

Companies established and/or operating in any of the Member states of the EU are regulated by the company law of the Member State. However, on the one hand, company laws of Member States must comply with some rules and principles which constitute the body of supranational laws delivered by EU institutions, binding **as either hard or soft law**. On the other hand, no sovereign State or its institutions may issue acts directly binding on all citizens and companies established and/or operating in the EU, thereby prevailing over the company laws of the Member states.

The Bulgarian Constitution²³ through Article 19(4) provides that: *‘The law shall establish conditions conducive to the setting up of cooperatives and other forms of association of citizens and legal entities in the pursuit of economic and social prosperity.’*

The primary piece of legislation governing the types, corporate structure and governance, as well as the requirements for the establishment of commercial companies in Bulgaria is the **Commerce Act (CA)**.²⁴

The **Commercial register and the Non-Profit Legal Entities Register Act**²⁵ regulates the requirements and procedure for registration, in a centralised electronic-based register, of commercial legal entities operating under Bulgarian law and of changes in the corporate status of such entities (the ‘Commercial Register’).

Other relevant primary legislation governing specific corporate and company matters includes: the Accounting act (AA);²⁶ the Corporate Income Tax Act;²⁷ the VAT Act;²⁸ the Investments Promotion Act;²⁹ the

²³ Prom. SG. 56/13 Jul 1991, last amend. SG.106/22 Dec 2023.

²⁴ Prom. SG. 48/18 Jun 1991, last amend. and suppl. SG. 66/1 Dec 2023.

²⁵ Prom. SG. 34/25 Apr 2006, last suppl. SG. 105/19 Dec 2023.

²⁶ Prom. SG. 98/16 Nov 2001, last last amend. and suppl. SG. 105/19 Dec 2023. With regard to types of entities, see Article 19 AA: micro-entities; small entities; medium-sized entities; large entities.

²⁷ Prom. SG. 105/22 Dec 2006, last last amend. and suppl. SG. 108/30 Dec 2023.

²⁸ Prom. SG. 63/4 Aug 2006, last last amend. and suppl. SG. 108/30 Dec 2023.

²⁹ Prom. SG.97 /24 Oct 1997, last last amend. and suppl. SG. 22/18 March 2022.

BULSTAT Register Act;³⁰ the Independent Financial Audit Act;³¹ the Tax and Social Security Procedure Code;³² the Credit Institutions Act;³³ the Public Enterprises Act, various special acts with regard to the Commerce Act;³⁴ the special statutory instruments for the incorporation of state-owned companies set up under the Article 62(3) of the Commerce Act (special acts with regard to the Commerce act and the Public Enterprises Act); etc.³⁵

Below, we will briefly review how companies and merchants incorporated under Bulgarian law may enjoy of freedom of establishment and freedom to provide services. We will describe the common rules for merchants, the different types of companies, the main legal forms for doing business in Bulgaria, including some issues related to the new legal regime for public enterprises. Bulgaria has its own traditions in the field of commercial and civil law which serves as a base for overcoming contemporary challenges.³⁶

³⁰ Prom. SG.39 /10 May 2005, last last amend. and suppl. SG.106/22 Dec 2023.

³¹ Prom. SG. 95 /29 Nov 2016, last last amend. and suppl. SG. 25/29 March 2022.

³² Prom. SG. 105/29 Dec 2005, last suppl. SG. 80/19 Sep 2023.

³³ Prom. SG. 59/21 Jul 2006, last suppl. SG. 13/13 Feb 2024.

³⁴ Such as: Gambling Act (GA), Execution of Sentences and Detention Act (ESDA), Employment Promotion Act (EmPA), Environmental Protection Act (EPA), Safe Use of Nuclear Energy Act (SUNEA), Water Act (WA), the Maritime Spaces, Inland Waterways and Ports of the Republic of Bulgaria (MSIWPRBA), Railway Transport Act (RTA), Civil Aviation Act (CAA), Forestry Act (FA), Animal Husbandry Act (AHA), supplemented by a number of by-laws – regulations and ordinances on the application of laws, incl. structural regulations.

³⁵ Some special Laws are also applicable: Special Investment Purpose Companies Act, Insurance Code, Financial Supervision Commission Act, Public Offering of Securities Act, Recovery and Resolution of Credit Institutions and Investment Intermediaries Act, Markets in Financial Instruments Act, Supplementary Supervision of Financial Conglomerates Act, etc.

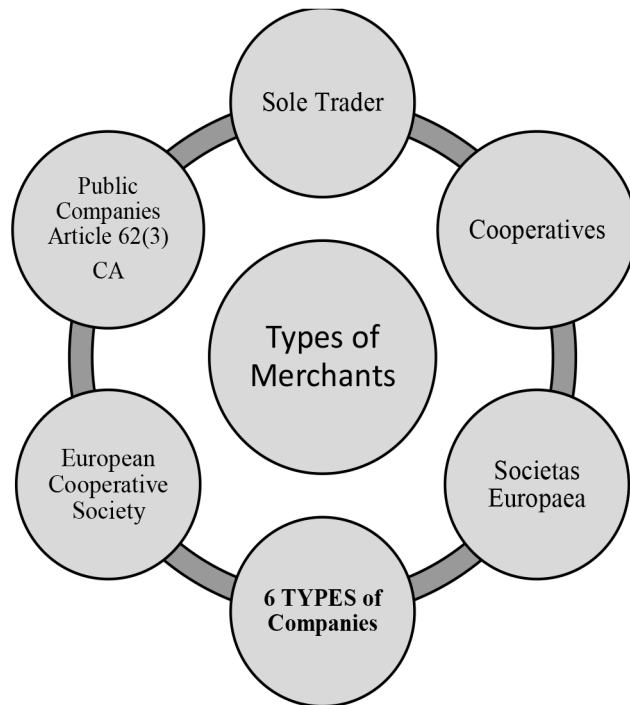
³⁶ For more information see also: **Герджиков, О.** Учебник по търговско право – Част първа. София, Труд и право, 2021; **Герджиков, О.** Учебник по търговско право – Част втора. София, Труд и право, 2021; **Калайджиев, А.** Търговско право – обща част. София, Труд и право, 2015; **Калайджиев, А.** Облигационно право. Обща част. София, Сиела, 2020; **Калайджиев, А.** Търговци. София, Сиела, 2014; **Стойнев, И.** Правен режим за защита на конкуренцията в ЕС. Том I. Антикартелно право. София, Сиела, 2018; etc.

III. TYPES OF MERCHANTS

1. Basic issues

A merchant is any natural or legal person engaged by occupation in any of the transactions listed in Article 1(1) of the CA.³⁷ Merchants are: the commercial companies; cooperatives; any person, who has established an enterprise, which, in accordance with its purpose and volume, requires that its business be conducted on a commercial basis, even if its activity is not listed under Article 1(1) of CA. A merchant is also the *Societas Europaea* – the European Company under Council Regulation (EC) № 2157/2001 of 8 October 2001 on the Statute for a European company (SE).

³⁷ Within the meaning hereof, ‘merchant’ shall **mean any natural or juridical person engaged by occupation in any of the following** transactions 1. purchase of goods or other Articles for the purpose of reselling them in their original, processed or finished form; 2. sale of one’s own manufactured goods; 3. purchasing securities for the purpose of reselling them; 4. commercial agency and brokerage; 5. commission, forwarding and transportation transactions; 6. insurance transactions; 7. banking and foreign-exchange transactions; 8. bills of exchange, promissory notes and cheques; 9. warehousing transactions; 10. licence transactions; 11. supervision of goods; 12. transactions in intellectual property; 13. hotel operation, tourist, advertising, information, entertainment, impresario and other services; 14. purchase, construction or furnishing of real property for the purpose of sale; 15. leasing. (Regarding Commercial Transactions see Chapters 10 and 11).

Diagram 1 – Types of Merchants

Persons who are not merchants: natural persons engaged in farming, artisans, persons providing services through their own labour or exercising a liberal profession, except where their activity may be defined as a business within the meaning of Article 1(3) CA and persons providing hotel services by letting rooms in their own home (Article 2 CA).

Commercial companies are formations having property that is different from the property of their founders. They can conclude agreements, execute obligations and acquire rights. They can perform legal activities through their bodies. They have a name and an identification code. They have a seat and a registered office where they operate. They also have a designated scope of activities. There are different types of commercial companies. All of them are recognised as separate legal entities. Regardless of the nationality of its founder(s), each company registered in Bulgaria is considered a Bulgarian legal entity and is governed by effective Bulgarian

laws and regulations. Foreign participation in a Bulgarian company can be up to 100%. Business may also be conducted in the form of: sole trader; partnership; a partnership limited by shares; a limited liability company; shareholding company and (since 2023) variable capital company. CA also recognises consortiums and holding companies. A holding company can be a joint-stock company, a limited partnership or a limited liability company.

2. Companies

Only the companies set forth in the CA may be established (Article 64(2) CA). In this respect the following **types of Companies are regulated by the CA (Article 64(1))**:

Diagram 2 – Types of companies

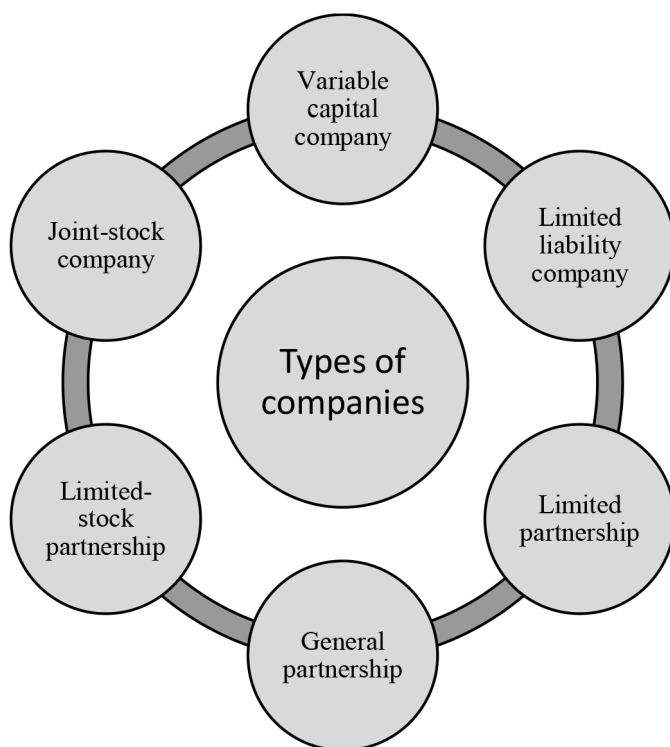
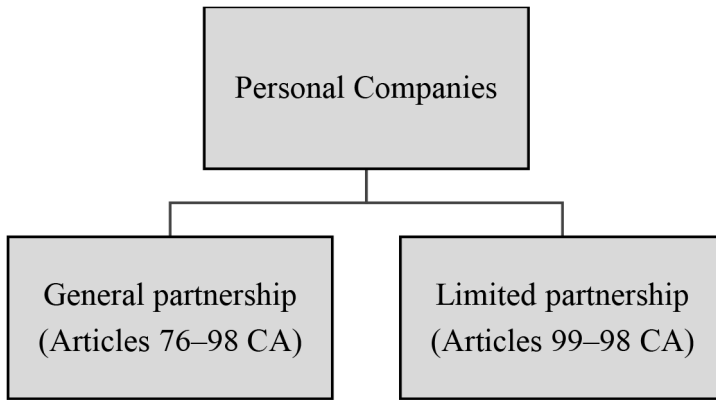
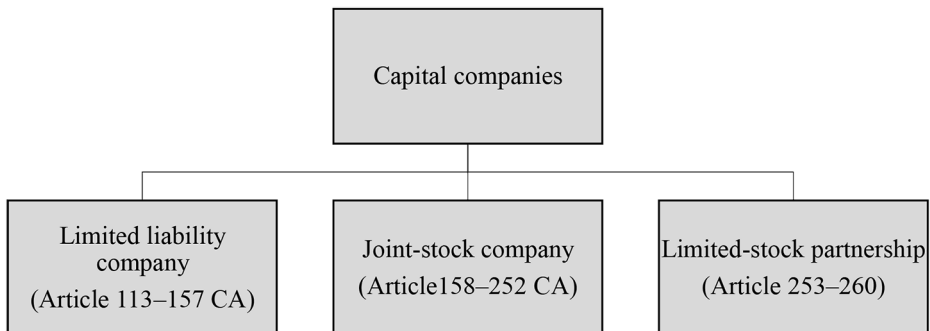


Diagram 3 – Personal companies**Diagram 4 – Capital companies**

With the promulgation of the Act to Amend and Supplement the Bulgarian Commerce Act on 1 August 2023, a new type of company was introduced – the Variable Capital Company (‘VCC’). VCC is a **hybrid** form between **personal** and **fixed-capital companies**, differing from both but sharing some similarities with each (see Article 260a–260ab CA). This type of company can be used for start-up activities.³⁸

³⁸ See for example: The national competition ‘Best Youth Startup in Bulgaria’. <https://sites.google.com/view/fmfib-startup-competition-2024/home> [Accessed on 15 January 2024].

3. The most popular forms for doing business in Bulgaria

The most popular form for doing business in Bulgaria is the limited liability company and the joint-stock company (see p. 5 below regarding investment legislation). The reasons can be reviewed in the Table below.

Table No. 1 Most effective forms for doing business in Bulgaria

Company type	Joint-Stock Company	Single Member Joint-Stock Company	Limited Liability Company	Single Member Limited Liability Company
Registered Capital (required minimum)	BGN 50,000, fully subscribed, each share paid up to at least 25%	BGN 50,000, fully subscribed, each share paid up to at least 25%	BGN 2 fully subscribed, paid up to the legally established minimum	BGN 2 fully subscribed, paid up to the legally established minimum
Equivalent in EURO (EUR 1 = BGN 1.95583)	approx. 25,000	approx. 25,000	approx. 1	approx. 1
Liability of Shareholders	limited to the shares in the capital	limited to the shares in the capital	limited to the shares in the capital	limited to the shares in the capital
Resident Shareholders Required	no	no	no	no
Number and Type of Shareholders	two or more, natural persons or legal entities	one, natural person or legal entity	two or more, natural persons or legal entities	one, natural person or legal entity
Type of Shares	registered, bearer or dematerialized	registered only	share certificates in a limited liability company are not securities	share certificates in a limited liability company are not securities
Different Classes of Shares	yes	yes (though unusual)	no	no
Transferability of Shares	free unless otherwise provided for in the Articles of Incorporation	free unless otherwise provided for in the Articles of Incorporation	free to another shareholder, otherwise upon consent with a majority of $\frac{3}{4}$ of votes cast unless otherwise provided for in the Articles of Incorporation (the majority of $\frac{3}{4}$ is construed as mandatory and the Articles may stipulate only for a higher majority)	free to another shareholder, otherwise upon consent with majority of $\frac{3}{4}$ of votes cast unless otherwise provided for in the Articles of Incorporation (the majority of $\frac{3}{4}$ is construed as mandatory and the Articles may stipulate only for a higher majority)

Company type	Joint-Stock Company	Single Member Joint-Stock Company	Limited Liability Company	Single Member Limited Liability Company
Form of Share Transfer	by means of <i>delivery</i> (for bearer shares) by means of <i>endorsement</i> entered into the Company's Shareholders' Book (for registered shares) by means of <i>assignment</i> and <i>registration</i> with the Central Depository (for dematerialized shares)	by means of <i>endorsement</i> entered into the Company's Shareholders' Book	by means of written <i>contract</i> with notarized signatures and entry into the Company's Book of Shares; entry into the Commercial register is also required	by means of written <i>contract</i> with notarized signatures and entry into the Company's Book of Shares; entry into the Commercial register is also required
Managing Bodies	General Meeting of Shareholders <i>One-tier system</i> – Board of Directors <i>Two-tier system</i> – Supervisory Board and Managing Board	Sole Owner of the Capital (Sole Shareholder) <i>One-tier system</i> – Board of Directors <i>Two-tier system</i> – Supervisory Board and Managing Board	General Meeting of Shareholders, Managing Director/s	Sole Shareholder Managing Director (the Sole Shareholder may also appoint itself as Managing Director)
Shareholders' Meetings	at least once per year	at least once per year	at least once per year	at least once per year
Delay for Convening Shareholders' Meetings	30 days after the announcement with notice in the Commercial Register if no bearer shares issued the Articles of Incorporation may stipulate convening by written notice to each shareholder (shorter term possible)	The Sole Owner of the Capital exercises the powers of the General Meeting of Shareholders, no formal requirements imposed for adopting of resolutions, except drawing of minutes in writing for each resolution adopted	7 days after written notice to each shareholder unless otherwise stipulated in the Articles of Incorporation (the term of 7 days is construed as mandatory and the Articles may only stipulate a longer term)	The Sole Shareholder exercises the powers of the General Meeting of Shareholders, no formal requirements imposed for adopting of resolutions, except drawing of minutes in writing for each resolution adopted
Minimum Number of Directors	<i>Board of Directors</i> – 3 to 9 members <i>Supervisory Board</i> – 3 to 7 members <i>Managing Board</i> – as defined in the Articles of Incorporation but not more than 9 members	<i>Board of Directors</i> – 3 to 9 members <i>Supervisory Board</i> – 3 to 7 members <i>Managing Board</i> – as defined in the Articles of Incorporation but not more than 9 members	one or more Managing Directors representing the company jointly and severally, or only jointly if expressly stipulated	one or more Managing Directors representing the company jointly and severally, or only jointly if expressly stipulated

Company type	Joint-Stock Company	Single Member Joint-Stock Company	Limited Liability Company	Single Member Limited Liability Company
Resident Directors Required	no	no	no	no

4. Basic and common rules regarding companies

Some basic and common rules regarding companies are introduced in CA (see Articles 7–16a, Articles 56–75 CA, etc.). The company's founders must be Bulgarian or foreign natural or legal persons of full capacity to act. Any person may participate in more than one company to the extent where such participation is not prohibited by law. Whenever a company participates in another company, its rights as a partner or sole owner must be exercised by the person authorised to represent the company, or by an expressly authorised person. All companies have to obtain, hold and provide, in the cases specified by law, adequate, accurate and current information on the natural persons who are their beneficial owners, including details of the beneficial interests held by the said natural persons. This is part of the measures against money laundering (see the Measures against Money Laundering Act).

Prior to the establishment of a company, the persons intending to become founders may conclude an agreement on any actions they need to take to prepare for the incorporation. For example, this agreement could include clauses about the type of the company, the capital, the seat and the scope of activities of the company, etc. For non-performance of obligations under that agreement, including if the company is not established, the parties will be liable only for actual damages caused. Any actions by the founders on behalf of the company to be incorporated, prior to the date of its registration, will give rise to rights and obligations for the persons performing them and not for the company which does not yet exist. Any concluded agreements should indicate that the company's incorporation is pending. When the company is established, the rights and obligations will be transferred to the incorporated company. It is possible for the founders to **reserve a trading name** prior to incorporating the company in order to ensure that the trading name they have chosen will be available when

entering the company in the Register. The application for name reservation must be submitted to the Commercial register and the registration officer will examine whether the trading name is available. If the trading name is available, it will be reserved for 6 months and no other person will be able to reserve or register this name within the said six-month period. In order for a company to be incorporated, it must be registered in the Commercial register. The company will be deemed incorporated on the date of its registration in the Commercial Register.³⁹ The founders must sign the respective incorporation documents. The application for registration should be submitted by the appointed representative or management body and must include the information provided by law for the respective type of company. Registration comprises the submission of a standard application form with all necessary documents appended. The documents can be submitted in paper format in the Commercial Register or digitally through electronic signature. The registration procedure varies in terms of length but usually takes several business days.

The incorporation of a company will be invalidated only when any of the following violations of the law has been committed: there is no Memorandum of Incorporation, or the Memorandum of Incorporation is not drawn up in the form prescribed by the law; the number of persons of full capacity to act participating in the incorporation of the company is less than the number provided for by the law; the business objectives of the company contradict the law or good morals; the Memorandum or the Articles of Association (as the case may be) do/does not contain the trading name, the scope of activities of the company or the size of contributions, as well as the capital, when required by law; the part of the capital prescribed by law has not been paid in. Any interested party, as well as the public prosecutor, may file a request to invalidate the company before the court. The court's decision to invalidate the company is effective as of its coming into force. As of that moment, the company will be deemed dissolved and the court will submit the decision for entry in the Commercial Register,

³⁹ **Effects: Declarative effect** – the publication in the Commercial Register involves the presumption that the published circumstances are known to third parties (presumption of knowledge); **Constitutive effect** – in accordance with commercial law, the registration into the Commercial Register becomes legally effective only if it is provided by law (the circumstance that is subject to publication is not effective until its registration).

after which liquidation will be carried out by a liquidator appointed by the registrar with the Registry Agency. Any member of a company may bring an action before the court to protect his/her membership rights if these have been violated by bodies of the company.

Every partner or shareholder may file a request before the court to **revoke a decision of the General Meeting**, if the decision contravenes mandatory provisions of the law, the Memorandum of Association or, respectively, the Articles of Association of the company. The request must be filed against the company within 14 days of the date of the General Meeting, if the claimant was present or duly notified, or, if not, within 14 days after the claimant becomes aware of the decision, but not later than three months after the date of the General Meeting. The directions of the court, provided when revoking decisions of the General Meeting, the interpretation of the law, the Memorandum of Association and the Articles of Association are binding on the General Meeting for any subsequent discussions of the same issue. Any decisions or actions by company bodies contravening an effective court decision will be null and void.

Companies may be transformed through: acquisition – the entire property of one or more companies (transforming companies) is transferred to one existing company (acquiring company), which becomes its/their successor;⁴⁰ **merger** – the entire property of two or more companies (transforming companies) is transferred to a newly incorporated company, which becomes their successor;⁴¹ **split** – the entire property of one company (transforming company) is transferred to two or more companies, which become its successors for the respective part;⁴² **spin-off** – part of the property of one company (transforming company) is transferred to one or more

⁴⁰ Transforming companies are dissolved without liquidation. In this case the legal form of the acquiring company may not be changed simultaneously.

⁴¹ The transforming companies are dissolved without transformation.

⁴² The transforming company is dissolved without transformation. The companies, to which the property of the transforming company is transferred, may be existing (acquiring companies) in a *split through acquisition*, newly incorporated companies in a *split through incorporation*, as well as both existing and newly incorporated companies at the same time. The legal form of the acquiring company may not be changed simultaneously with the split.

companies, which become its successors for that part of the property;⁴³ **change of the legal form** (type of company) – for example, a joint-stock company may be transformed into a limited liability company. In all forms of transformation, the transforming, acquiring and newly incorporated companies (i.e., the companies involved in the transformation) may differ in type, unless otherwise provided for by law.

Liquidation is carried out after dissolution of the company (for the relevant rules, see Articles 261–265 CA). The trading name of a merchant placed in liquidation must contain the words ‘in liquidation’. The liquidator/s is/are appointed by the partners/shareholders. For example, the liquidator in a limited liability company will be the manager unless there is a resolution of the General meeting appointing another person. Liquidators must be recorded in the Commercial Register and must submit their notarised consent with specimens of their signatures. Liquidators are liable for their activities related to the liquidation.

Bankruptcy is a proceeding initiated by the merchant itself or by a creditor under a commercial deal or fiscal receivable when a merchant is unable to repay its financial debts (regarding the rules, see Article 607–800 CA). With regard to credit institutions, see the Banks Bankruptcy Act as a special statutory instrument. The purpose of bankruptcy proceedings is fair satisfaction of the creditors and rescue of the debtor’s enterprise as a going concern, if possible. Satisfaction of creditors is achieved through liquidation of the merchant’s property. Bankruptcy proceedings must take into consideration the interests of the creditors, the debtor and the debtor’s employees. Bankruptcy proceedings are initiated for a merchant who is *insolvent*. Except upon insolvency, bankruptcy proceedings can also be initiated upon *over-indebtedness* (sometimes referred to as ‘balance sheet insolvency’) of a limited liability company, a joint-stock company or limited-stock company (i.e., limited liability companies). Insolvent is any merchant

⁴³ The transforming company is not dissolved. The companies to which the part of the property of the transforming company is transferred, may be existing companies (acquiring companies) in a *spin-off through acquisition*, newly incorporated companies in a *spin-off through incorporation*, as well as both existing and newly incorporated companies at the same time. The legal form of the transforming company or the acquiring company may not be changed simultaneously with the spin-off.

unable to meet any due: monetary obligation arising out of, or related to a **commercial transaction**, including its validity, performance, non-performance, termination, invalidation or cancellation, or the consequences from its termination; public liabilities to the State or municipalities related to the merchant's business; liabilities for private state receivables; obligation to pay wages to at least one third of the workers and employees, which has not been discharged for more than two months. The insolvency court, in its practices, has introduced the interim concept of 'decapitalisation' and takes the view that a company should not be declared insolvent, where it is unable to repay its capital to its members or shareholders (who are also creditors for the paid-in capital), but does not have 'external' creditors. Despite the existence of the general provision in Article 612 (1) and (3) of the CA, most of the special laws establishing state-owned enterprises (SOEs) (see Table 2: state-owned enterprises which are not commercial companies formed by law as per Article 62(3) CA⁴⁴ below) include an explicit prohibition of insolvency proceedings for such enterprises and in some cases, this has been introduced by the relevant regulation.

IV. PUBLIC ENTERPRISES

1. Legal framework

The doctrine devotes little space to the analysis of Public enterprises. The place of **public enterprises** (State-Owned Enterprises (SOEs) and Municipal enterprises) in the financial system and the system of public finances of the state is important and will be presented below in a nutshell.⁴⁵ **Public enterprises** are part of the public finances of the state and

⁴⁴ Source: **Analysis of State-Owned Enterprises Established by Special Laws on the Basis of Article 62(3) of the Commerce Act for the Purpose of Clarifying the Nature of their Activities** – Report, approved by the Council of Ministers with Decision No. 231 of 18 March 2021.

⁴⁵ The author was member of the team that prepared the report **Analysis of State-Owned Enterprises Established by Special Laws on the Basis of Article 62(3) of the Commerce Act for the Purpose of Clarifying the Nature of their Activities**, approved by the Council of Ministers with Decision No. 231 of 18 March 2021.

help towards the sustainability of public finances, also referred to as fiscal sustainability (see also Chapters 18, 19, 20, 22, 24). The enacted Public Enterprises Act (PEA)⁴⁶ and the Regulation on the implementation of the Public Enterprises Act (RIPEA)⁴⁷ regulate new requirements that build on the rules of the Commerce Act (CA)⁴⁸ regarding the legal regime of state-owned enterprises, including their relations with public finances and the budget with view of the principles for the exercise of state ownership of state-owned enterprises (PEA, Chapter Two, Articles 5–10). Articles 61 and 62 of the Commerce Act regulate the main provisions governing the status of merchants which are state-owned enterprises, and the PEA is a special law in relation to the Commerce Act.

It is no coincidence that the motives of the draft of PEA stated that the Act aims to create a legal framework that requires from state-owned enterprises to apply, to a much greater extent and not just perfunctorily, the criteria of economic conduct, accountability, control and transparency set out in the documents of the European Union and the Organisation for Economic Cooperation and Development.⁴⁹ In relation to the management and control of state-owned enterprises, the ‘sound corporate governance standards’ included in the OECD Guidelines on Corporate Governance of State-owned Enterprises apply, which also include standards on the role of the State as owner, represented by the relevant public authorities in the relations regulated by the legal norms of the PEA and the RIPEA. In this respect, the PEA preserves the powers of the Council of Ministers to exercise the rights of the State in state-owned enterprises, respectively the designation of the relevant line ministers as principals of commercial companies and state-owned enterprises (with the possibility of the second hypothesis under Article 13 PEA). State policy in the field of state-owned enterprises is determined and implemented by the Council of Ministers:

⁴⁶ Prom. SG 79 of 8 October 2019, amended SG 84 of 6 October 2023.

⁴⁷ Prom. SG No. 40 of 5 May 2020, amended and supplemented SG 11 of 2 February 2023.

⁴⁸ Prom. SG No. 48 of 18 June 1991, amended and supplemented SG 35 of 19 April 2024.

⁴⁹ §1 of the Supplementary Provisions of PEA, item 10. ‘Standards of good corporate governance’ means the standards included in the OECD Guidelines on Corporate Governance of State-Owned Enterprises.

Article 10(1) PPA; Chapter Three, Articles 11–12 PEA; Chapter Four, Articles 13–19 PEA; Chapter Two, State Policy, Articles 2–12 RIPEA; Chapter Three ‘Coordination of the State’s participation in state-owned enterprises’, Articles 13–22 RIPEA. The Public Enterprises and Control Agency (PECA)⁵⁰ is the central unit coordinating the management of state-owned enterprises, coordinating state policy in relation to state-owned enterprises, monitoring and reporting to the Council of Ministers on its implementation, and carrying out the functions and activities assigned to it by PEA and the RIPEA. Even the Constitutional Court is yet to issue a decision concerning the new state-owned enterprise regime. By means of a Ruling of 23 April 2024 in Case No. 14/2024, the Constitutional Court admitted for consideration on the merits the request of the Council of Ministers of the Republic of Bulgaria to establish the unconstitutionality of the Decision of the National Assembly of 29 March 2024 on the assignment to the Minister of Energy, respectively to Bulgarian Energy Holding EAD, not to distribute dividend from the profits of Bulgarian Energy Holding EAD for the financial year of 2023 (State Gazette No. 28 of 2 April 2024).

In view of the above, from the analysis of current European and national legislation, as well as from the point of view of financial and administrative law theory, it can be said that the public relations in the system of management, control and coordination of state-owned enterprises and the executive authorities involved in these relations as per PEA and the RIPEA, are differentiated and identified on the basis of the theory of financial legal relations developed in the work of Prof. Milcho Kostov ‘Financial Legal Relations’,⁵¹ since the budget is at the centre of the system and these relations are in fact budgetary (financial) relations. Relations in the field of management and control of state-owned enterprises can be viewed in two aspects:

- 1) as a set of management and control relations, and
- 2) as a set of state bodies that carry out executive and regulatory activities in this field.

⁵⁰ Decree No. 68 of 13 April 2020 of the Council of Ministers adopted the Rules of Procedure for PECA (Article 21 and Article 61 RIPEA).

⁵¹ See **Костов, М.** Финансови правни отношения. София, БАН, 1979, с. 256.

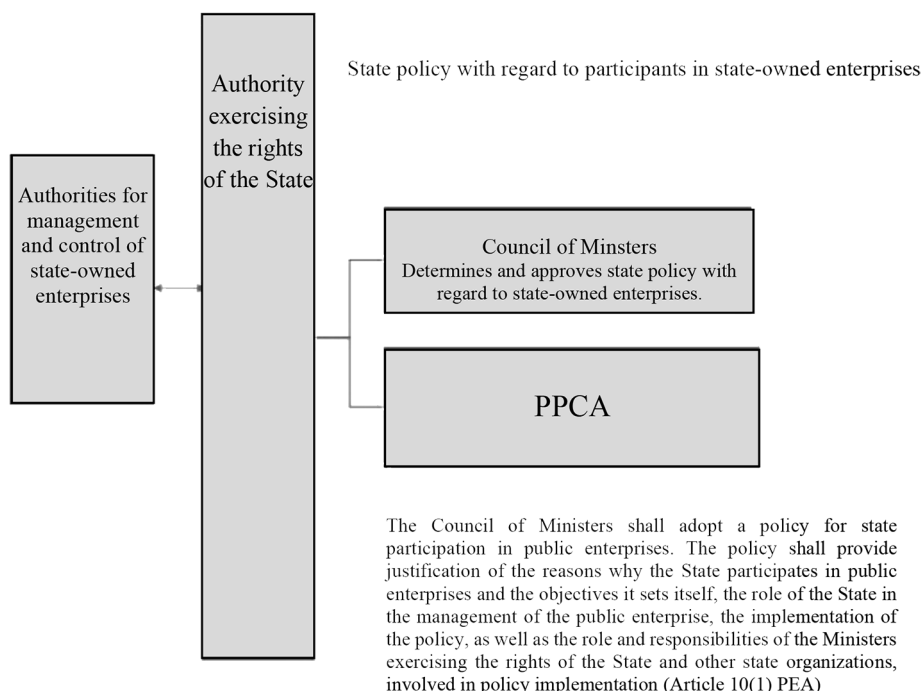
PEA establishes a legislative foundation for stronger ownership coordination and monitoring; more independent, qualified and transparently-nominated boards of directors; improved disclosure at both individual enterprise level and state level; and a more level playing field with regards to private companies by means of gradual phasing out of the ‘state enterprise’ statute for SOEs engaged in commercial activities. PEA sets the new rules for SOEs: policy of participation of the State in public enterprises (supervision) – Article 10 PEA; professional and independent management and control bodies (Chapter Five PEA sets requirements to the management and control bodies; further details are provided in Articles 20–24 and 31–37 RIPEA; the medium-term goals and planned results of SOEs are laid down in Articles 57–60 RIPEA); Public announcement – Chapter Seven PEA and Articles 28–31 and 61–63 of the Regulation; principles of exercising state ownership over state-owned enterprises (SOEs) – Chapter Two PEA, Articles 5–10; the types of public enterprises are listed in Articles 2–4 PEA. The Public Finance Act (PFA), the Accountancy Act (AA), the Administration Act (AdA), the Financial Management and Control in the Public Sector Act (FMCPSA), and the Public Procurement Act (PPA) are also applicable.

The Privatisation and Post-Privatisation Control Agency (PPCA), as a specialised institution responsible for the coordination of public policy with regard to public enterprises, monitors and reports to the Council of Ministers on its implementation and fulfils the functions and activities assigned to it by PEA and RIPEA.

The **state policy** was adopted by a Decision of the Council of Ministers.⁵²

⁵² Decision No. 1045 of the Council of Ministers of 21 December 2022 for the Adoption of a Programme for the Transformation of State-Owned Enterprises established through Special Laws pursuant to Article 62(3) of the Commerce Act. See: <https://www.apk.government.bg/bg/54> [Accessed on 15 January 2024].

Diagram 5 – Preparation and adoption of the State policy in the field of Public enterprises



The OECD Guidelines on Corporate Governance of public enterprises (the Guidelines) are applicable and were incorporated in the content of PEA as mentioned above. Their main role is to provide *‘recommendations to governments on how to ensure that state-owned enterprises operate effectively, transparently and in an accountable manner. This is the internationally accepted standard whereby governments exercise the state ownership function so as to avoid traps of both passive attitudes to ownership and excessive state interference.’*

The legal grounds for SOEs are laid down in Article 61 and Article 62 CA. Article 62(1) states that *state-owned enterprises shall be formed as or transformed into single member limited liability companies⁵³ or single*

⁵³ Permissible legal form only for ‘micro’, ‘small’ and ‘medium’ enterprises, as well as for public enterprises – subsidiaries.

member joint-stock companies pursuant to a procedure to be established by law. Article 62(2) states that *municipal undertakings shall be formed as or transformed into single member limited liability companies or single member joint-stock companies through a resolution of the municipal council.* Article 62(3) states that *state-owned enterprises which are not companies may be formed by a law.*⁵⁴ The Legal Framework includes also: the Accountancy Act (AA), the Administration Act (AdA), the Financial Management and Control in the Public Sector Act (FMCPSA), the Public Procurement Act (PPA), the Bulgarian National Audit Office Act, the Independent Financial Audit Act, the Privatisation and Post-Privatisation Control Act (PPCA), etc. (see Chapters 18, 22, 24). All these enterprises have relations with the state budget and municipal budgets (Chapter 19). Some of these acts are supplemented by a number of by-laws – regulations and ordinances on their implementation, including structural regulations. Bulgaria's poor performance on key institutional and governance indicators in the areas of judicial independence, corruption and corporate governance of state-owned enterprises has had a long-term impact on economic potential and welfare. There is a need for upgrading the state-owned enterprise corporate governance by adopting and putting into effect the forthcoming legislation.⁵⁵

Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC, Regulation (EU) No 549/2013 of the European Parliament and of the Council of 21 May 2013 on the European system of national and regional accounts in the European Union,⁵⁶ Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings⁵⁷ are also applicable.

⁵⁴ The Legal acts are special and CA rules are common. See them in Table 2 below.

⁵⁵ 2023 EU Semester Country Report for Bulgaria, p. 3 and p. 26.

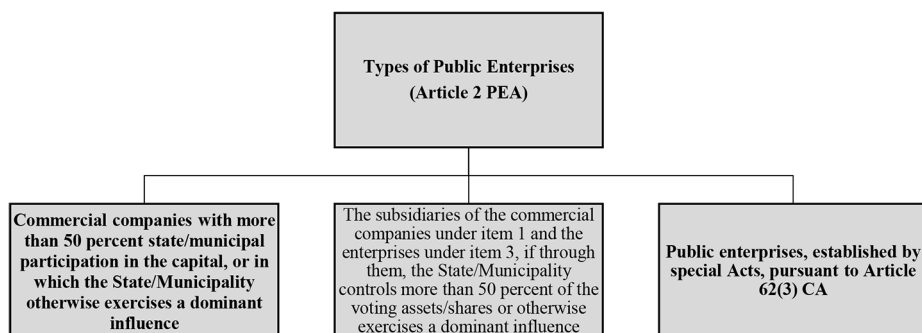
⁵⁶ *OJL* 158, 27.5.2014, p. 77–112.

⁵⁷ *OJL* 318, 17.11.2006, p. 17–25.

2. Types of public enterprises

Public enterprises shall be legal persons, established and managed for the benefit of the citizens and society, in order to achieve maximum value for society through efficient allocation of resources, where necessary: to eliminate existing market defects; to provide goods or services of strategic importance or those, related to national security or development;⁵⁸ to manage strategic property for the State (Article 5 PEA). The provisions of this Act shall not apply to the Bulgarian Development Bank.⁵⁹ See below different types of public enterprises.

Diagram 6 – Types of Public enterprises



⁵⁸ See Resolution No. 181 of the Council of Ministers of 20 July 2009 on the determination of strategic sites and activities relevant to national security.

⁵⁹ See Bulgarian Development Bank Act.

Diagram 7 – Types of Public enterprises according to their legal form

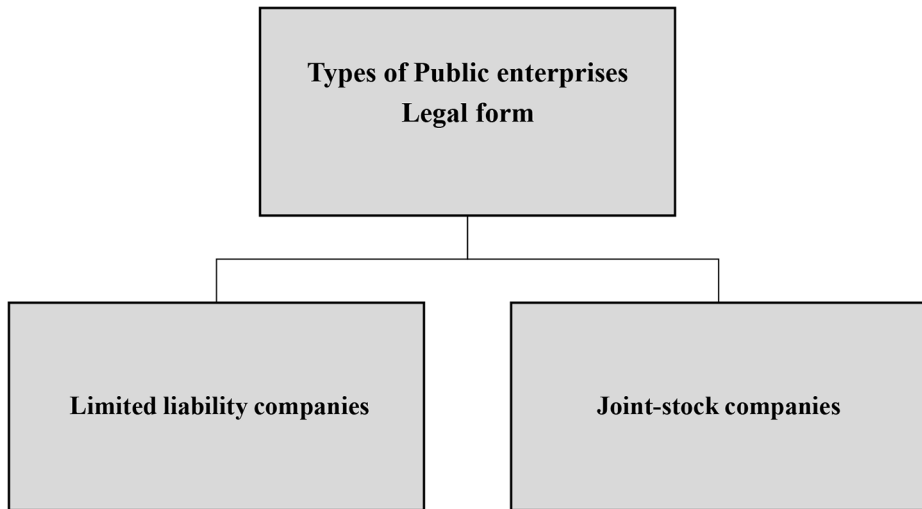


Diagram 8 – Types of Public enterprises according to Chapter Two, Section I and Section II of the Accountancy Act.

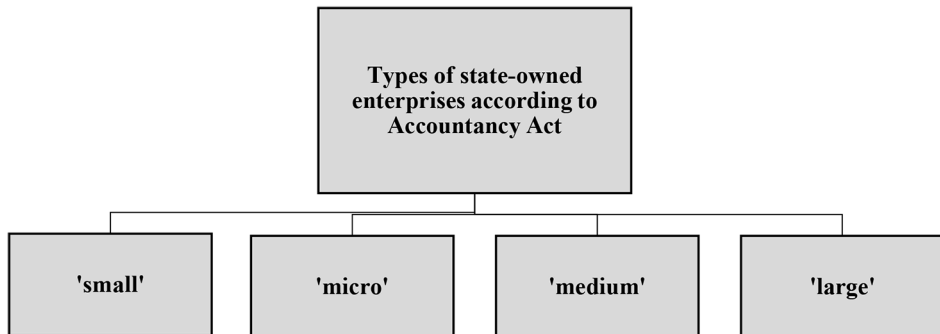


Table 2 – State enterprises which are not companies formed by law according to Article 62(3) CA

Ministry	State-owned enterprise	Special act (law)
Ministry of Youth and Sports (MYS)	State-owned Enterprise 'Bulgarian Sports Totalizer' (SOEBST)	GA (canc.) и GA (Gambling Act)
Ministry of Justice (MJ)	State-owned Enterprise 'Prison Fund' (SOEPF)	IPSA (Implementation of Penal Sanctions Act (canc.), ESDA (Execution of Sentences and Detention Act)
Ministry of Labour and Social Policy (MLSP)	State-owned Enterprise 'Bulgarian-German Vocational Training Centre' (SOEBGVTC)	EmPA (Employment Promotion Act)
Ministry of Environment and Water (MEW)	State-owned Enterprise for the Management of Environmental Protection Activities (SOEMEPa)	EPA (Environmental Protection Act)
Ministry of Energy (MEu)	State-owned Enterprise 'Radioactive Waste' (SOERW)	SUNEA (Safe Use of Nuclear Energy Act)
Ministry of Economy (ME)	State-owned Enterprise 'Management and Administration of Dams' (SOEMAD)	WA (Water Act)
Ministry of Transport, Information Technology and Communications (MTITC)	State-owned Enterprise 'Bulgarian Ports Infrastructure Company' (SOEBPIC)	MSIWPRBA (Maritime Space, Inland Waterways and Ports of the Republic of Bulgaria Act)
	State-owned Enterprise 'National Railway Infrastructure Company' (SOENRIC)	RTA (Railway Transport Act)
	State-owned Enterprise 'Bulgarian Air Traffic Services Authority' (SOE BULATSA)	CAA (Civil Aviation Act)

Ministry	State-owned enterprise	Special act (law)
Ministry of Agriculture, Food and Forestry (MAFF)	Southwestern State-owned Enterprise – town of Blagoevgrad (SWSOE)	FA (Forestry Act)
	Southeastern State-owned Enterprise – town of Sliven (SESOE)	FA (Forestry Act)
	South Central State-owned Enterprise – town of Smolyan (SCSOE)	FA (Forestry Act)
	Northwestern State-owned Enterprise – town of Vratsa (NWSOE)	FA (Forestry Act)
	Northeastern State-owned Enterprise – town of Shumen (NESE)	FA (Forestry Act)
	North Central State-owned Enterprise – town of Gabrovo (NCSOE)	FA (Forestry Act)
	Stud Farm ‘Kabiuk’	AHA (Animal Husbandry Act)

The majority of Bulgaria’s 221 **public enterprises** are incorporated as joint-stock companies (55% of the total number of enterprises), 37% as limited liability companies and 8% as state enterprises.

V. INVESTMENT LEGISLATION

Currently, in strict adherence to EU rules in the field of State Aid, Competition, including protection of Article 18 and the four freedoms (TFEU), Bulgaria attracts foreign direct investments in different ways, using tax incentives, applying some investor programmes, the ‘Startup visa’, etc.

In general, the Investment Promotion Act establishes that the promotion of investments is carried out mainly through tax relief under the CITA.⁶⁰ Foreign investors, including national, obtain incentives under IPA following the requirements and conditions provided in the Act. Depending on the evaluation factors, each investor may apply for a different class of investment certificate for the relevant project. The class of certificate (A, B or Priority) determines the package of incentive measures that can be utilized.⁶¹ As regards to VAT, tax relief is contained in the directives themselves under a compatible State aid scheme and does not need to be notified by the Member State and the ‘de minimis’; the relevant provisions are contained respectively in Chapter Twenty ‘Investment projects’ and in the provisions of Articles 57, 164–167 of the VAT Act (special arrangements for charging value added tax upon importation and reduced 30-day period for refund of the value added tax in the implementation of an investment project).

In addition, the Foreigners in the Republic of Bulgaria Act⁶² stipulates that the Ministry of Innovation and Growth is responsible for issuing, extending and revoking a certificate for a high-tech and/or innovative project, called a ‘Startup visa’. For this purpose, the Ministry developed a special regulation (Resolution No. 318 of October 7, 2022 for the adoption of an Ordinance on the Terms and Conditions for Issuing, Extending and Revoking a Certificate for a High-tech and/or Innovative Project).⁶³ The main purpose of the ‘Startup visa’ is to attract citizens of third countries and investments in companies registered in Bulgaria, developing products and services with high added value by providing the opportunity to obtain a permit for long-term residence in Bulgaria in accordance with the relevant procedure. The incentive measure is aimed at start-up companies

⁶⁰ See Article 166–190 CITA. Article 184: Tax relief for carrying out production activity in municipalities with unemployment higher than the average for the country, which shall be applied in the form of minimum aid under Article 188 or in the form of aid for regional development under Article 189. Article 189b – tax relief, representing state aid for farmers.

⁶¹ See also the information provided by the Bulgarian Investment Promotion Agency: <https://investbg.government.bg/about-the-investor/> [Accessed on 15 January 2024].

⁶² Prom. SG. 153/23 Dec 1998, last suppl. SG. 67 /4 Aug 2023.

⁶³ Prom. SG. 82/ 14 Oct 2022.

with an innovative product and/or service; discussions with regard to the compatibility of these regimes with the principle of equality and non-discrimination have not been raised. As mentioned above, with the promulgation of the Act on the Amendment and Supplement the Bulgarian Commerce Act on 1 August 2023, a new type of company was introduced in Bulgaria in order to develop the start-up ecosystem in Bulgaria and attract foreign investments – the VCC.

Last but not least, a new Investment Promotion Act is needed not just to fulfil the requirements of the Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union,⁶⁴ but also to comply the Commission Regulation (EU) 2023/2831 of 13 December 2023 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid,⁶⁵ Commission Regulation (EU) 2023/1315 of 23 June 2023 amending Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, and Regulation (EU) 2022/2473 declaring certain categories of aid to undertakings active in the production, processing and marketing of fishery and aquaculture products compatible with the internal market in application of Articles 107 and 108 of the Treaty,⁶⁶ etc. Bulgaria can be an attractive investment destination,⁶⁷ not only because of the available grants and financial instruments funded by the EU funds (Chapters 26 and 27).

⁶⁴ *OJL* 79I, 21.3.2019, 1–14.

⁶⁵ *OJL*, 2023/2831, 15.12.2023.

⁶⁶ *OJL* 167, 30.6.2023, p. 1–90.

⁶⁷ See Invest Bulgaria Agency: <https://investbg.government.bg/> [Accessed on 15 January 2024].

CHAPTER 9:

CORPORATE GOVERNANCE AND ESG STANDARDS

Marina Stefanova

ABSTRACT

This chapter presents an overview of some issues related to corporate responsibility and sustainability, and more specifically, to the recent European developments regarding strategic management and reporting. The aim is to help corporate governors, members of C-Suites, and investor relations directors and stewards to understand the content of the concept for ‘corporate social responsibility (CSR) practices’ and their usefulness. The principles of modern corporate governance will be examined and how they correlate with the operations, value creation and reporting of individual corporate governance bodies. Finally, the theory of corporate sustainability will be illustrated by the newest ESG standards, KPIs, reporting requirements and standardized measurements.

KEY WORDS

corporate responsibility and sustainability, CSR, responsible business conduct, Integrated reporting, ESRS

I. INTRODUCTION

The abbreviation ESG, standing for ‘environmental, social, governance’, was first used in the 80s, with no developments in the 90s, and rapid progress from 2003 onward. It marks the latest evolution in the corporate government debate as it interlinks previously unrelated topics such as corporate social responsibility (CSR) and socially responsible investment (SRI). Corporate governance has become synonymous to the discussion about the future of the capitalist system and the role of finance and business in shaping the future of society.¹ It has developed from a concept associated with public

¹ **Câmara, P., Filipe Morais (eds).** The Palgrave Handbook of ESG and Corporate Governance. Palgrave Macmillan, 2022, vii-viii.

manipulation, crisis, and failure, to improving the economic system for the benefit of all. On the other hand, sustainable development has gradually become a major topic for the business world, forcing companies to explore the sustainability layers of business activities and value creation in their business models and strategy (Joyce & Paquin, 2016; Evans et al., 2017).²

Following the Covid-19 health crisis and climate adaptation challenge, the ESG movement shows the relevance both of investor-led changes and of board-led reforms. It highlights that companies must adapt to the new context and the transition must be followed by changes in business models with upgraded performance metrics, risk management, stakeholder dialogue, resilience strategies, C-suite duties, and disclosure practices. The role of ethical codes, internal regulations and organizational practices has therefore grown immensely. The whole corporate governance system must decisively prepare, adopt, execute, monitor, and enforce decisions in ESG matters.

II. BASIC ISSUES

1. General Terms

The term ‘corporation’ comes from the Latin word ‘corporacio’, a ‘union of people with common interests’. Alchian and Demsetz gave the first modern definition of the corporation in 1972.³ They view the corporation as a ‘nexus of contracts’. According to the current understanding, the corporation is a legal entity registered by the relevant judicial authorities and acting in its own name. It is an association of individuals that acts as an independent unit with own rights, privileges and duties, and the ‘property’ function is separated from the ‘management’ function. Additionally, it creates an opportunity and means of securing profit, without liability for the individual. The main characteristics of a modern corporation include:

² **Joyce A., Raymond Paquin.** The triple layered business model canvas: A tool to design more sustainable business models. // *Journal of Cleaner Production*, 2016, 135(1), 1474–1486.

³ **Alchian, A., Harold Demsetz.** Production, Information Costs, and Economic Organization. // *The American Economic Review*, 1972, Vol. 62, No. 5, 777–795.

1. status of an independent legal entity,
2. limited liability of individual investors,
3. transferability of investors' shares,
4. unlimited time, and
5. centralised management.

A major driver for the establishment of the first corporations was the need for funding large investment projects. The corporation provided an opportunity for many independent owners to invest part of their money to gain a higher profit, without having to participate directly in commercial activities. These advantages have their disadvantages – insufficient opportunities to exercise the right to vote (mainly minority owners), entrusting management to third parties, and double taxation. A system to manage and control corporations was designed to connect the strategic governance of the corporation with the general representatives of the capital, its shareholders and other stakeholders. Corporate governance creates the structure through which the company's goals are set, the means to achieve these goals are determined, and their implementation is monitored.

Corporate governance is an interaction between various actors in establishing the direction of activity and behaviour of the corporation. Shareholders and the management team are represented by the board of directors and the executive director. They direct the development of the corporation in the interest of shareholders so that they can achieve a good return on their investments by controlling, in the manner chosen by them, the behaviour of professional managers. Every strategy, product innovation, operations, and marketing, every acquisition and divestiture, decision about asset allocation, finance, joint ventures, financial reports, systems, compensation, and community relations – every decision and each one of the thousands of decisions within these – is determined by some part of the system of corporate governance.⁴ These decisions must be aligned with principles for long-term sustainable value creation for investors, employees, and the community and not for the short-term benefit of one closed group.

⁴ **Monks, R., Nell Minow.** *Corporate governance*. 5th ed. Wiley, 2011.

Investors demand more transparency from companies, particularly when it comes to their governance arrangements and robust stakeholder governance.⁵ They expect material quantitative and qualitative disclosures that present a clear and full view of the performance of the company. This should naturally include the extent to which the business engages with its key stakeholders and how these stakeholders influence the business model of the corporation.

2. Stakeholder Engagement

The importance of good corporate governance, purposeful business and the evolving fiduciary duties of directors is no longer a side-talk but a highlight in every public debate, like the Business Roundtable⁶ that was held in 2019. In 2021, the World Economic Forum issued a report on the ‘Future of the Corporation’ in collaboration with Baker McKenzie.⁷ It further underscores the importance of good stakeholder governance, business resilience and the need to align on ‘values and outcomes at the boardroom level’ to enable ‘prosperity for all’. Sustainable business models depend on the quality of relationships between a company and its key stakeholders. Creating and capturing value relies on good relationships with employees, customers, suppliers, capital providers, governments, and civil society (Glaveli, et al., 2023).⁸

Stakeholder engagement covers all processes of interaction with relevant audiences. Relevant stakeholders are the persons or groups, or their legitimate representatives, who have rights or interests related to the matters that are or could be affected by adverse impacts

⁵ WBCSD. Enhancing the credibility of non-financial information: the investor perspective, 2018. Available at: <https://www.wbcd.org/Programs/RedefiningValue/External-Disclosure/Assurance-Internal-Controls/Resources/Enhancing-the-credibility-of-non-financial-information-the-investorperspective>.

⁶ The Business Roundtable, 2021. Available at: <https://www.businessroundtable.org/>

⁷ World Economic Forum in collaboration with Baker McKenzie. The Future of the Corporation, 2021; available at: http://www3.weforum.org/docs/WEF_The_Future_of_the_Corporation_2021.pdf.

⁸ **Glaveli, N., Maria Alexiou, Apostolos Maragos, Anastasia Daskalopoulou, Viktoria Voulgari.** Assessing the maturity of sustainable business model and strategy reporting under the CSRD shadow. ASECU, 2023, 1–9

associated with the enterprise’s operations, products, or services (EFRAG, 2023).⁹

Meaningful stakeholder engagement refers to ongoing engagement with stakeholders that is two-way, conducted in good faith by the participants on both sides and responsive to stakeholders’ views. Enterprises can prioritize the most severely impacted or potentially impacted stakeholders for engagement. Usually, the degree of impact on stakeholders predisposes the degree of engagement.

Current corporate practices of building stronger commitment include stakeholder advisory panels, materiality assessments, understanding the macro landscape to identify risks and opportunities, presentations, external consultants, engagement with employees/ unions or suppliers in site visits (see Figure 1).¹⁰

Figure 1



The world most renowned standard – AA1000 Stakeholder Engagement Standard¹¹ – covering the topic of engagement distinguishes between several methods of engagement depending on the level of engagement of the respective stakeholders:

⁹ EFRAG. Towards Sustainable Businesses: Good Practices in Business Model, Risks and Opportunities Reporting in the EU. Main Report. 2021. Available at: <https://www.efrag.org/Assets/Download?assetUrl=/sites/webpublishing/SiteAssets/EFRAF%20PTF-RNFRO%20-%20Main%20Report.pdf>

¹⁰ WBCSD. Boards and their stakeholders: The state of play. 2021. Available at: <https://www.wbcd.org/contentwbc/download/12423/185307/1>

¹¹ AA1000 Stakeholder Engagement Standard, https://www.accountability.org/static/940dc017198458fed647f73ad5d47a95/aa1000ses_2015.pdf

Table No. 1 Engagement methods

LEVEL OF ENGAGEMENT	POSSIBLE METHODS OF ENGAGEMENT	
Remain Passive	No active communication	• Stakeholder concern expressed through protest • Letters • Media • Websites etc.
Monitor	One-way communication: stakeholder to organisation	• Media and internet tracking. • Second-hand reports from other stakeholders possibly via targeted interviews.
Advocate	One-way communication: organisation to stakeholder	• Pressure on regulatory bodies • Other advocacy efforts through social media • Lobbying efforts
Inform	One-way communication: organisation to stakeholder, there is no invitation to reply	• Bulletins and letters • Brochures • Reports and websites • Speeches, conference and public presentations
Transact	Limited two-way engagement: setting and monitoring performance according to terms of contract	• 'Public-Private partnerships' • Private Finance Initiatives • Grant-making • Cause-related marketing
Consult	Limited two-way engagement: organisation asks questions, stakeholders answer	• Surveys • Focus groups • Meetings with selected stakeholder/s • Public meetings • Workshops
Negotiate	Limited two-way engagement: discuss a specific issue or range of issues with the objective of reaching consensus	• Collective bargaining with workers through their trade unions

LEVEL OF ENGAGEMENT	POSSIBLE METHODS OF ENGAGEMENT	
Involve	Two-way or multi-way engagement: learning on all sides but stakeholders and organisation act independently	• Multi-stakeholder forums • Advisory panels • Consensus building processes • Participatory decision-making processes • Focus groups • Online engagement tools
Collaborate	Two-way or multi-way engagement: joint learning, decision making and actions	• Joint projects • Joint ventures • Partnerships • Multi-stakeholder initiatives • Online collaborative platforms
Empower	New forms of accountability; decisions delegated to stakeholders; stakeholders play a role in shaping organisational agendas	• Integration of stakeholders into governance, strategy and operations of the organisation

Source: AA1000 Stakeholder Engagement Standard (2015)

3. Risk Assessment

The process of performing risk assessment starts immediately after the identification and prioritization of the most severely impacted or potentially impacted stakeholders for engagement.

Material risks and opportunities generally appear either from impacts or from dependencies. To assess their materiality, a few quantitative and/or qualitative thresholds based upon anticipated financial effects in terms of performance, financial situation, cash flows, access to finance and cost of capital should be used.

Sustainability matters are defined in the delegated act glossary as environmental, social and human rights, and governance factors, including sustainability factors defined in Article 2(24) of Regulation (EU) 2019/2088 (i.e., SFDR).¹² According to the SFDR, impacts are directly caused by operations, products or services to people or the environment.

¹² Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

Impacts to which companies have contributed are those not caused directly and solely by the undertaking's operations, products or services.

The goal of the materiality assessment is to identify the material impacts, risks and opportunities related to matters that are to be reported (ESRS 2 SBM 3)¹³ OR the material impacts and/or material financial effects due to risks and opportunities relate to a matter, and hence that matter becomes material for the undertaking (ESRS 1 paragraph 43 and 49).¹⁴

On the next level, the financial materiality assessment identifies of risks and opportunities that affect or could reasonably be expected to affect the undertaking's financial position, financial performance, cash flows, access to finance or cost of capital over the short-, medium-, or long-term. Consequently, the company management should identify:

(a) the existence of dependencies on natural and social resources as sources of financial effects (see paragraph 50);

(b) their classification as sources of:

i. risks (contributing to negative deviation in future expected cash inflows or increase in deviation in future expected cash outflows and/or negative deviation from an expected change in capitals not recognised in the financial statements); or

ii. opportunities (contributing to positive deviation in future expected cash inflows or decrease in deviation in future cash outflows and/or positive deviation from expected change in capitals not recognised in financial statements).

Once the company has identified its risks and opportunities, it must determine which of them are material for reporting.¹⁵ This should be based on a combination of

¹³ Commission delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L_202302772_.

¹⁴ Et al.

¹⁵ Commission delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L_202302772_.

- (i) the likelihood of occurrence, and
- (ii) the potential magnitude of financial effects determined on the basis of appropriate thresholds.

In this step it must consider the contribution of those risks and opportunities to financial effects in the short-, medium- and long-term based on:

- (a) scenarios/forecasts that are deemed likely to materialise; and
- (b) potential financial effects related to sustainability matters deriving either from situations with a below the ‘more likely than not’ threshold or assets/liabilities not, or not yet, reflected in financial statements.

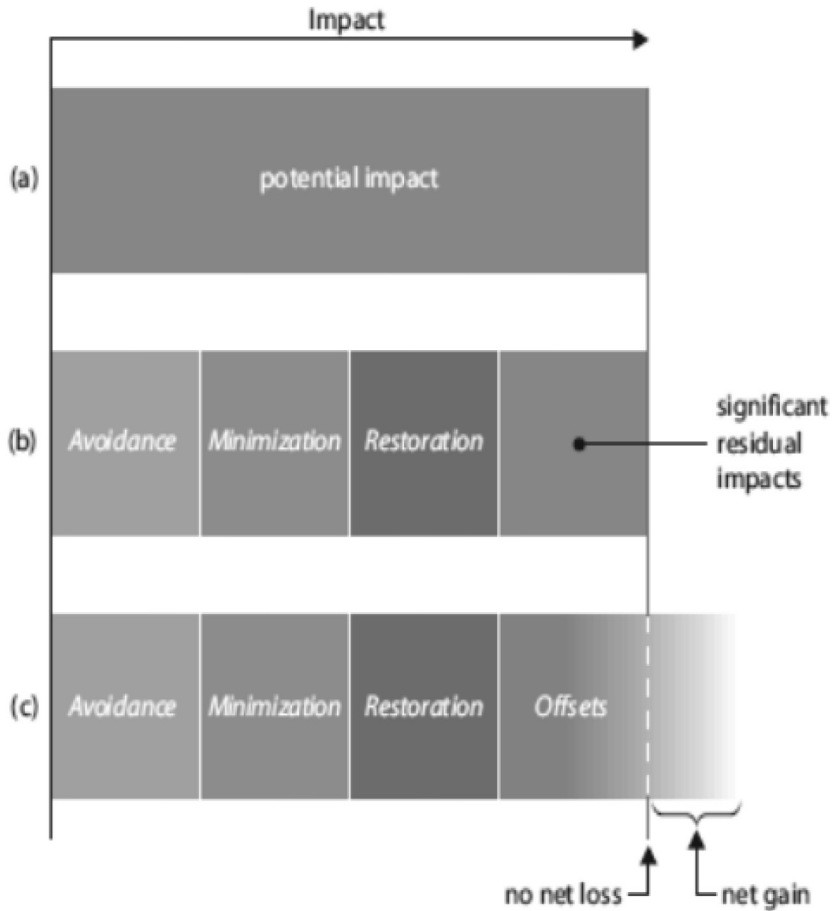
This includes:

- i. potential situations that, following the occurrence of future events, may affect cash flow generation potential;
- ii. capitals that are not recognised as assets from an accounting and financial reporting perspective but have a significant influence on financial performance, such as natural, intellectual (organisational), human, social and relationship capitals; and
- iii. possible future events that may have an influence on the evolution of such capitals.

Once the impacts, risks and opportunities are identified and prioritized, the company is expected to agree on a mitigation strategy. A recent guide issued by the Cross Sector Biodiversity Initiative (CSBI)¹⁶ introduces the term ‘mitigation hierarchy’ (see Fig. 2), which means:

- a) ‘the sequence of actions to anticipate and avoid impacts on biodiversity and ecosystem services; and
- b) where avoidance is not possible, minimize; and
- c) when impacts occur, rehabilitate, or restore; and
- d) where significant residual impacts remain, offset.’

¹⁶ CSBI. A cross-sector guide for implementing the Mitigation Hierarchy. 2015, p. 80.

Figure 2 – Impacts, residual impacts and net loss/gain

4. Materiality analysis

The identification and prioritization of the impacts, risks and opportunities form the foundation of the materiality analysis. The Global Reporting Initiative (known as GRI)¹⁷ is the first international independent standards organization that helps businesses, governments, and other organizations understand and communicate their impacts on issues such as

¹⁷ Global Reporting Initiative, www.grireporting.org.

climate change, human rights, and corruption. Since its first draft guidelines were published in 1999, GRI's voluntary sustainability reporting framework has been adopted by multinational organizations, governments, small and medium-sized enterprises (SMEs), NGOs, and industry groups. Over 10,000 companies from more than 100 countries use GRI.

During the next 20 years, there were various developments and implications of the materiality concept (See Table 2):

Table No. 2 Materiality in different frameworks

Standard	Highlight	Definition
GRI (Global Reporting Initiative)	Encourages double materiality	GRI guidelines don't mandate a specific approach, but they encourage companies to report on both financial materiality (how ESG factors affect their finances) and impact materiality (their social and environmental impacts).
SASB (Sustainability Accounting Standards Board)	Financial materiality (sector-specific)	SASB focuses on industry-specific ESG metrics that have a financial impact on companies. However, they acknowledge the importance of considering broader sustainability impacts.
TCFD (Task Force on Climate Related Financial Disclosures)	Financial materiality (climate focus)	TCFD recommendations target climate-related risks and opportunities with a financial materiality lens.
CDP (Carbon Disclosure Project)	Impact materiality (focus on specific areas)	CDP focuses on environmental impact, particularly on climate change, water security, forests, and supply chain. They request data on a company's environmental performance and strategy.
CSRD (Corporate Sustainability Reporting Directive)	Double materiality	CSRD emphasises double materiality. Companies will need to report on how sustainability issues affect their business and vice versa.
SEC (US Securities and Exchange Commission)	Financial materiality	The recent SEC climate disclosure rule mandates reporting on climate-related risks and opportunities with a financial materiality focus.

The concept of materiality involves both quantitative and qualitative considerations. Quantitative materiality focuses on the financial impact of an item on the financial statements, while qualitative materiality considers the nature and circumstances surrounding the item. Materiality is typically considered through three separate lenses:¹⁸

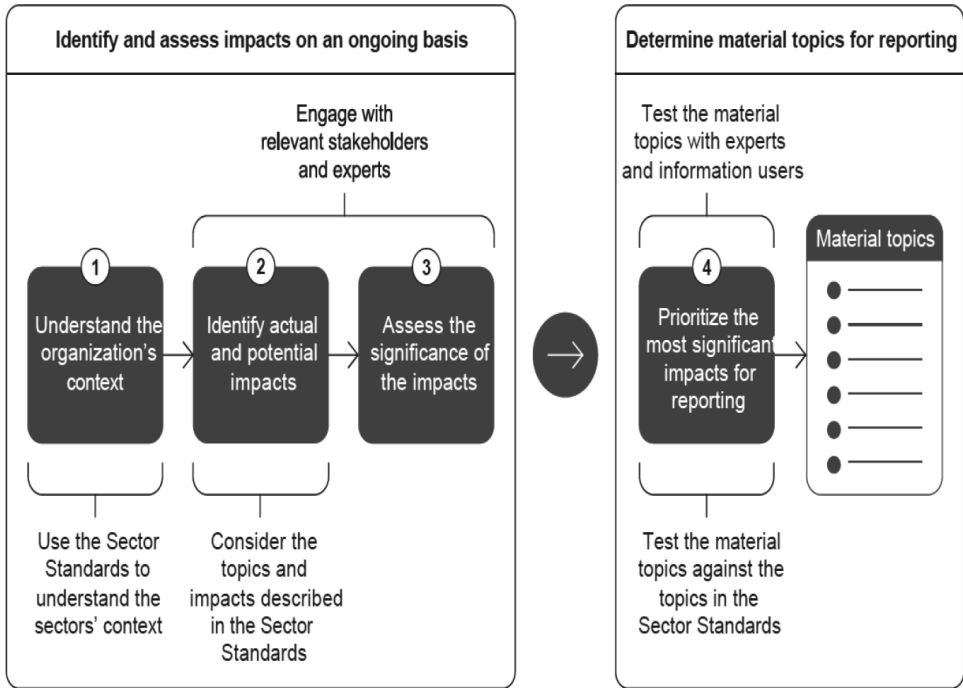
- Quantitative financial thresholds – typically assessed as a set threshold for correcting errors and including disclosures about significant transactions;
- Qualitative financial aspects – generally an informal understanding of ‘what’s important’ to the company that frames narrative reporting; and
- Sustainability-related information – a focused review on sustainability-related issues, typically collecting multiple stakeholder viewpoints and mapping these on a matrix.

While each of these lenses overlap and interrelate, most companies look at them separately. This differs from how investors evaluate information for decision-making. Investors want to understand the business model and strategy in a holistic and connected way.

The process to determine material topics has two dimensions as illustrated in Fig. 3:

¹⁸ Financial Reporting Council. Materiality in practice: applying a materiality mindset. 2023. Available at: <https://www.frc.org.uk/library/frc-lab/themes/materiality/materiality-in-practice-applying-a-materiality-mindset/>

Figure 3 – Process to determine material topics



Source: GRI (2023)

In the EU, the materiality assessment should align with the requirements of ESRS¹⁹ and follows the following steps:

- understanding the context and definition of the stakeholder engagement strategy;
- identification of the list of potential material sustainability matters and impacts, risks and opportunities; and
- determination of the final list of material matters based on an assessment of the materiality of the impacts, risks and opportunities.

¹⁹ Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards.

The European standards frame these two materiality dimensions, as:

- a. ‘an impact perspective when it pertains to the undertaking’s material actual or potential, positive or negative impacts on people or the environment over the short-, medium- and long-term. Impacts include those connected with the undertaking’s own operations and upstream and downstream value chain, including through its products and services, as well as through its business relationships.’ (ESRS 1 paragraph 43); and
- b. ‘a financial perspective if it triggers or could reasonably be expected to trigger material financial effects on the undertaking.’²⁰

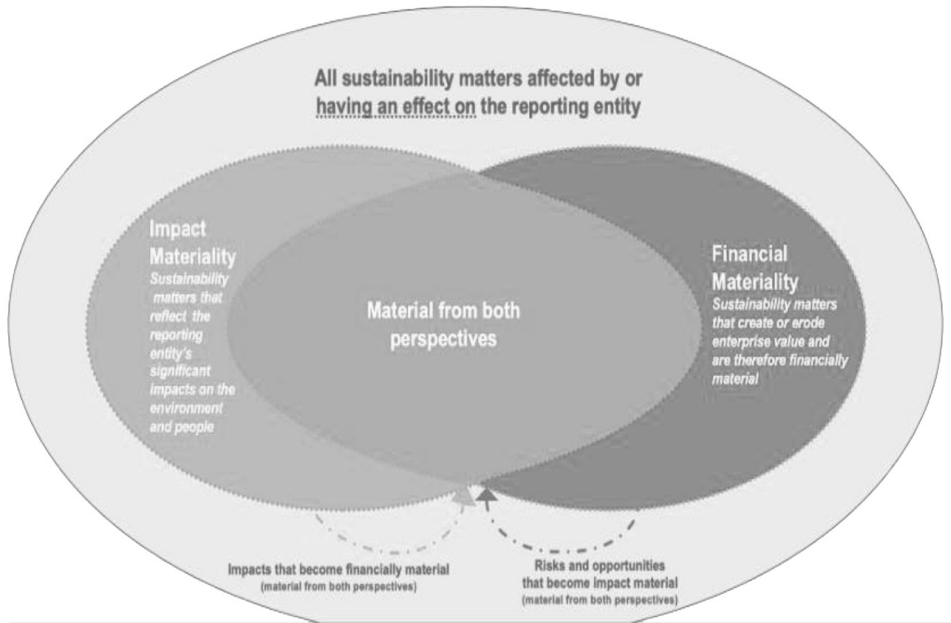
This is the case when a sustainability matter generates or may generate risks or opportunities that have a material influence, or could reasonably be expected to have a material influence, on the undertaking’s development, financial position, financial performance, cash flows, access to finance or cost of capital over the short-, medium- or long-term.’ (ESRS 1 paragraph 49).

Financial materiality is not only a subject of European interest and regulation. Some of the largest international institutional investors, namely Blackrock and Vanguard, have released guidance for board of directors and senior management on expectations about corporate performance on ESG issues.²¹ The U.S. Supreme Court defines the financial materiality information as information that if disclosed would have a substantial likelihood of being viewed by a reasonable investor as having significantly altered the ‘total mix’ of information available (*TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449). Once ranked as ‘material’, an issue focuses the attention of corporations, triggering the need for due diligence, internal controls, disclosure to shareholders, acknowledgement by the CEO and CFO, and allocation of resources to manage it.

²⁰ EFRAG. Implementation guidance for the materiality assessment, 2023.

²¹ **Freiberg, D., Jean Rogers, George Serafeim.** How ESG Issues Become Financially Material to Corporations and Their Investors. // Harvard Business Review Working Paper, 2020, No. 20-056.

Figure 4. Impact and financial materiality



Lastly, it is important to highlight that not only the issues are financially material but also the change in time. For a topic to become such, it needs to go through the following five stages: the status quo, catalyst events, stakeholder reaction, company reaction, and regulatory reaction as well as innovation.²²

5. Management standards

The International Standardization Organization is the international organization that developed more than ten dedicated management standards, incl. ISO 14000, ISO 26000, ISO 50000, ISO 45000. Most MNCs apply multiple standards thus introducing an integrated management system. In parallel, the International Labour Organization (ILO)'s eight core conventions outline specific groups or population that require special

²² **Freiberg, D., Jean Rogers, George Serafeim.** How ESG Issues Become Financially Material to Corporations and Their Investors. // Harvard Business Review Working Paper, 2020, No 20-056.

attention: women, children, migrant workers and their families, persons belonging to national or ethnic, linguistic, and religious minorities, indigenous peoples, and persons with disabilities.

Nevertheless, the introduction of management standards in the sustainability domain started by OECD in the late 80s. The OECD Guidelines on Responsible Business Conduct of Multinational Enterprises²³ are the main international standards for corporate governance, and they were updated recently to include a new chapter on ‘Sustainability and resilience’. In 2023, the Guidelines underwent an extensive revision to address pressing environmental, social, and technological challenges. A central tenet was the enhanced emphasis on sustainability reporting, which was redesigned to stay attuned to the principles of corporate governance.²⁴ The Guidelines emerged as the first internationally recognized standards on climate mitigation, backed by the government. This set the directive for enterprises to align their greenhouse gas emissions with globally agreed temperature goals. They stress the role of due diligence in guaranteeing the relevance and authenticity of sustainability data, no matter its materiality, and prioritize sustainability risk management.

The Guidelines are addressed by governments to multinational enterprises and are consistent with international good practice. Enterprises are encouraged to observe the Guidelines in whichever country they operate. Regardless of its ownership or structure, all entities within an enterprise should observe the Guidelines. The Guidelines reflect good practice for both domestic and multinational enterprises, while small and medium enterprises are encouraged to follow them to the fullest extent possible.

The document frames business conduct covering the issues of governance, operations and culture introducing policies in seven main domains: human rights, employment and industrial relations, science and research, environmental protection, anticorruption, consumer interests, competition and taxation.

²³ OECD Guidelines for Multinational Enterprises on Responsible Business Conduct. Paris, OECD Publishing, 2023.

²⁴ Financial Reporting Council. Materiality in practice: applying a materiality mindset. 2023. Available at: <https://www.frc.org.uk/library/frc-lab/themes/materiality/materiality-in-practice-applying-a-materiality-mindset/>

General policies²⁵

Enterprises should:

1. Work towards sustainable development by contributing to economic, environmental and social progress.
2. Respect the internationally-recognized human rights of those affected by the enterprise's activities.
3. Cooperate with the communities they operate in to build local capacity.
4. Create jobs and facilitate training opportunities for employees.
5. Seek or accept no unusual exceptions to regulatory frameworks.
6. Uphold good corporate governance principles throughout the whole enterprise.
7. Develop and apply self-regulatory practices and management systems that foster mutual trust in host societies.
8. Make sure that workers know about and comply with enterprise policies.
9. Protect workers who legitimately 'blow the whistle' on breaches of the Guidelines, laws, or enterprise policies.
10. Carry out risk-based due diligence to identify, prevent and mitigate real and potential adverse impacts of the enterprise's activities along the length of its supply chain.
11. Avoid causing or contributing to adverse impacts in areas covered by the Guidelines, and fix them when they occur.
12. Mitigate or prevent adverse impacts directly linked to enterprise activities through a business relationship.
13. Encourage business partners including suppliers to apply the principles of the Guidelines.

²⁵ Australian National Contact Point, <https://ausncp.gov.au/oecd-guidelines>.

14. Ensure that local communities have a voice in projects or decisions that will impact their community.
15. Avoid improper involvement in local political activities.

Where possible, Enterprises should:

1. Support internet freedom, as appropriate to their circumstances.
2. Engage in or support dialogue on responsible supply chain management, taking into account the effect this may have on developing countries and international standards.

Disclosure

1. Ensure accurate and timely disclosure of all material matters across the whole enterprise.
2. Have disclosure policies that include information on: financial and operating results; objectives; structures of groups of enterprises and control mechanisms; remuneration policy; related party transactions; risk factors; worker and stakeholder issues; and governance structures and policies.
3. Disclose: value statements; how well they perform to those values; audit systems and performance against them; and quality of stakeholder relationships.
4. Have high-quality accounting and financial disclosure standards.

Human Rights

1. Respect, avoid infringing upon and address impacts on human rights.
2. Avoid causing or contributing to adverse human rights impacts.
3. Mitigate adverse effects on human rights linked to enterprise activities or business relationships.
4. Have a policy commitment to human rights.

5. Carry out human rights' due diligence.
6. Cooperate in remediation of rights breaches caused or contributed to by the enterprise.

Employment and industrial relations

1. Respect workers' rights to organise, allow collective bargaining, contribute to the abolition of child and forced labour and provide equal opportunities and treatment to all workers.
2. Provide facilities and information to workers to enable fair collective bargaining.
3. Promote consultation and cooperation between workers, employers, and worker representatives.
4. Provide no worse working conditions or employment relations than comparable employers, provide wages that will satisfy at least the basic needs of workers and keep them safe at work.
5. Use local workers (to the extent possible) and provide training to up-skill them.
6. Provide fair notice or warning before making lay-offs.
7. Use no economic threats such as moving operations to influence collective negotiations.
8. Enable worker representatives to negotiate on collective bargaining or labour- management relations.

Environment

1. Establish and maintain robust environmental management systems and environmental performance objectives or targets, and monitor them.
2. Be open with the public and workers about the environmental, health and safety effects of the enterprise's activities, and undertake appropriate consultation with communities affected by the enterprise's environmental, health and safety policies and their implementation.

3. Take into account the environmental, health and safety effects of products and services over their life cycle and prepare environmental impact assessments when effects might be significant.
4. Make cost-effective investment to reduce environmental damage from products even if there is not scientific certainty about the risks.
5. Maintain contingency plans for preventing, mitigating, controlling, and reporting environmental and health damage.
6. Continually seek to improve environmental performance, and apply to supply chains too, where appropriate.
7. Provide environmental and safety training to workers in environmental health and safety, and general environmental management areas.
8. Contribute to enhancing environmental awareness and protection in public policy.

Combating bribery, bribe solicitation and extortion

1. Do not offer bribes to public officials or employees of business partners, or accept such offers from them, either directly or through intermediaries
2. Develop and maintain adequate internal mechanisms for preventing and detecting bribery.
3. Prohibit or discourage facilitation payments, and accurately record any payments made.
4. Apply bribery risk due diligence to ensure agents are paid only for legitimate services, and are overseen appropriately.
5. Be transparent in anti-bribery activities.
6. Train and inform workers of anti-bribery policies.
7. All political contributions should comply with public disclosure requirements and be reported to senior management.

Consumer Interests

1. Ensure that goods and services meet agreed or legally-required consumer health and safety standards, including labelling requirements.
2. Provide accurate, verifiable and clear information that enables consumers to compare products and make informed decisions about them.
3. Provide consumers with an effective, inexpensive and easy-to-use way of resolving complaints or disputes.
4. Ensure that products are not misrepresented, in ways such as giving false information or omitting information that consumers would want to know.
5. Support consumer education about products, including the areas of: sustainable consumption; social, economic and environmental impacts; and how to make informed decisions about complex issues.
6. Respect and protect consumer privacy.
7. Work with authorities to prevent deceptive marketing, and reduce threats to public health, safety and the environment from the enterprise's goods and services.
9. Consider the needs of vulnerable and disadvantaged consumers and the challenges of e- commerce for consumers.

Science and technology

1. Seek to ensure that enterprise activities are compatible with the science and technology policies of host countries and contribute to local and national innovation.
2. Adopt practices that will encourage the transfer and diffusion of technologies while respecting intellectual property rights.
3. Seek to address science and technology needs of host countries.
4. Ensure that intellectual property rights license agreements are fair and contribute to the long-term development of host countries.

5. Get involved with local research institutions and participate in joint research with them.

Competition

1. Carry out activities in line with competition laws and regulations, considering the effects or potential effects on competition in any relevant jurisdiction.
2. Avoid participating in anti-competitive agreements such as price fixing, collusion, output restrictions and market division.
3. Cooperate with competition investigators promptly and completely.
4. Educate senior management and employees on the importance of complying with competition laws.

Taxation

1. Pay taxes on time and comply with the letter and spirit of tax laws of host countries.
2. Treat tax governance and compliance as important parts of oversight and risk- management systems.

The Guidelines also set out a due diligence framework that governments actively support and monitor by:

1. embedding responsible business conduct into policies and management systems;
2. identifying and assessing actual and potential adverse impacts associated with the enterprise's operations, products, or services;
3. ceasing, preventing and mitigating adverse impacts;
4. tracking implementation and results;
5. communicating how impacts are addressed; and
6. providing for or co-operating in remediation when appropriate.
7. ESG reporting

For the last century, corporate reporting continues to evolve to address not only the financial drivers of value creation but also the sustainability

dimensions of business activities. Today, policymakers, capital providers, and companies see the externalities or impacts that business activities have on people and the planet. Annual reports are key because they provide a focal point for disclosure regulation in many jurisdictions and an anchor for other, more timely performance communications (KPMG 2016).²⁶

The sustainability reporting frameworks have been developing in the years, building an international coherence and interoperability among the GRI's Sustainability Reporting Guidelines, the United Nations Global Compact (UNGC), the UN Guiding Principles on Business and Human Rights, OECD Guidelines, International Organization for Standardization (ISO) 26000 and the International Labour Organization (ILO) Tripartite Declarations, etc.

7. Integrated reporting

The latest theoretical developments result in the International Integrated Reporting Council publications.²⁷ Integrated Reporting (IR) in corporate communication is a 'process that results in communication, most visibly a periodic 'integrated report', about value creation over time. An integrated report is a concise communication about how an organization's strategy, governance, performance and prospects lead to the creation of value over the short, medium and long term.'

It means the integrated representation of a company's performance in terms of both financial and other value relevant information. Integrated Reporting provides greater context for performance data, clarifies how valuable relevant information fits into operations or a business, and may help make company decision-making more long-term. While the communications that result from IR will be of benefit to a range of stakeholders, they are principally aimed at providers of financial capital allocation decisions.

²⁶ Athanasakou, V., Martin Walker, Steven Young, Paolo Alves, Mahmoud El-Haj, Paul Rayson. Mandatory Annual Report Descriptions of Business Model and Strategy, Investor Uncertainty, and Disclosure Cascade Effects. 2022. Available at <http://dx.doi.org/10.2139/ssrn.3212854>.

²⁷ IFRS Foundation. International Reporting Framework. 2021. Available at: <https://integratedreporting.ifrs.org/wp-content/uploads/2021/01/InternationalIntegratedReportingFramework.pdf>.

8. OECD Guidelines²⁸

According to the new amendments to the OECD Guidelines, sustainability reporting is a compulsory element of the responsible business conduct of enterprises. They should consider established disclosure policies in the countries and sectors in which they operate, and consider the views and informational requirements of shareholders and other relevant stakeholders. Enterprises should disclose regular, timely, reliable, clear, complete, accurate and comparable information in sufficient detail on all material matters. This information should be disclosed for the entire enterprise, and, where appropriate, along business lines or geographic areas. Disclosure policies of enterprises should include, but not be limited to, material information on:

- a. the financial and operating results of the enterprise;
- b. enterprise objectives and sustainability-related information;
- c. capital structures, group structures and their control arrangements;
- d. major share ownership, including beneficial owners, and voting rights;
- e. information about the composition of the board and its members, including their qualifications, the selection process, other enterprise directorships and whether each board member is regarded as independent by the board;
- f. remuneration of members of the board and key executives;
- g. related party transactions;
- h. foreseeable risk factors, among which interest rate or currency risk; risks related to derivatives and off-balance sheet transactions; business conduct risks; digital security risks; compliance risks; and sustainability risks, notably climate-related risks;
- i. governance structures and policies including the extent of compliance with national corporate governance codes or policies and the process by which they are implemented;
- j. debt contracts, including the risk of non-compliance with covenants.

²⁸ OECD (2023), OECD Guidelines for Multinational Enterprises on Responsible Business Conduct, OECD Publishing, Paris, <https://doi.org/10.1787/81f92357-en>.

Information about board and executive remuneration is also of concern to shareholders, including the link between remuneration and the enterprise's long-term performance, sustainability and resilience.

9. European Sustainability Reporting Standards

In Europe, the sustainability reporting evolution is mainly the outcome of the pressure of capital providers, as well as EU's interest and directives (e.g., Non-Financial Reporting Directive 2014/95/EU (NFRD)²⁹ and the Corporate Sustainability Reporting Directive (CSRD)) for high quality information disclosure on business model, strategy and sustainability risks and opportunities (Di Tulio et al., 2019). In 2014, the European Commission obliged large multinational corporations to provide non-financial disclosure to the markets. The first Directive applied to public companies with more than 500 employees. Companies that would provide such reporting would be required to report on environmental, social and employee-related, human rights, anti-corruption and bribery matters. Additionally, these large corporations would be required to describe their business model, outcomes and risks of the policies on the above topics, and the diversity policy applied for management and supervisory bodies.

In 2020, the sustainability reporting requirements for companies were further expanded in the EU's Corporate Sustainability Reporting Directive (CSRD) which took effect in 2023. At present, EU law requires large companies and listed companies to publish regular reports on the social and environmental risks they face, and on how their activities impact people and the environment; Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting³⁰ are applicable.

The development of technical requirements is delegated to the European Financial Reporting Advisory Group (EFRAG). Its mission is to serve the European public interest in both financial and sustainability reporting by developing and promoting European views in the field of

²⁹ *OJL 330, 15.11.2014, 1–9.*

³⁰ *OJL 322, 16.12.2022, 15–80.*

corporate reporting. In its sustainability reporting activities, EFRAG provides technical advice to the European Commission in the form of draft European Sustainability Reporting Standards (ESRS).

The Advisory Body introduced a system of 12 sector-agnostic, a yet undefined number of sector-specific, and company-specific standards. In addition, listed and non-listed SMEs have their two dedicated reporting sets. The Standards establish both quantity and quality criteria³¹ related to the clarity and comprehensiveness of overall business model (BM) and strategy disclosure, the disclosure of BM's potential across time horizons and its dependencies and impacts on sustainability issues, material sustainability issues that are likely to affect the company's performance, BM's exposure to sustainability risks and opportunities, and the sustainability strategy, targets, KPIs, its monitoring and progress.³²

10. International Sustainability Standards

Apart from Europe, in 2022, GRI and the International Financial Reporting Standards Foundation (IFRS Foundation)³³ announced that they would collaborate to align the International Sustainability Standards Board's³⁴ investor-focused Sustainability Disclosures Standards for capital markets with the GRI's multi-stakeholder focused sustainability reporting standards. In 2023, the ISSB issued its inaugural standards (IFRS S1³⁵ and IFRS S2)³⁶ for sustainability-related disclosures in capital markets.

³¹ EFRAG. Practices Evaluation Approach. 2021.

³² **Glaveli, N., Maria Alexiou, Apostolos Maragos, Anastasia Daskalopoulou, Viktoria Voulgari.** Assessing the maturity of sustainable business model and strategy reporting under the CSRD shadow. ASECU, 2023, 1–9.

³³ International Integrated Reporting Council, <https://www.ifrs.org/>.

³⁴ International Sustainability Standards Board, International Sustainability Standards Board.

³⁵ IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information,

<https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s1-general-requirements/>.

³⁶ IFRS S2 Climate-related Disclosures, <https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s2-climate-related-disclosures/>.

CHAPTER 10:

COMMERCIAL TRANSACTIONS LEGAL FRAMEWORK, CONCEPT, TYPES. ABUSE OF RIGHTS

Ivan Rushev

ABSTRACT	KEY WORDS
This chapter presents the legal framework of commercial transactions. The issue of legal sources (laws, commercial customs, international treaties, decisions of the Constitutional Court and those of the Supreme Court of Cassation) is discussed. Attention is drawn to the concept of commercial transaction, the types of commercial transactions and the correlation between civil and commercial transactions. The issues of the regulation and the nature of abuse of rights as well as the legal consequences of such abuse are also examined.	commercial transactions, legal sources, types of commercial transactions, abuse of rights

I . INTRODUCTION. SOURCES OF THE REGULATORY FRAMEWORK FOR COMMERCIAL TRANSACTIONS

The legal framework of commercial transactions is mainly contained in **Part Three, Chapter Twenty-One** (Article 286–Article 606a) of the Commerce Act (effective 1 November 1996).

Article 288 of the Commerce Act (CA), entitled ‘Sources’, is located within the general provisions of the section on commercial transactions. According to it, ‘the provisions of civil legislation shall apply to any matters of commercial transaction not regulated herein and when, the civil legislation is incomplete, business customs shall apply’. This provision is to be interpreted broadly. In **the first place**, it goes beyond the ‘*sedes materiae*’ – the part on transactions. The provision of Article 288 concerns

all sources of commercial legislation, not just those related to transactions. **Next**, the literal meaning of Article 288 provides for the primary application of the Commerce Act alone, followed by civil laws. However, these cannot supersede application of other (special) laws of commercial legislation beyond the Commerce Act (CA): the **Merchant Shipping Code (MSC)**, title amended in SG No. 113/2002, effective 01.01.1971); the **Credit Institutions Act (CIA)**, effective 01.01.2007); the **Concessions Act (CoA)**, effective 02.01.2018); the **Competition Protection Act (CPA)**, promulgated in SG No. 102 of 28 November 2008); the **Commodity Exchanges and Wholesale Markets Act (CEWMA)**, promulgated, SG No. 93 of 1 November 1996); the **Special Pledges Act (SPA)**, effective 01.04.1997 with numerous amendments); the **Insurance Code (IC)**, effective 01.01.2016); the **Public Offering of Securities Act (POSA)**, effective 31.01.2000); the **Electronic Commerce Act (ECA)**, effective 24.12.2006) and others. Therefore, in order for civil legislation to apply, a ‘loophole’ must exist in both commercial law and the other commercial legislation acts.

The provisions of Article 288 CA should also be interpreted broadly in another direction. **We should take into account** the ‘gap’ not only in the law (in its narrow sense, as an act of the National Assembly) but also in any statutory act. This means that the main sources of commercial legislation, and in particular those regarding commercial transactions, are commercial legislative acts, including sub-legislative acts (**Decree of the Council of Ministers No. 426 of 2014**). Where provisions exist that are not regulated in these acts, the provisions of general law will apply in a subsidiary manner. In the area of transactions, this is primarily the **Obligations and Contracts Act**, which, regarding the conclusion, invalidity, performance and non-performance of contracts, limitation periods etc., is the **main subsidiary source** of commercial legislation (Article 288 CA). However, such are **also other civil laws** – e.g., the **Non-Profit Legal Entities Act** which notes, in its Article 3, that non-profit legal entities may also pursue business activities (either independently or as participants and in the form of Commerce Act entities); the **Succession Act**, on the succession of commercial capacity or membership relationship, regarding the capital of a Limited liability or Joint-stock company; Article 22(3) of the **Family**

Code, according to which the property, acquired by either spouse who is a sole proprietor during marriage for the purpose of engaging in business activities and included in his/her enterprise, will belong only to him/her and shall not become community property, etc.

Additionally, where the civil laws do not provide a solution to a particular commercial legal case, **commercial customs** come into play as a **further, subsidiary source** in case of incompleteness in civil legislation. In order to be recognised as a legal source, a custom must be applied continuously (*inveterata consuetudo*) with an awareness of its binding character (*opinio necessitatis*) and must be recognised. This obligatory nature must be recognised by the law. This is most often done in court, in the event of a dispute as to whether a customary rule has the quality of a commercial custom. Most often, a custom acquires its binding force directly from the law (*secundum legem*), when the CA expressly refers to the custom. Thus, for example, according to Article 37, ‘*Where the commission rate has not been agreed upon, it shall be presumed to amount to the customary rate paid for the specific activity*’; pursuant to Article 299(1) CA, when third parties provide for the arrangements of a transaction, these arrangements must be ‘*consistent with and ... the business custom*’; the same applies to the court’s decision to supplement a commercial contract (Article 300 CA).

In the event of differences in commercial custom, the ‘**business custom at the place of performance**’ prevails (Article 288 CA). For example, pursuant to Article 494(2) CA, the exchange rate of a foreign currency must be determined in accordance with the business customs at the place of payment and, pursuant to Article 154 MSC, the costs of discharge of cargo from a ship, and its removal, is determined by the customs [(practices)] in force in the port.

Business customs should be distinguished from the so-called ‘**customs in practice**’ (de facto ‘**customs**’ [(practices)]). They lack the characteristic of being binding and are observed only for convenience, security, timesaving and are therefore not a source of law. However, they are a source in commercial transactions because they serve to interpret (supplement) the will of the parties to these transactions.

Similar to the provision of Article 288 CA is the norm contained in Article 1 of the repealed Commerce Act. This norm also provided for the subsidiary application of civil laws and customs, but with a different priority: according to it, business custom *preceded* the application of civil law. The current regime takes account of the long-standing interruption of commercial-legal traditions following the repeal of the CA in 1950, until the gradual restoration of commercial-legal traditions, which began with the adoption of General Part I (Articles 1–55) and Part II – Types of Merchants (Articles 56–285) in 1991; continued with Part IV – Bankruptcy (Articles 607–760i) in 1994 (amended repeatedly); the current Part III – Commercial Transactions (Articles 286–606a) in 1996, and the most recent Part V – Merchant Restructuring Proceedings (Articles 761–800) effective since 2017. Business customs have decreased their relevance due to non-application but are preserved and in force primarily in foreign trade relations.

In recent years, customary rules of trade have gradually been restored, influenced by the unification of international business customs (e.g., the Uniform Customs and Practice of the International Chamber of Commerce in Paris on documentary credits and guarantees payable on demand; the Uniform Rules of Cash Collection, its rules on interpretation of commercial terms (Incoterms) etc.). In addition to subsidiary application, as provided for in Article 288 CA, the application of civil legislation and business customs (and other rules, too) to legal transactions may also occur pursuant to Article 46(2) of the Statutory Instruments Act. The text stipulates that where a statutory instrument is incomplete, cases not provided for therein will be governed by the provisions applicable to similar cases, provided that is in accordance with the purpose of the act (*analogia legis*).

International treaties can also be sources of regulation in commercial transactions. Following their endorsement (accession of Bulgaria), they have to be ratified by the National Assembly and promulgated. Thus, they become part of our domestic law, without being domestically sourced, but enjoying priority over domestic statutory acts (Article 5(4) of the Constitution). In the field of transactions, the 1980 United Nations Convention on Contracts for the International Sale of Goods (the ‘Vienna Convention’, ratified by Decree No. 264 of 1990, State Gazette No. 23 of 1990) is of major importance as a source of international origin. Following

Bulgaria's accession to the EU, secondary European law on various types of commercial transactions (Regulations and EU Directives incorporated into our domestic commercial legislation) has become of great importance.

Additional sources of commercial law, and thus of [those covering] commercial transactions, are the decisions of the Constitutional Court (Article 149 of the Constitution), the binding practices of the Supreme Court of Cassation (SCC) and the former Supreme Court, given in interpretative decisions of the General Assemblies of the Commercial and Civil Chambers of the SCC and the joint interpretative decisions of the two supreme courts: the Supreme Court of Cassation and the Supreme Administrative Court.

Both the decisions of the **Constitutional Court** and general acts of the **SCC** contain interpretations of norms. However, while the decisions of the Constitutional Court are *erga omnes* (applicable to all), the interpretative decisions of the SCC are binding only on judicial and executive authorities. These are not directly binding on the parties to commercial transactions and will only bind them as parties to the litigation process in disputes relating to them. Insofar as the decisions of the Constitutional Court have, as their object, relations of a different type, they may, indirectly, affect disputes in commercial transactions.

Modern doctrine does not consider either justice or the rules of morality (good morals) as sources (even indirect or subsidiary) for the legal regulation of transactions. Rather, they are non-legal rules for assessing the conduct of persons and fairness as a substantive criterion of assessment in the activity of the court. Thus, for example, in Article 307 CA, the court has to assess, when amending or terminating a contract on the grounds of economic hardship, whether its preservation is contrary to fairness and good faith. The application of fairness is broader in civil law relations (e.g., Article 52 OCA). In respect of the **rules of morality (good morals), although their violation is a ground for the nullity of the contract** (Article 26(1) OCA, which also applies to commercial transactions), the court never bases its decision solely on them. They are almost always applied together with other, 'stronger' grounds for nullity (contradiction with the law, impossible subject matter, lack of form or reason). Moreover, their violation has been formally transformed into an

element of the legal norm, i.e., it has been given legal relevance separate from its function as an extra-legal regulatory factor.

II. CONCEPT OF A COMMERCIAL TRANSACTION

A transaction is a fundamental concept in law. It is a widespread institution in all branches of law. Other than in contracts, which are the classical expression of bilateral arrangements, today such transactions are found in private law: **in the general part of civil law**, such as the power of attorney (Articles 37–43 OCA); confirmation of a voidable transaction (Article 35 OCA); ratification of a transaction concluded without representative authority (Article 42 OCA and Article 301 CA); renouncing of the right of ownership (Article 100 of the Property Act), etc.; in **Contract Law**: objection for contract non-performance (Article 90 OCA); right of retention (Article 91 OCA); set-off statement (Articles 103–105 OCA); invalidation (Article 32 OCA); the rescission of bilateral contracts (Article 87–88 OCA); reduction of penalty (Article 92(2) OCA); the exercising of rights of an inactive debtor by his creditors (Article 134 OCA); declaring the relative invalidity of legal acts by which the debtor harms its creditor (Article 135 OCA); renunciation and withdrawal of a mandate (Articles 287–289 OCA); revocation of a donation (Article 227 OCA, Article 55 of the Family Code), etc.; in **Inheritance Law**: wills (Article 13–18 and others of the Succession Act (SA)); waiver and acceptance of inheritance (Article 49–50 SA); bequests (Articles 19 and 22 SA); invalidation of a waiver of succession (Article 56 SA); in **Family Law**: child recognition (Article 65 FC); the challenging and annulment of recognition (Articles 66–67 FC); choice of regime for the separation of property between spouses (Article 18(2) FC); termination of a matrimonial contract (Article 42(1)2 FC); and its rescission (Article 42(2) FC), etc.

There are many more contracts, i.e., bilateral transactions, which, unlike unilateral ones (Article 44 OCA), are not limited in number. Pursuant to Article 9 OCA, the parties may freely conclude contracts, determining their contents insofar as these do not contravene the mandatory provisions of the law and good morals.

The genesis of the transaction is in civil law, from where it passes into commercial law. Being based on civil law, a transaction bears all the latter's generic features, to which specific ones are added. It is defined as a legitimate legal fact, the principal element of which is the expression of will, or consent of one or more persons, aimed at certain legal consequences.

The specificity of the commercial transaction is derived from two basic criteria: **economic** and **legal**.

According to economic criteria, commercial transactions are those that directly serve the process of circulating goods (i.e., 'trade' in the economic sense of the term) or are related to it (the so-called 'accretive' commercial transactions). The main objective of separating the law of commerce from general civil law is to ensure adequate regulation precisely of commercial activities. The law of commerce mediates the circulation of goods and capital, legally linking producer, merchant and consumer. It is commercial transactions that specifically serve the circulation of goods and capital.

The main legal institute for this is the 'sale', or 'commercial sale'. However, 'sale' implies several activities that are related to and serve the 'sale'. These are: transport; freight forwarding; warehousing; banking; insurance; etc. The legal forms for undertaking these activities are, severally: transport and warehousing transactions; commission and freight forwarding contracts; banking transactions; insurance contracts, etc. These are all commercial transactions.

III. ABSOLUTE, RELATIVE, AND PRESUMPTIVE COMMERCIAL TRANSACTIONS

However, it is **legal criteria**, not economic ones, that are the guiding principles in defining legal concepts. Commercial legislation uses two legal criteria to qualify transactions as commercial.

The first relates to the specific nature of transactions and the **second** to the particularity of the persons who carry them out.

The first criterion is considered as **objective** and the second as **subjective**. The **objective criterion** for determining commercial transactions

is reflected in the provisions of Article 286(2) CA. Pursuant to them, the transactions under Article 1(1) of the Commerce Act are also considered commercial transactions, regardless of the capacity of the persons concluding them. Therefore, these transactions are designated as **‘objective’** or **‘purely commercial’ transactions**. They are commercial regardless of who carries them out and can, therefore, be undertaken also by a non-trader. This circumstance neither negates the commercial character of the transaction nor gives a commercial capacity to the person who undertakes it. This is because the performance of commercial transactions is not the sole criterion for qualifying a person as a trader. Such transactions are:

- The purchase of goods or other things for resale, in their original processed or manufactured form;
- bills of exchange, promissory notes and cheques;
- the sale of goods of own production;
- warehouse transactions;
- the purchase of securities with a view to sale;
- licensing transactions;
- transactions concluded by sales representatives and intermediaries in the course of their business;
- commodity control contracts;
- commission, freight forwarding and transport transactions;
- transactions in intellectual property;
- insurance transactions;
- hotel, tourist, advertising and information, programme, impresario or other services;
- banking and foreign exchange transactions;
- the purchase, as well as transactions related to the construction and furnishing of immovable property for sale;
- leasing;

This list, in addition to not being exhaustive, indicates not only transactions but the activities in respect of which they take place. Such are, for example, the commercial representation and intermediation provided for in item 4 of Article 1(1) CA; commodity control in item 11; the construction or furnishing of immovable property in item 14.

It follows from the absolute nature of those transactions, that they do not cease to be commercial if they are concluded by persons who are not subjects to commercial law but to civil law. When these **absolute transactions** are undertaken **as an occupation**, (i.e., **systematically**, as a source of permanent income) this **renders the person carrying them out a merchant**.

Some of the transactions referred to in Article 1(1) of the CA **are varieties of civil law transactions**. For example, commercial sales in the form of speculative purchase and sale (purchasing of goods or negotiable securities for the purpose of reselling them – Items 1 and 3), as well as the sale of one's own manufactured goods (Item 2), are varieties of the contract of sale under the OCA (Article 183 et seq.); the commission and forwarding agreement are contractual variants of a mandate contract (Article 280 et seq. OCA). Some banking transactions are also varieties of civil law contracts. For example, a bank deposit is a type of ordinary deposit (Article 250 OCA); a bank loan is a type of a loan (Article 240 OCA), etc. Some of the transactions referred to in Article 1 have no equivalent in civil law, e.g., transport and insurance transactions, some banking transactions, foreign exchange transactions, etc.

The second criterion for the classification of transactions as 'commercial' is related to the **capacity of the persons concluding them**. Pursuant to Article 286(1) CA, any transaction concluded by a merchant in relation to their business is considered to be a commercial transaction. **These are referred to as 'subjective' or 'relative commercial' transactions**. In these, **the party to the transaction renders it a commercial transaction**. In case of doubt, the transaction concluded by a merchant **is considered to be in relation** to its business (Article 286(3) CA). The law introduces this presumption as an additional criterion for defining the transaction as 'commercial'. When it is carried out by a merchant, it is considered to be

in relation to their business. Such transactions are, therefore, designated as **presumptive commercial transactions**.

The foregoing shows that our legislature does not use a single criterion in defining transactions as ‘commercial’ but **uses a mixed system**. An **objective criterion** is used, which is based on a list of transactions announced in advance as commercial (Article 286(2) in conjunction with Article 1(1)). A **subjective criterion** is also used according to which, transactions carried out by a merchant in that capacity are considered to be commercial. To determine whether a transaction undertaken by a merchant is carried out in its capacity *as* a merchant, i.e., whether it is connected with its business, a ‘rebuttable presumption’ is used. The most frequently cited example is the rental of premises. Where the lessee is a merchant, it is presumed that this is needed for the activity carried out by the lessee (e.g., for an office or a warehouse). The fact that the lease is not listed in the merchant’s subject matter of activity does not, in itself, preclude the commercial nature of the transaction (Decision No. 127 of 2011 of the Supreme Court of Cassation (SCC), Commercial Chamber, 2nd Commercial Division). However, if the premises are rented for another purpose, for example as the residence of the merchant’s family, the presumption of the commercial nature of the transaction will be ‘rebutted’ and it will not be considered commercial (Decision No. 102 of 2009 of the SCC, Commercial Chamber, 1st Commercial Division).

In individual cases, case law explicitly excludes certain types of transactions from the ‘commercial’ scope. Thus, for example, employment contracts are not commercial transactions despite the fact that, most often, the employees of the merchant conclude an employment contract with the merchant. (Decision No. 120 of 2008, SCC, Commercial Chamber, 1st Commercial Division.) Neither is the contract for a consortium in the form of a civil law company considered a commercial transaction (Decision No. 404, SCC, Commercial Chamber, 1st Commercial Division.). A privatization contract, under which shares of a state or municipal enterprise are transferred, is neither an ‘absolute’ nor ‘relative’ commercial transaction (Interpretative Decision No. 1 of 2009 in Commercial Case No. 1 of 2009, General Assembly of the Commercial Chambers, SCC).

IV. RATIO BETWEEN CIVIL AND COMMERCIAL TRANSACTIONS

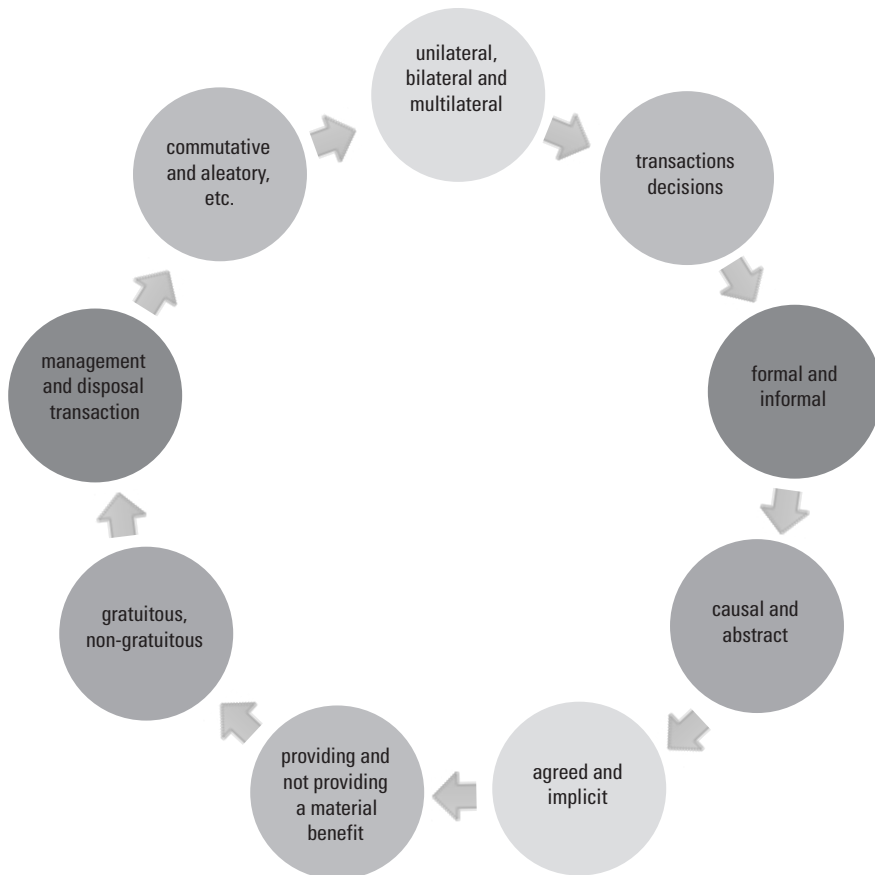
The significance of the division of transactions into ‘civil’ and ‘commercial’, lies in the fact that the general regime (e.g., under OCA) will apply to civil law transactions, while the special regime established in commercial laws (the CA and the other laws of commerce, as specified above) will apply to commercial transactions. However, Bulgarian legislature does not establish two separate, independent, regimes for civil and commercial transactions. For those general features of a commercial transaction which derive from civil ones, civil law will apply. For those that are specific only to commercial transactions, the Commerce Act will apply. Thus, for example, the basic rights and obligations of the buyer and the seller under a commercial transaction will be governed by Articles 183–200 OCA, but, where specific features are provided for in the regime, the special rules of Chapter XXI ‘General Provisions’ of the Commerce Act will apply in respect of: interest (Article 294); joint liability (Article 304); liquidated damages (Article 309), etc. As has been pointed out, where there are no certain special provisions governing commercial transactions, the general civil law regime will apply. Its use is not restricted to situations common to both civil and commercial matters. The meaning of Article 288 CA is that special rules concerning commercial transactions will be brought forth, by interpretation, out of ‘general civil law’.

The commercial nature of transactions also affects the means of redress. The new Civil Procedure Code (CPC) (2008) provides, in its Chapter XXXII, for special proceedings in commercial disputes. These are disputes relating to the conclusion, interpretation, validity, performance, non-performance or termination of any such transaction. It also provides for filling gaps in a commercial transaction or its adjustment due to intervening circumstances; (Article 365(1) CPC). Thus, based on Article 1(1), which defines the subject-matter of commercial transactions (or Article 286 CA – types of commercial transactions), the CPC defines the subject-matter of commercial disputes.

V. TYPES OF COMMERCIAL TRANSACTIONS

From the point of view of their legal characteristics, commercial transactions are generally subject to their general civil law classification. In some cases, however, there are deviations in the treatment of certain transactions, depending on whether they are civil or commercial (e.g., in the case of formal transactions). In addition to the general classification, commercial transactions are also subject to an additional classification criterion.

According to the general classification of transactions, they are:



1. Unilateral, bilateral and multilateral transactions. Transactions – decisions

The division is not based on how many parties to the transaction there are (there are almost always two), but on how many of them express their will, or what the content of that will is in relation to that of the others. A **unilateral transaction** contains a statement of intent of only one of the parties to the legal relationship, directed at the other party which does not make a statement. It is sufficient that its statement reaches the other. Such, in commercial law, are: an assignment, virement, a bank guarantee, documentary letter of credit, promissory note, cheque, endorsement, etc. In **bilateral transactions** (called **contracts**), both parties to the legal relationship make statements which must coincide in order to form a consensual agreement. Examples of commercial contracts include: a commercial sale, commission and forwarding contract, a transportation contract, an insurance contract, a credit contract, a lease, etc.

In multilateral transactions (incorrectly referred to as ‘multilateral contracts’) the statements of participants (partners, founders) are of equal content. They are not directed towards each other, but towards the achievement of a common goal such as the establishment of a civil or commercial company or a cooperative or non-profit association. Since, in this case, the interests of the parties are unidirectional (unlike bilateral transactions), they express a common will resembling a unified statement, notwithstanding that those intentions originate from more than one person. Yet, they are not considered as a type of unilateral transaction, which according to Article 44 OCA are *numerus clausus* (limited by number). Nor are they contracts, because that term is used in private law to indicate bilateral transactions. They lack parties understood as opposing holders of rights and obligations.

Multilateral transactions can be **constitutive ‘contracts’** or **transactions ‘resolutions’**. The former are aimed at the creation of a new legal entity – e.g., a commercial company, or a non-legal entity (e.g., a civil law partnership, or consortium in commercial law). And the latter express the will of the collective bodies of legal entities already created.

Resolutions are a type of multilateral transaction adopted by the organs of an existing legal entity, which may or may not be institutionalised in a body corporate. Such transactions, ‘resolutions’ **in civil law**, are taken by, for example the general assembly of condominium owners, an association under the Non-profit Legal Entities Act or by participants in a civil law partnership, etc. In commercial law, ‘decisions’ are taken by the partners in a commercial company, shareholders, bondholders, their general meetings or management boards, by the board of directors and by the supervisory board in a joint stock company. However, there is no fundamental difference in the legal regime of transactions ‘resolutions’ in civil and commercial law. They are subject to common requirements concerning the quorum and/or manner of taking decisions by unanimity or a simple or qualified majority. The differences provided for in individual laws are mainly of a technical nature.

2. According to another criterion, applicable only to commercial transactions, they are **unilateral and bilateral commercial transactions**. This differentiation is based on the **capacity of the parties to the transaction**. If both parties to the transaction are merchants, it is regarded as a ‘**bilateral commercial transaction**’. However, if only one of them is a merchant, the **transaction is defined as ‘unilateral commercial’**. This classification criterion is provided for in Article 287 CA, pursuant to which: *‘the provisions of commercial transactions shall apply to both parties, if the transaction is commercial for one of the parties...’*. This means that the non-merchant will also be bound by the provisions of commercial law, except in cases where the law expressly excludes this. Such an exception is provided, for example, in Article 318(2) CA in the case of a commercial sale. Pursuant to it, *‘the sale of an item for personal use, when the buyer is a natural person, shall not be deemed a commercial sale’*.

3. The division of transactions into **formal** and **informal** applies to both civil and commercial transactions. The distinguishing criterion is whether the form is elevated to a mandatory element of the factual composition of the transaction. Where the validity of a transaction is conditional on compliance with a particular form, the transaction is formal, otherwise it is informal.

The regime of formal commercial transactions, however, is different from that in civil law. In the latter, a ‘formal transaction’ is one where the form is prescribed by **law**. In commercial law, along with this criterion (Article 293(1) CA), **the parties may also establish a mandatory form** (Article 293(2) CA) and thus *render* the transaction formal. This means that the parties (or each of them) may render the operation of the transaction conditional on compliance with a certain form.

The consequences of non-compliance with the form are also **different**. In civil law, failure to comply with the prescribed form necessarily leads to nullity of the transaction (Article 26(2) OCA). In commercial law, the consequence is generally the same, but with one important exception: a party may not claim such negation if its own behaviour implies that it has not contested the validity of the statement (Article 293(3) CA). In this case, there is a significant departure from the regime of nullity of transactions in civil law. In civil law, the regime is mandatory, and the effects of nullity arise regardless of the conduct of the parties to the transaction. Lack of compliance with the form is a defect. The Commerce Act, on the contrary, determines nullity due to non-conformity of the form on the basis of the conduct of the party invoking this ground for nullity.

In commercial law, the **electronic form** is widespread **and is equated with the private written form**. It is provided for in the Electronic Commerce Act of 2006 and the Electronic Document and Electronic Trust Services Act (since 2001) (its original title, the Electronic Document and Electronic Signature Act, was changed in 2017). This feature is the consequence of the conclusion of a large number of commercial transactions electronically, via the Internet.

4. Causal and abstract transactions

This division of transactions is familiar in both civil and commercial law. In practice, however, ‘abstract’ transactions are absent from civil law and are found almost exclusively in commercial law. They are, as a rule, unilateral and formal. Such are the so-called ‘bill of exchange effects’, to wit: bills of exchange, promissory notes and cheques; commercial assignment, endorsement, etc. In these, it is legally irrelevant why the action is being taken. It is disconnected from the reason, which is not

manifested in the transaction itself, and is not conditioned by the causal relations attached to it, which give an answer to the question as to why the abstract obligation is undertaken.

‘Causal’, on the contrary, are the bulk of transactions, including commercial ones. Their validity depends on the ground of the transaction itself, i.e., on the reason why each party is obliged to the other, under the same legal relationship. Causal transactions are observed only in the so-called ‘*prestation*’ transactions, those in which there is a transfer of property.

5. Other divisions of transactions into **‘consensual’** and **‘real’**; **transactions of management and of disposition; and commutative and aleatory**, apply equally to those of civil and commercial law.

6. Prestational and non-prestational (providing and not providing a material benefit).

This division is inherent in civil law transactions. **Non-prestational** transactions are those in which there is no exchange of goods. Such are ‘authorisation’, ‘child recognition’, etc. In commercial law there are also transactions that do not confer a material benefit, for example commercial authorisation and power of procuration, although they do not often have an independent nature, but serve the main contract. Conversely, **‘abstract’** transactions are, for the most part, non-prestational. As noted, they usually assume obligations detached from the cause of the transaction itself. These can be traced back to abstract-related, other transactions.

7. Another division based on the previous one, is that of **non-gratuitous and gratuitous**. It finds application almost exclusively in civil rather than commercial law, such as the typical civil law transactions of donation, will, interest-free loan, etc. Business relationships are essentially ‘non-gratuitous’. They are not based on equivalent exchange. Neither is a sponsorship contract gratuitous, although in ordinary life, it is identified with a donation, which is a gratuitous contract. However, from a legal point of view, one party to this commercial transaction provides a certain material benefit, usually to support the achievement of the sponsored recipient’s intangible goals. In return, however, although no material

consideration is due, the sponsored advertises the sponsor. Again, this characterises the contract as ‘non-gratuitous’.

A commercial transaction may lose its non-gratuitous character only exceptionally, e.g., if merchants conclude a loan agreement with an explicit provision that it is interest-free (Article 294(1) CA), which in principle provides for interest to be payable in bilateral commercial transactions. Exceptions to the rule are only possible in the case of relative (subjective) commercial transactions.

VI. ABUSE OF RIGHTS

1. Regulation of abuse of rights

Until the adoption of OCA (1950), Bulgarian legislation did not regulate the abuse of rights, and our doctrine perceived it **as a type of ‘tort’** (Article 56 OCA, repealed), the most important feature of which is the **exclusive intention to harm, without any apparent actual benefit to the right holder**.

Article 57(2) of the Constitution **expressly prohibits the abuse of rights** – i.e., acting to the detriment of the rights or legitimate interests of others. And its Article 58(2) makes it a constitutional duty of citizens to respect the rights and legitimate interests of others.

In civil law, the abuse of a right is primarily derived from **Article 8(2) OCA**, according to which persons enjoy their rights to satisfy their own interests and may not exercise such rights against the interests of society. Symmetrically, Article 3 of the CPC obliges persons participating in legal proceedings to exercise the procedural rights conferred on them in good faith, and in compliance with good morals, otherwise they will pay damages. Another rule relating to this matter is contained in **Article 289 CA**, according to which no right based on a commercial transaction may be exercised with the sole intention of causing injury to another party.

Thus, the presence of abuse of rights in civil law, both substantive and procedural, is derived from the **principle of exercising rights in good**

faith. These texts of the OCA, the CPC, and the CA are **general** because they elaborate on the constitutional prohibition of abuse of rights at the statutory level. They draw the line for the exercise of one's own rights and the rights and legitimate interests of others.

Other **specific provisions in civil, procedural, labour and commercial legislation** consider abuse not only as a limitation to the exercise of subjective rights, but also introduce sanctions for the misuse of rights (e.g., Article 403(1) CPC, Article 87(4) OCA, Article 8(1) of the Labour Code). **Article 631a CA** provides for liability for damages against a creditor whose application for initiation of bankruptcy proceedings has been rejected, if the debtor establishes that the creditor has acted deliberately or with gross negligence. **Article 137(3), sentence 2 CA** prevents the abuse of voting rights in the General Meeting of a Limited Liability Company: the partner being dismissed from the limited liability company may not vote and their share will be deducted from the capital when determining majority.

The conclusion to be reached from these texts **is that the importance of the institute of 'abuse of rights' goes far beyond the modest place given to it** as a limit to the exercise of subjective rights.

2. Nature of the abuse of rights and its legal consequences.

Both doctrine and legislation hold different views that refer to either the so-called '**objective**' or '**subjective**' theory. According to the latter, as expressed in Article 289 CA, no right based on a commercial transaction may be exercised with the sole intention of causing injury to another party. This requires, when establishing the abuse of a right in commercial law, that ***animus nocendi*** (intention to harm) be established, i.e., that the exercise of rights is intentionally aimed at causing injury to the other party, and that the leading motive is the intention to harm.

Conversely, the '**objective**' theory, derived from civil law (Article 8(2) OCA), does not in any way require fault or intent to cause injury, but only that the right not be exercised as intended. An objective inconsistency

between the exercise of the right and its function of satisfying only those interests which the law recognises as worthy of defence, is sufficient for the purpose. Thus, in litigation, the existence of an abuse of a right is sufficiently demonstrated when another's rights are objectively violated and there is a disparity with public interest, without there necessarily being an intent to harm.

When comparing these two theories in the texts of Article 8(2) OCA and Article 289 CA, respectively, the point at issue regarding the legal nature of this phenomenon is whether abuse requires an intention to harm and unlawful conduct, or whether or not there is a *need* for intention to cause harm to exist.

The objectivity of the theory is attacked with the assertion that 'there is nothing innocent about the abuse of rights' because, in the very nature of the term 'abuse', 'malice' (*malus*) is implicit'.

There are several arguments in favour of the so-called '**subjective theory**': the '**fair limits**' for the exercise of a substantive or procedural right, the satisfaction of interests that the legislator deems worthy of protection, and the achievement of legitimate goals. When the exercise of a right is contrary to its social purpose, it is unlawful because it takes place beyond the limitations and constitutes an abuse of right. On the other hand, objective theory conflates **the concepts of fault in civil and criminal law**. 'Fault' in civil law does not depend on the subjective attitude of the perpetrator to the act committed by him (as in criminal law), but reflects a failure to exercise due care (by a prudent person or merchant). This 'objectification' of fault is most clearly seen in commercial law.

In contrast to the **non-performance of legal obligations**, the **exercise of subjective rights is not always a matter** of culpable conduct, but of the requirement that the parties act in good faith in the exercise of their rights and obligations (Article 63 OCA). Thus, without necessarily concerning fault, the issue rather concerns the reprehensible nature of the particular behaviour.

It is logical to assume that the conduct of a person who abuses rights is necessarily unlawful, and this is the leading factor in qualifying the exercise of right as abuse. According to the 'subjective' theory, the motive

or purpose of this abusive exercise of rights is irrelevant. The decisive factor is whether the conduct *objectively* deviates from the general requirement that rights be exercised to satisfy the interests of those exercising them. The unlawfulness in this case is that the requirements and limitations applicable to the exercise of rights have not been respected, without, necessarily an intention to do harm. Ultimately, and according to a 'subjective' theory, it is not an intention to harm that must be demonstrated, but an objective inconsistency between the interests for which the person is granted that right and the interests for which it is exercised.

CHAPTER 11:

CONCLUSION OF COMMERCIAL TRANSACTIONS

Ivan Rushev

ABSTRACT	KEY WORDS
This chapter discusses the general conditions of commercial transactions and the parties thereto. It also reviews the ratio between the two legal arrangements given in the law of obligations, as part of general civil law and as part of commercial law, relating to each other as 'general' to 'special regulation'. The issue of the concept of commercial transaction, factual composition of the conclusion of the transaction, the binding force of the offer, and the form of the commercial transaction are presented. Additional acts of the parties or of third parties in connection with the conclusion of a commercial transaction, hardship and cases of transaction confirmation are also examined in this part of the Handbook.	commercial transactions, conclusion of commercial transactions, offer, acceptance, hardship

I. INTRODUCTION. PARTIES TO COMMERCIAL TRANSACTIONS

Part Three of the Commerce Act (CA)¹ brought systematization to the law on commercial transactions which, in essence, constitutes commercial contract law. Its 'General Provisions' – Chapter XXI (Articles 286–317) deal with the creation, modification, performance, non-performance and termination of legal relations arising from transactions which are commercial for at least one of the parties; and also, with commercial securities and the transfer of commercial rights. The present chapter will only discuss the main provisions concerning the conclusion of commercial transactions. Some of

¹ Prom. in SG 83/1996 with numerous amendments.

the individual types of commercial transactions governed by Chapters XXII to XXXIII CA, and those outside the scope of the chapters, possess certain specific features which build on these general rules.

By virtue of Article 287 (in conjunction with Article 286 CA) the provisions on commercial transactions apply to both **parties** where at least one of them is a merchant and the transaction relates to the business pursued by that merchant or where the transaction belongs to the ‘absolute’ commercial transactions listed in Article 1(1) CA, the performance of which grants that person the capacity of a merchant. Thus, a party to a commercial transaction may be a ‘natural’ or ‘legal’ person who, by occupation, carries out any of the absolute commercial transactions listed in Article 1(1) CA; commercial companies; cooperatives (except housing cooperatives); any person, who has established an enterprise, which, in accordance with its purpose and volume, requires that its business be conducted on a commercial basis, even if its activity is not limited to ‘absolute’ commercial transactions. Transactions concluded by the persons referred to in Article 2 CA, notwithstanding that the CA expressly defines them as persons who are not merchants, are also ‘commercial’. These persons are: 1. natural persons engaged in farming; 2. artisans, persons performing services through their own labour or freelancing, except those referred to in Article 1(3) CA; 3. persons providing ‘hotel services’ by letting rooms in housing units they occupy.

The specific characteristics of commercial law, compared to general civil law and, in particular, those of the law of commercial transactions as opposed to contractual law, determine the establishment of specific rules for commercial transactions. A number of contracts, which prior to the adoption of Part Three CA, were governed under contract law, were removed from the Obligations and Contracts Act (OCA) and redrafted in the CA. Such are, for example, the commission contract, regulated, until 1996, in Chapter XI of the Special Part of OCA, which is now regulated in Chapter XXIV of Part Three of CA; and the forwarding contract, ‘transferred’ from Chapter XII of the Special Part of the OCA into Chapter XXV of Part Three CA. The same applies to contracts of carriage, insurance, unilateral transactions: promissory note, cheques, bills of exchange. Other contracts, such as leasing, public warehousing,

licensing, those for commodity control, and banking transactions, found legal regulation, for the first time, in the CA. A third category of contracts retained their legal regulation in the OCA, with only some specific elements characterising them as commercial transactions being reflected in the CA (e.g. commercial sale).

All this requires examination of the **relationship between the two legal frameworks**. The provisions, given by contract law (as part of general civil law), and those provided by the law of commercial transactions (as part of commercial law) relate to each other in the same manner as the terms ‘general’ to ‘specific’. Part Three CA contains specific rules which either depart from, or supplement, the basic rules laid down by contract law. In some cases, the rules of CA contain the *only* regulation of special commercial contractual relations, while those that are general remain in the general civil law. For this reason, Article 288 CA provides that the provisions of civil legislation apply to any matters of commercial transaction *not* regulated therein and, when the civil legislation is incomplete, business customs will apply. **This correlation applies to the conclusion of commercial transactions** governed by Articles 290–301, Section II of Chapter XXI of Part Three CA. Since the rules therein are specific, they exclude those that are general and govern the conclusion of contractual agreements (Section ‘A’ of Chapter Two of the General Part of the OCA, Articles 8–20) in cases expressly provided for in the CA. For example, the adoption of the general terms and conditions (Article 298(1)2 CA) preclude, between merchants, the application of Article 16(1) OCA. However, where there is an incompleteness in the CA (e.g. on the binding nature of an offer and its withdrawal; on the point in time at which the contract is deemed to have been concluded), the general provisions of Articles 13 and 14 OCA will apply.

II. THE CONCEPT OF CONCLUDING A COMMERCIAL TRANSACTION

The term ‘conclusion’ literally refers to bilateral transactions where two opposing statements must meet, intersect, thus ‘conclude’. In the case of unilateral transactions, the term refers to the execution and undertaking of the act in question; in the case of multilateral, to the taking of decisions, etc. In theory, the term **conclusion of a transaction (including the commercial transaction) is considered** in two aspects:

as an expression of will by one or more persons which are parties to the transaction, through which they determine the content of the legal effects they desire; and

by the manner in which the factual elements will be implemented in order to give rise to the transaction’s legal effects.

In the first sense, ‘conclusion of the transaction’ involves only the parties’ statements of intent. In the second sense, in addition to these, any additional legal actions performed by persons who are not parties to the transaction are also included as facts. These facts, without actually specifying the content of the desired legal consequences, nevertheless **determine the legal effect of the transaction**. The first meaning of ‘contract conclusion’ is that of the OCA which, in Article 8, defines it as ‘*an agreement between two or more persons to create, regulate or terminate a legal relationship between them*’. More particularly, the rules of Section A of Chapter Two of the General Part of the OCA govern the statements of the parties to the contract, the regime of the offer and its acceptance (Article 13 OCA), the moment of conclusion of the contract (Article 14 OCA) and the form of its validity (Article 18, Article 19(1) OCA).

Alongside these, this section of the OCA, dedicated to the conclusion of transactions, includes norms on the invalidity of transactions (e.g. Article 10, on the issue of interest and anatocism (compound interest); Article 17, on simulated transactions; Article 20, on the interpretation of contracts). The latter have no direct bearing on the ‘conclusion of transactions’.

III. FACTUAL ELEMENTS OF THE CONCLUSION OF THE TRANSACTION

The **minimum necessary actions** comprising the legal, constituent, elements of the commercial transaction include:

1. the making of a proposal (offer) for its conclusion; and
2. its acceptance,

i.e., the convergence of the reciprocal statements of at least two persons, as a result of which they become parties to the transaction.

In theory, and in practice, the **offer** is considered as a ‘statement of intent (invitation to treat)’ to conclude a contract, which one person extends to another. To be valid, the offer must satisfy **several essential requirements**: it must be serious, sufficiently complete (it must contain all the essential terms of the contract to be concluded) and it must be addressed to a specific person or persons. This ‘statement of intent’ does not constitute an independent legal transaction under Article 13 OCA, even though the law attaches certain legal effects to it. Its legal effect is of a limited, internal-organisational nature. It creates pre-contractual obligations for the offeror aimed at the formation of the transaction. The acceptance of the offer is *not* a transaction.

Article 290(1) CA expressly regulates the well-known rule of the ‘law of obligations’ that the dispatch of pricelists, catalogues, rates and the like, or communications through the mass media or otherwise addressed to an indefinite number of persons, is not regarded as an offer to conclude a contract. These constitute only an ‘**invitation**’ to such persons to make an offer in accordance therewith. The text is expressly referred to as a ‘public notice’. The explanation for this is that the proposer (offeror) is most often unwilling, or unable, to undertake an obligation encompassing an indefinite number of persons. The CA considers this communication to indicate a willingness to negotiate a contract if any of the other parties makes an offer. However, Article 290(2) CA gives legal significance to this willingness. If one of the indefinite number of persons to whom the said communication is addressed makes an offer in accordance with those pricelists, catalogues, etc., and the offer is unreasonably declined by the person providing the

notice, the latter will be liable for any damage caused thereby to the offeror. This is a form of pre-contractual liability under Article 12 OCA. The notice thus made, although not an offer, creates a precontractual obligation on the original proposer to accept the offer if it corresponds to its notice. In the general case (applicable to civil law transactions), when an offer is made, the counterparty to whom it is made has no **obligation** to accept it, but **only a right**. Whereas, given that the negotiation is actually initiated by the acceptor of the offer, Article 290 CA provides that the latter also has a pre-contractual obligation to accept that offer.

Article 290(2) CA creates a rebuttable presumption that, if the person who made the communication does not accept the offer made to him, he is acting without good reason.

It follows, from the interpretation of Article 290 in conjunction with Article 291 CA, that the mere sending of a communication to an indefinite number of persons does not prevent it from being ‘considered’ an offer. Article 291 CA names this a ‘**public offer**’. A sufficient prerequisite is for the quantities of goods offered and the time limit for acceptance of the offer (proposal) to be clearly noted. Failure to state the total quantity available and the deadline *for accepting* the offer are two varieties of ‘incomplete offer’ which do not bind the offeror. Nor does it create a right for the proposer to request its acceptance. Other reasons why a public offer may be incomplete are the indeterminacy of the price, method of payment, the lack of specificity of the type of goods offered.

IV. THE BINDING FORCE OF THE OFFER

The Commerce Act does not contain specific rules on the binding effect of an offer; therefore, the provisions of OCA will apply. By virtue of its pre-contractual obligations, the proposer is bound by its offer to the counterparty (Article 13(1) OCA). The proposer is obliged not to interrupt the negotiations and not to withdraw the offer for a certain period otherwise damages may be claimed (Article 12 OCA).

Article 13 OCA regulates several situations in which **the moment at which the proposer is deemed to be bound by its offer may differ**,

depending on whether the proposer has set a time limit for doing so or not. If the offer contains a time limit until which the proposer is deemed to be bound by it (the so-called ‘option’), the latter will be released, at the expiry of that time limit, if no agreement has been reached by then. If there is no fixed time limit within which the offer may be accepted, the proposer will be bound by it only upon immediate acceptance by the counterparty, if such is present. **The parties** will be deemed to be **present**, including when they are in contact by telephone, telefax, internet or other technical means allowing of an immediate response.

If the **offer** is made to **an absent person**, it will bind the proposer only until such time as is normally required, under the circumstances, for the acceptance to arrive. This time limit includes: (a) the time it normally takes for the offer to reach the other party, (b) the time taken for it to be considered by the counterparty, and (c) the time it normally takes for the response to reach the proposer. The proposer will not be bound by the offer if it is rejected by the counterparty or if the proposer withdraws it prior to expiry of the time limit. If the notice of such withdrawal reaches the counterparty before or at the same time as the proposal itself (Article 13(4) OCA), the proposer will not bear pre-contractual liability, otherwise it will be liable for the negative damages caused to the counterparty (Article 12 OCA).

With regard to the validity of the acceptance and the possibility of revocation, the general rules for contractual obligations (Article 14 OCA) apply to the commercial transaction. In contract law, when concluding contracts, the prevailing principle is that silence means disagreement/non-acceptance of the offer (Article 16(1) OCA), except in a few cases expressly provided for by law. Such cases are regulated, for example, in Article 16(3), Article 204(3) OCA. In these cases (by means of a rebuttable presumption) under certain conditions, silence is deemed to be an expressed will in a positive sense.

The reverse principle is adopted in Article 292 CA, according to which the offer to a merchant, with whom the offeror has a long-term business relation, is considered accepted if not immediately declined. The hypothesis is special and differs from that of Article 16(3) OCA, where silence is tantamount to acceptance only in respect of the proposed

amendment or replacement of the general terms and conditions of a contract involving prolonged performance and already concluded between the same parties. Under Article 16(3), in contrast to Article 292(1) CA, the amendment, or replacement, of general terms and conditions is deemed to have been accepted by the counterparty after expiry of a sufficient period of time granted to it in writing. The creation of a presumption that silence is equivalent to acceptance shifts the burden of proof. It places the obligation of proof that no contract has been concluded on the party who has not expressly stated its intention to reject the offer.

In the event that it expressly rejects the offer, under Article 292(1) CA, the merchant will be obliged to keep the goods safe, at the expense of the offeror. However, the merchant does not have this pre-contractual obligation if it is not guaranteed by the offeror or a third party for the costs of safe-keeping or if safe-keeping causes greater inconvenience than usual. In the latter case, the merchant will be discharged from this obligation under the corresponding application of Article 97(2) OCA.

For this purpose, the merchant may deposit the said goods for safekeeping at an appropriate place, determined by the district court at the place of performance. Money, securities and valuables may also be deposited for safe keeping in a bank, at the place of performance, even without a court order. Where, however, the goods that have been delivered with a view to conclusion of the contract (which has not been concluded), are perishable, or their safe keeping involves significant cost or inconvenience, and when their nature prevents them from being deposited, the person who has received them may, after giving notice to the other party, request the district court to grant them permission to sell those goods and to deposit the amount received in a bank in the name of the other party (Article 97(3) OCA).

Sometimes conclusion of a legal transaction requires, in addition to the identical statements of intent of the parties, **other additional elements undertaken by persons who are not parties to the transaction**. In these cases, **the factual elements of the transaction** will be complete without these additional elements, but they nevertheless constitute **necessary conditions for the occurrence of the transaction's effect** (the so-called

conditio juris ('condition of law')). Such elements form the so-called **'factual elements of the transaction in the broad sense'**, that are necessary for the occurrence of its legal effect. For the first time, the CA systematically regulates such 'factors' and their legal effect, e.g., **the granting of authorisations or approval by a government authority** (Article 295 CA), **the confirmation of the contract by a third party** (Article 296 CA) or the **determination, by a third party** (including a court or arbitration), **of the content of individual clauses in the transaction**. These include the exercise of the right of choice (Article 130(2), Article 131(3) OCA) and the determination of the amount of a claim by one of the parties (where there is no evidence of such amount) by the court, at its discretion, as provided for in Article 162 of the Civil Procedure Code (CPC).

V. FORM OF THE COMMERCIAL TRANSACTION

The form of the transaction in civil law is understood as the **form in which the law requires the parties' statements to be made** (handwritten, written, written with notary certification of signatures, in the form of a notary deed, or in a court record). Sometimes **the parties may provide for a particular form of** expression of their will in concluding the contract, thus being more stringent than the provisions of law.² In other cases, a form, which is not generally required for the particular type of contract, is applied because of the particular way of contract conclusion. For example, the 'written form' may be a condition of validity in the case of conclusion of a contract under general conditions laid down, in advance, by one of the parties. Pursuant to Article 298(1)2 CA, such terms become binding upon the other party when it declares its acceptance thereof in writing.³

² In the opposite case – when they stipulate conditions for the conclusion of the transaction, no less favourable compared to the statutory ones, **the transaction** will be null and void **on any of the grounds** under Article 26(2) OCA.

³ **The contract will be formal when the party who has previously established the general conditions also declares them in writing**, without it being necessary **to expressly convey them at the time of conclusion**, as required by Paragraph (2) of the same text. It is **sufficient that these general terms and conditions are posted in publicly accessible places, either in the form of open access material or on notice boards, including electronically**. In the latter case, the 'written form' in the strict sense would not be available.

Item 2 of the same Paragraph raises more questions. According to it, the ‘general terms’ previously established by one party become binding upon the other when the latter is a merchant and has been, or should have been, aware thereof and has failed to object thereto immediately. The cumulative existence of the first two conditions laid down in the provision: that the counterparty must also be a merchant; and that it has been, or should have been aware, of those general terms and did not immediately object to the same, creates an irrebuttable presumption of ‘acceptance’. A subsequent objection that the contract was concluded on those terms, without challenging the existence of either of the first two conditions, would be without legal effect. The party interested in denying conclusion of the contract under those terms and conditions must prove either the lack of commercial quality or ignorance (respectively, that it is not obliged to know them). This would rather relate to impossibility of the counterparty, acting with the ‘care of a good merchant’, to know about those terms.

Thus, the text establishes another presumption, this time rebuttable, that the other party to the transaction should be aware of, or should have been aware of these general terms.

Where, however, the validity of the transaction is subject to a written form, the general terms specified by the merchant will be binding upon the other party only if they have been submitted to the latter at conclusion of the transaction. The provision of Article 298(2) (in contrast to Para. (1)), does not merely provide for the party specifying the general conditions to make them known to the counterparty. That party is obliged to effectively communicate them, i.e., to hand over the document in which they are reflected. This is considered a condition for the validity of the transaction.

VI. ADDITIONAL ACTIONS OF THE PARTIES, OR THIRD PARTIES, IN CONNECTION WITH THE CONCLUSION OF A COMMERCIAL TRANSACTION

Other complications in the formation of the will of the parties are related to their prior agreements – either a third party needs to specify the content of individual clauses in the contract (Article 299 CA), or in the event of certain circumstances, they themselves need to supplement the contract by mutual agreement. However, where the parties cannot agree on the content of such additional clauses, either of them may ask the court to do so (Article 300 CA).

The provisions of Articles 299 and 300 CA represent cases, rather explicitly regulated in the CA, of additional statements of intent (actions) of third parties, with a different legal significance for the factual elements of the transaction (in a narrow sense), or for those necessary for the occurrence of its effect.

Such **additional legal facts are: statements or acts of third parties which**, together with the statements of the parties, are necessary for its legal effect. They could also determine the occurrence of these legal effects without having any relation to the content of the provisions of the contract.

Third parties, in this case, may be private persons or bodies with public law jurisdiction (state, including judicial). The actions of both private law entities and public authorities (including the courts) may be aimed at determining the content of particular arrangements in the contract (e.g., Articles 299 and 300 CA). However, they may also only determine the effect (creation, modification, termination of rights and obligations) of that transaction (Articles 295 and 296 CA).

The provision of **Article 299 CA** refers primarily to the first category of actions of third parties (private entities or state bodies): those aimed at **determining the content of specific arrangements in the contract**. It enables a third party to determine the content of such contractual arrangements when **the parties have provided for this**. In such a case, these arrangements become binding on contracting parties if the third party has specified them in accordance with the purpose of the contract, the remaining contents thereof, and business custom.

The provision is similar to that of **Article 131(3) OCA**, under which, in the case of alternative obligations, at the will of the parties, the choice may be given to a third party. Despite the similarity of the two provisions, there are significant differences between them. Article 131 OCA is applicable only to ‘alternative obligations’. These are cases in which the debtor owes two or more different items in consideration, but performance of one of them (the one determined by the choice) releases him from his obligation. The third party has the right to choose only which of the several items due in consideration should be provided by the debtor.

Article 299 CA has a wider scope. Pursuant to it, at the will of the parties, the third party is empowered to determine the content of individual arrangements with binding effect upon them. It is permitted to choose not only between two or more alternatives which the parties, by their original agreement, have determined as due.

The statement of the third party under Article 299(1) may be relevant either for determining the content of legal consequences or for determining whether they arise. The exercise of the right of choice under Article 131(3) OCA determines, above all, the choice of what is owed and, consequently, the legal consequences of the transaction. In both cases, the obligation of the parties will arise only from the moment of the designation (or from the day of exercise of the right to choose), unless the parties have agreed otherwise. In both cases, if the third party does not exercise the right of choice (Article 131(3) OCA), or does not make the determination (in accordance with the purpose of the contract, its other contents and business customs), the right of choice (i.e., determination of the content of what is due) passes to the court. The provision of Article 299(2) CA is more precise than that of Article 131(3) CA. It explicitly indicates which of the parties is to request the court to specify arrangements if the third party fails to do so, or has specified arrangements inconsistent with Paragraph (1) (the purpose of the contract, the remaining contents thereof and business customs).

Another opportunity for the court to specify such arrangements is provided by Article 300 CA. However, this text has a broader scope than the previous one. Pursuant to Article 299 CA, the parties’ agreement empowers a third party to determine the content of individual (specified by the parties) clauses of the contract. Article 300 CA empowers the court, on

the basis of the parties' agreement and upon the occurrence of certain (also stipulated by them) circumstances, to supplement the contract, effectively to create new clauses in it. In order for this to happen, the prerequisites set out in the text must be present (prior agreement between the parties that the contract should be thus supplemented, in the event of circumstances specified by them; occurrence of those circumstances and failure to reach agreement between them on that supplementation).

In such a situation, each of the parties has the right to request the court to supplement the contract. This possibility is counterbalanced by the legal obligation of both parties (the requesting party and the other) to accept the court's supplementation. The right to request supplementation of the contract is exercised by a unilateral statement, in a judicial procedure. The decision of the court will supersede the consensus not reached by the parties. It will be binding on them if, when rendering its decision, the court has taken into consideration the purpose of the contract, the remaining contents thereof and business customs as a subsidiary source of commercial law (Article 300, sentence 2 CA).

Until the entry into force of Part Three CA, Article 2(2) (subsequently repealed) of the International Commercial Arbitration Act (ICAA)⁴ expressly provided for the possibility of the parties arranging for arbitration to adapt the contract to newly arising circumstances (including its supplementation and amendment under the so-called '*clausula rebus sic stantibus*', but only to the extent that the domicile or seat of at least one of the parties is not in Bulgaria. The possibility provided for in Article 300 CA is broader than that in Article 299 CA, also regarding the persons (but not subject matter), than the one provided for in Article 2(1) of the ICAA. It is now expressly provided for in Chapter XXXII, 'Proceedings in Commercial Disputes' of the CPC. Pursuant to Article 365 CPC, the subject matter of this proceedings is 'actions having, as their object, a right or legal relation arising from, out of or appertaining to: (1) a commercial transaction, including the conclusion, interpretation, validity, performance, non-performance or termination of any such transaction, the consequences of the termination thereof, and **for filling gaps in a commercial transaction or adjustment of any such transaction due to**

⁴ 3MTA, обн. ДВ 60/05.08.1988 г., the quoted Article 2(2) was repealed in 2001.

intervening circumstances.” The substantive grounds for the court to fill gaps in a commercial transaction or to adapt its content to newly arising circumstances are set out in Articles 299 and 300, but also Article 307 CA.

VII. INTERVENTION OF THE COURT IN THE CASE OF SO-CALLED ‘HARDSHIP’

The possibility for a more radical intervention by the court in the contract concluded between the parties is provided for in Article 307 CA. The text regulates the well-known, in theory, issue of the so-called ‘hardship’ – a situation in which, due to newly occurring circumstances which the parties could not and should not have foreseen, the exact performance of an existing contract, without being objectively impossible, proves too burdensome for one party and, at the same time, creates unexpected advantages for the other. (Article 307 CA uses the expression ‘*the preservation of the contract is contrary to fairness and good faith*”). By virtue of this provision, upon finding such circumstances, the court may, upon ‘*request by a party, amend or terminate the contract, in full or in part*’.

The text differs substantially from that under Article 300 CA and the repealed Article 2(1) ICAA. In the two latter cases, the contract is amended by virtue of the previously expressed will of both parties that the court will do so, upon the occurrence of certain circumstances. And, insofar as no agreement is reached as to how specifically the contract is to be amended, the decision of the court determines this specific content. This decision supplements and specifies the parties’ will superseding their lack of consensus on the specific content of the clauses, where they had previously agreed that such an amendment should be made. In this sense, Article 300 CA only regulates the supplementation of the contract.

Article 307 CA, however, provides for a radical impact on the fate of the concluded contract and its modification or even termination, occurring by virtue of the unilateral will of one of the parties, without a prior agreement between them to amend the contract or what the terms should be for its amendment or termination.

In the case of Article 300 CA, the contract is supplemented by the court, by agreement between the parties, whereas in Article 307 CA the amendment or termination is achieved by virtue of the unilateral and judicially exercised right of a party who would be in an extremely disadvantageous position if it were to perform exactly as specified.

VIII. HYPOTHESES OF CONFIRMATION OF THE TRANSACTION

In other cases, the action of the third party is limited to confirming the statement of one of the parties or the transaction as a whole. Pursuant to Article 296(1) CA, if a transaction has been concluded subject to confirmation by a third party, it will have effect upon the confirmation thereof (*ex nunc (from now on)*), unless the parties have expressly provided otherwise. Where one of the parties has undertaken to obtain the confirmation, it must immediately inform the other of the outcome (Article 296(2) CA). In the latter case, the party acts under the terms of Article 23 OCA and promises the action (confirmation) of a third party.

If the third party does not confirm the contract, the party that undertook to obtain the confirmation will be liable for the so-called ‘negative damages’ suffered by the other party from contract conclusion. This will indemnify the counterparty for its legitimate expectation that the contract will take effect. Until confirmation is received, the transaction is *in pendente conditione (pending)*. It is only when it becomes clear that such confirmation will *not* follow that it will definitively become void for lack of final factual, constituent elements.

Where third-party confirmations are involved, their statements are not included in the factual elements of the transaction in the strict sense. They only condition the validity of the main statements of intent, without performance of which the transaction would be void for lack of consent (Article 26(2) OCA). However, confirmation by the third party does not determine the validity of the parties’ statements, but only gives rise to effect of the transaction itself (*conditio juris*).

However, in commercial transactions, pendency cannot last indefinitely. Therefore, Article 296(3) CA provides that if, within three months following conclusion of the transaction, the party who has not stipulated confirmation, has not been informed of the outcome (whatever it may be), it may decline the transaction. Confirmation given by a third party – a private person, constitutes an additional statement but has no independent character and is exercised by a unilateral statement which must reach the offeree, the counterparty, or both parties to the transaction.

Statements of third parties, such as state authorities, are also limited either to determining the content of certain agreements between the parties (Article 299(2) CA; Article 300 CA), or determining the occurrence of the legal action desired by the parties. The first group of cases has already been discussed above. The second is subject to the provision of **Article 295 CA**. Pursuant to its Para. (1), where **the validity of a commercial transaction requires an authorisation or approval by a government authority**, the transaction will have effect as of the granting thereof.

Another classification of the conditional statements of third parties is that of **authorisations and approvals**, with regard to the timing of their granting in relation to the execution of the principal statements. When they precede the statements of the parties, they are called **authorisations** and take effect only after the parties have agreed and are revocable until that time. Where, conversely, additional statements follow the main statements of intent of the parties in time, they are called **approvals**. In those cases, too, the transaction produces its legal effects only when such approvals are given, with effect ‘from now on’ (*ex nunc*).

The statement of government authorities, expressed in the authorisation or approval of the concluded transaction, transforms the factual composition necessary to give effect to the transaction into a mixed one, where, in addition to the private law element (the will of the parties), a public law element is included – the act of the government authority, which issues the legally required authorisation or approval. In general, however, despite its mixed nature, the factual composition of the transaction is civil law, i.e., the main (determinant, not conditional) element is private law. And, in general, it is aimed at giving rise to civil law consequences.

Similarly to Article 296(3), Article 295(2) CA also provides for adverse consequences for the party that has undertaken to request the authorisation or approval. Despite having taken care to request authorisation or approval without delay, that party bears the costs associated with this request as well as the obligation to inform the other party of the result. Insofar as it concerns an act of a public authority, the document in evidence of such approval could also be obtained by the other party directly from the authority concerned.

CHAPTER 12:

BIRD VIEW ON BULGARIAN PROPERTY LAW

Georgi Spasov

ABSTRACT	KEY WORDS
This chapter presents in a nutshell some issues related to property law, the basic legal framework, including core concepts such as title, possession, usage, easement. Limited rights in real estate, co-ownership and joint ownership of common sites, public and private property are also reviewed. State and municipal property are highlighted, including exclusive public property. A brief introduction is made into issues such as zoning regulations and restrictive requirements, as well as transactions in real estate – objects forms, perfection, etc.	property law, state and municipal property.

I. INTRODUCTION

The issue of title to assets and their transfer is a landmark issue in world history and civilization. Society uses assets to improve quality of life and to keep humans thriving, so guaranteeing that people will be able to obtain, retain, collect, transfer and inherit assets is the spine of social order. Legal framework guarantees this, not to mention that this is a matter already dealt with by the Ten Holy Commands – *do not steal*. Ever since society adopted a structure and organisation, assets have inspired social moves and developments – including changes in the location of tribes (in pursuit of larger, more sufficient or better-quality assets); some have even chosen to live under slavery in order to retain access to assets. Attitude toward assets has, for example, differentiated between farmer tribes (working on the land) and nomads (whose main assets were horses or camels), although the assets of nomads also need land to find food. Access

to [more] assets has determined who would be the leader of a society; inheritance of assets has allowed hereditary monarchies to prosper; hunger for assets is the traditional cause of many wars in the past and even now. There is a theory that the next world war will be a war for potable water.

Social orders: slavery, feudalism, capitalism and socialism (and communist theory) always had a different attitude to assets as one of their basic principles.

In slavery, some humans were assets without themselves being entitled to any own assets at all.

In a feudal society, the owner of a larger territory (including when awarded by the sovereign) became the local sovereign. Titles varied depending on the size of the land owned. In a classic monarchy (and also in Muslim societies) the sovereign owned the land and let others use or manage it. In a socialist society the sovereign was proclaimed to be the people and the people cared less about their common assets, but had a different attitude to their consumer belongings. Communist theory held that people would not care about assets and everything would be common property, but society has never tested this in practice.

People are distinguished by access to assets as rich or poor.

Ownership is an area of clash between public and private interests.

Land has always been the most valued asset, being the source of food. In Bulgarian law, at least, there has always been special treatment and differentiation between real estate and other assets. (Examples: Constitution, provisions in the Commerce Act for the acquisition/disposition of real estate, Family Code, etc.).

In Bulgaria, 84.3% of people own their housing, reports Eurostat in 2023 (compared to 93.1% in Romania, 55.3 % in Austria and only 50.4% in Germany, and an average of 68% for the European Union). Many people own summer houses, other homes and collect rent. Real estate is a very popular form of investment in Bulgaria and many individuals and companies invest in real estate.

Some assets are subject to registration in registers (land, typically, and vehicles). Some charges, especially those over real estate and registrable assets, are also required to be registered in the same registers.

II. LEGAL FRAMEWORK

Legal regulation is relatively stable, because right to ownership and its protection are fundamental social values and pillars of social stability, important for any civilized society. While there are many restitution laws and specific pieces of Parliamentary legislation on agricultural land, forests, seacoast, and regulatory legislation – such as the Cadastre and Property Register Act, the Spatial Planning Act, etc. (and secondary legislation), the core pieces of Parliamentary legislation for the scope of this class are just four – the Bulgarian *Constitution*, the *Property Act* (a sort of code of the basic principles), the *State Property Act* and the *Municipal Property Act*. These are listed below with their amendments (the latest one cited), in evidence of how stable property law in Bulgaria is.

Constitution of the Republic of Bulgaria¹ (“Constitution”)²

Property Act – (‘PA’) 1951, last amended by SG 7 of 2018, which amendment was declared unconstitutional by Decision No. 3 of 2022 of the Constitutional Court, published in “*State Gazette*”³ No. 18, 2022), more particularly the part which runs that: “The statute of limitations for the acquisition of properties – private state or municipal property, shall cease to run until 31 December 2022, including for the acquisition of agricultural land owned by or to which the right of ownership has been restored under the *Agricultural Land Ownership and Use Act* for state or municipal schools, or for other state and municipal institutions in the system of pre-school and school education.”

State Property Act (“SPA”) 1996, latest amendment: Article 63a. (New – SG 28/20, in force from 13.03.2020, amend. – SG 34/20, in force from 09.04.2020, amend. and suppl. – SG 44/20, in force from 14.05.2020, amend. – SG 32/22, in force from 26.04.2022). “Items which are private

¹ Prom. SG. 56/13 July 1991, amend. SG. 85/26 Sep 2003, amend. SG. 18/25 Feb 2005, amend. SG. 27/31 Mar 2006, amend. SG. 78/26 Sep 2006, amend. SG. 12/6 Feb 2007, amend. and suppl. SG. 100/18 Dec 2015.

² The English translation of the Bulgarian legal texts is the one provided by the legal information system Ciela, version 5.1.22012.770. Copyright 2015 Ciela Norma AD & Haarlemsoft IPR B.V.

³ “State Gazette” [“*Darzhaven Vestnik*”] is the Bulgarian Official Journal (“SG”).

state property may, by an act of the Minister of Health or a person authorised by him or her in cases of declared state of emergency, as well as in case of declared **emergency epidemic situation** due to the epidemic spread of a contagious disease under Article 61(1) of the Health Act and up to three months after their cancellation, may be provided to the medical establishments under Articles 8–10 of the *Medical Establishments Act*, as follows: 1. medical and laboratory equipment, medical devices and personal protective equipment that do not constitute consumables – for temporary use free of charge; 2. (suppl. – SG 44/20, in force from 14.05.2020) medical products, personal protective equipment, medical devices, disinfectants, hygiene and other materials and consumables – free of charge.”

Municipal Property Act – (MPA) 1996, latest amendment: Article 8 (2) (suppl. – SG 45/12, in force from 01.01.2013, amend. – SG 96/17, in force from 02.01.2018, suppl. – SG 17/21). “The procedure for the acquisition of property rights and limited property rights, for the granting for management, lease and disposal of properties and chattels which are municipal property, and the powers of the mayors of municipalities, of mayors of regions, of mayors of mayoralties and of deputy-mayors shall be determined by an ordinance of the municipal council in compliance with the provisions of this Act and of the special laws in this field. No construction and/or services within the meaning of the *Concessions Act* and the *Public Procurement Act* may be awarded on the basis of a lease contract where the estimated value of the lessee’s income for the term of the contract is higher than the European threshold within the meaning of the *Concessions Act* (Article 8(2); Article 21 (7) (new – SG 54/08; prev. text of Para. 06, amend. – SG 15/11, suppl. – SG 16/21) The detailed development plans under para. (1) shall be approved by the municipal council irrespective of their scope except for the cases under Article 81(5) of the *Spatial Development Act*; and Article 21 (10) (New – SG 16/21) Municipalities shall maintain a register of the properties subject to expropriation for implementation of the measures under para. (1). The object for the construction of which the property is to be expropriated and the detailed development plan on the basis of which the property is expropriated shall be entered in this register.”

Regulation of property at the level of the Constitution is quite detailed, which, once again, is due to the social importance of the subject. Yet the

Constitution simply sets the principles of protection of the right to property, public and private property, inviolability of private property (including restricted expropriation), the special protection of land and of arable land, and defines the exclusive rights, sovereign rights and monopolies of the Bulgarian state, as well as the standing of foreigners.

CONSTITUTION

Article 17(1) The right to property and inheritance shall be guaranteed and protected by law.

(2) Property shall be private and public.

(3) Private property shall be inviolable.

(4) The regime applying to the different units of state and municipal property shall be established by law.

(5) Forcible expropriation of property in the name of State or municipal needs shall be effected only by virtue of a law, provided that these needs cannot be otherwise met, and after fair compensation has been ensured in advance.

Article 18(1) The State shall enjoy exclusive ownership rights over the underground resources; beaches and national thoroughfares, as well as over waters, forests and parks of national importance, and the natural and archaeological reserves established by law.

(2) The State shall exercise sovereign rights in prospecting, developing, utilising, protecting and managing the continental shelf and the exclusive off-shore economic zone, and the biological, mineral and energy resources therein.

(3) The State shall exercise sovereign rights with respect to radio frequencies and the geostationary orbital positions assigned by international instruments to the Republic of Bulgaria.

(4) A state monopoly shall be establishable by law over railway transport, the national postal and telecommunications networks, the use of nuclear energy, the manufacturing of radioactive products, armaments and explosive and powerful toxic substances.

(5) *The conditions and procedure by which the State shall grant concessions over units of property and licenses for the activities enumerated in the preceding two⁴ paragraphs shall be established by law.*

(6) *The state shall utilise and manage all the state's assets to the benefit of citizens and society.*

Article 21(1) Land, as a chief national asset, shall enjoy particular protection on the part of the State and society.

(2) *Arable land shall be used for agricultural purposes only. Any change in purposes shall be allowed only in exceptional circumstances, when necessity has been proven, and on terms and by a procedure established by a law.*

Article 22 (amend. SG 18/05) (1) Foreigners and foreign legal entities may acquire right of ownership over land under the conditions ensuing from the accession of the Republic of Bulgaria to the European Union or by virtue of an international treaty ratified, promulgated and entered into force for the Republic of Bulgaria as well as through inheritance by operation of the law.

III. CORE CONCEPTS. NOTIONS OF TITLE, POSSESSION, USAGE, EASEMENTS. LIMITED RIGHTS IN REAL ESTATE. CO-OWNERSHIP AND JOINT OWNERSHIP OF COMMON SITES

What is immovable property? There is a legal definition under Article 110 PA and such are: land, plants, buildings and other structures and in general anything which is permanently fixed to the land or to a structure (whether by nature or by man). Anything else (including energy) are chattels. The functional feature – ‘permanently fixed’ is important to interpret and an example would be that a lamp switch is immovable (as you will destroy the electric system, if you attempt to remove it), but a television set is a chattel, because if you take it away you will not damage the real estate.

⁴ This is a mistake in translation – the original reads ‘the preceding paragraphs’.

Physical control over assets is where it all started, even before any regulation. Just take a look at young children in a playground – the instinct of possession (to take away the toy you like from someone else) is part of human nature, and a reason to introduce rules. Societies where there are no such rules (if any, nowadays), are often referred to as ‘jungle’ societies.

You may know that in legal theory title rights are referred to as ‘absolute rights’, i.e., exercised by the owner in respect of any other person other than the owner. Only the owner can enjoy title and this is exercised by not letting any other person enjoy the same rights or letting another person use such rights for consideration, payable to the owner. This principle remains true regardless of whether the property in question is land, chattels or intangible property (such as copyright or intellectual property rights).

In the absence of an exact equivalent in English, we will talk about physical control as the ‘**holding**’ [of an asset]. *Holding* [*darjane* in Bulgarian] is nowadays a legal term denoting exercise of factual control over an asset. Holding (or delivery) is performance under certain contracts since Roman Law times (lending for use and pledges are evidenced by delivery). Retention rights (including in forwarding and transport services) are also based on lawfully holding someone else’s assets. As early as Roman times, lawyers noticed that there may be ‘false wealth’, because the practical presumption is that whoever holds the asset is its owner (but it is quite possible he/she is not the legal owner). Nowadays people speak of ‘credit millionaires’ who may enjoy holding (and even title to) expensive assets, but are heavily indebted and their assets may not be sufficient to pay off their debts. But an asset can be seen, while debts cannot (unless one makes due diligence).

Topped up with the intention to acquire the asset (and demonstratively disallowing such control by others), **holding** becomes **possession** [*vladenie* in Bulgarian, Articles 68–76 PA] and is legally relevant as method of obtaining title (by the passage of time). Possessors enjoy certain protection by the law and may have a claim to restore possession, if lost. In legal theory possession is an example of ‘legitimate expectation’, a somewhat imperfect subjective right, to be perfected upon its consolidation with the lapse of time.

Title [*pravo na sobstvenost* in Bulgarian] is the legally perfect absolute right, comprising three components (elements of title) – the right to use an asset (*usus*), the right to enjoy its accruals (*usus fructus*) and the right to dispose of the asset (*abusus*). The doctrinal definition of title is the ‘acknowledged and protected by the law right to possess, use and dispose of an asset, legally and factually, and to request each and all other persons to refrain from such actions (unlike in contract law, where claims are directed towards a specified counterparty). Possessing is the right to enjoy undisturbed title and protection in case of disturbance, guaranteed by law. Using is associated with either consumer use (own purposes) or commercial use (deriving the fruits of the asset, e.g., by collecting rent). Thus, usage is also a term, employed when a person, different from the owner, makes use of someone else’s property, whether for consideration or for free, and is attributable rather to contract law, as it entails the owner’s consent. In the case of breach of terms of use, or the in case of ostracism (expelling) of the owner, usage could turn into possession. The right to dispose of property is exercised through its transfer to a new owner.

The PA also defines limited rights in real estate (*in rem*), such as **right of habitation** and **right to construct**.

Limited rights in real estate are *rights in rem over someone else’s property* (Article 55 PA) and this law defines personal and non-transferable right of use (Article 56–62 PA, *pravo na polzvane* in Bulgarian), which is non-transferable and may extinguish by non-use of 5 years or more or by the death of the beneficiary (or by expiration of the specified period), as well as by destruction of the asset. The user is the custodian and responsible for the costs and a portion of the taxes; as well as right to construct (*pravo na sobstvenost varhu postroyka*, more popular as *pravo na stroezh*), and, depending on the location of the new construction, the following terms may also be used: *pravo na pristroyavane* (where the new construction is at the side of the old one), *nadstroyavane* (where the new construction is on top of the old one), *podstroyavane* (where the new construction is below the old one (Articles 63–67 PA). A land owner may grant a non-owner the right to construct a building for a specific period of time (or not limited by time, i.e., forever). This right is also extinguished by non-use, or with the expiration of the term for which it was granted (in such case

title to a building goes to the land owner, because title is elastic), also by destruction of the property. Sale of the building is subject to the right of first refusal of the land owner (as if they were co-owners).

Easement is the right of an owner of adjacent real estate to use neighbouring real estate (servient estate) for technical purposes, typically to pass through to his or her own property (right of passage/access to water supply or other infrastructure network). Easements exist since Roman times, but (except for the legal definition in the Waters Act, Article 103) have not been legally defined. Typically, these are referred to as limited real estate rights for the beneficiary and lien for the servient estate. Easements arise by law, administrative acts, by transaction (including testament) or are acquired by passage of time.

There is a notion of **co-ownership** [*sasobstvenost* in Bulgarian – Articles 30–36 PA], where title over the same asset is shared among more than one subject of law, which thus hold notional proportions of the title ([*idealni chasti*]). There are rules on the exercise of rights in such case, including mandatory right of first refusal in case of sale; entitlement to compensation for use (on demand), sharing of costs, and different requirements towards exercise of possession (aiming to consolidate title). Co-owners manage their joint property by voting with their shares. Such situation arises in case on inheritance of ownership rights by several heirs.

There is also the notion of **condominium** – community shared property [*etazhna sobstvenost*], regulated by Articles 36–46 PA and the *Condominium Ownership Management Act*, over the so-called ‘common parts’ of a building, where a building comprises individual properties (if more than 3, this is mandatory). The purpose is to ensure that the ‘common parts’ are maintained and costs of use and maintenance are covered and split among the owners of individual properties (typically flats). Co-owners manage their joint property by voting with their shares; sometimes the rules are more complex. There is a separation between maintenance costs (depending on the notional shares of the owners) and consumption and usage costs (typically dependent on the number of users).

Special type of co-ownership that is undivided into shares is **matrimonial property**. It is undivided until termination of the marriage

and is thus different from co-ownership, where shares are clear at the start. Determination of shares is performed under the rules of the *Family Code* (and the *Inheritance Act*). Alternatively, it is now possible to negotiate this issue through a marital contract, concluded before or after the marriage).

IV. PUBLIC AND PRIVATE PROPERTY. STATE AND MUNICIPAL PROPERTY. EXCLUSIVE PUBLIC PROPERTY. ZONING REGULATIONS AND RESTRICTIVE REQUIREMENTS.

As set in the Constitution, property is differentiated by its owner as public and private. Where the owner is a public body (the State or a municipality) it is a matter of public property. Where the owner is an entity of private control or an individual, it is considered private property.

Public property is further differentiated by owner as property of the State and property of municipalities. State property (as defined by the SPA) is operated either by the central administration (typically ministries) or district governors. Municipal property (as defined by the MPA) is operated by the relevant municipal councils and mayors. Both pieces of legislation define ‘public’ and ‘private’ property of both the state and of the municipalities and provide for special procedures for the sale, exchange or allowing the use of such ‘private’ property, as ‘public’ property is generally not available for transactions (other than concessions). There are also procedures in the laws to change ‘public’ into ‘private’ and vice versa. Notably, the assets of state-owned and municipally-owned companies are not property of the state or the municipalities, accordingly. It ought to be mentioned that the law disallows appropriation of ‘public’ state or municipality property with the lapse of time.

State Property

The Constitution further defines *exclusive state property* (including through exercise of sovereign rights) over specified assets and reserves specified businesses as state monopolies. Effectively, these are divestiture prohibitions, and the Constitution allows only for temporary use by other subjects of the law through concessions.

If we revisit Article 18 of the Constitution, the State has *exclusive property* (paragraph (1)) over underground resources; beaches and national thoroughfares, as well as over waters, forests and parks of national importance, and the natural and archaeological reserves established by law. Thus, owning privately a plot of land does not allow you to extract the underground resources just because you own the surface. You cannot own the beach even if your nice villa is next to it.

A different term – *sovereign rights* – is used in Article 18(2) and (3) of the Constitution in respect of: prospecting, developing, utilising, protecting and managing the continental shelf and the exclusive off-shore economic zone, and the biological, mineral and energy resources therein (in paragraph (2), listing tangible assets) and radio frequencies and the geostationary orbital positions (in paragraph (3), listing intangible assets). While only paragraph 3 expressly reads so, the assets – object of sovereign rights are recognized through various international conventions, to which Bulgaria is a party.

Article 18(4) of the Constitution proclaims which assets and businesses are eligible for *state monopoly* – railway transport, the national postal and telecommunications networks, the use of nuclear energy, the manufacturing of radioactive products, armaments and explosive and powerful toxic substances. These comprise social services of particular importance or highly risky activities, where special control is required in the interests of society. The Constitution delegates to the Parliament to adopt laws on the implementation of these monopolies. Where such law is absent, there can be no monopoly. Establishing a monopoly by law over other (non-listed) assets or businesses would run contrary to the Constitution.

What is common for all of the above assets and activities is that they are, to use the Roman law term, *res extra commercio*. They cannot be divested by the state. However, Article 18(5) of the Constitution allows for the granting of *concessions* to persons other than the state in order to make better use of these assets or business opportunities, again by delegation to the Parliament to adopt laws laying down the relevant conditions and procedures. The *Concessions Act* (the effective one is in force as of 2018)

implements this opportunity in line with the EU regulatory framework.

Article 2(2) SPA defines **public property of the State** by reference to the Constitution, determination by the law or an act of the Government (including properties of national importance, designated for satisfaction of public needs through common use), as well as regulated land properties assigned to border control points and the buildings built thereon and the properties conceded to administrative bodies for the fulfilment of their functions. Pursuant to Article 3 SPA, state property (not necessarily public) are also the assets acquired through a transaction or an international agreement, obtained as liquidation quotas, inherited (where there are no legatees by law or by will and testament and all legatees or heirs have renounced or lost the right to accept them, with the exception of these real estates and chattel which become municipal property) or otherwise assigned by law to the state. Real estate and chattels that are designated as public state property and which have ceased to have this feature, will be declared private state property by a decision of the Council of Ministers, unless designated as exclusive property of the state by the Constitution. Unlike private property, properties and chattels which are public state property, cannot be subject to administration and be acquired by prescription.

Importantly, the real estate and chattel of commercial companies and non-profit legal entities, even if the state was the sole owner of the property transferred to them, are not property of the state (unless these go into liquidation and the assets are transferred to the owner as liquidation quota).

The State can certify its right of title over real estate through a ‘state property act’.

Municipal Property

Municipal property is a relatively new concept as it was differentiated from state (until then, the people’s) property only in 1991.

Article 2(2) MPA defines **municipal property** by reference to the acquisition instrument – typically by operation of law, but also from transactions, grants, inheritance, voluntary work, settlements with other municipalities. Importantly, the assets of commercial companies and

nonprofit legal entities are not municipal property, even if the municipality was the sole owner of the property transferred to them, but property of the said entities. In case of liquidation, their assets become municipal property as part of the liquidation quota of the owner of the entity.

Article 3 MPA defines what is *public municipal property*. In addition to the designation by law, there are two functional features that determine such public property: (i) real estate, designated for the performance of the functions of local government and local administration bodies; and (ii) other properties, designated for permanent satisfaction of public needs of local importance, determined by the municipal council. Where such functional designation is changed, these assets may be declared private municipal property by the municipal council.

Unlike private property, real estate and chattel which is public municipal property, the lands of the municipal land fund and the forest territories owned by the municipality cannot be acquired by prescription by anyone. Public municipal property is exempt from restitution in kind. Public municipal property cannot be alienated and transferred in ownership to third persons, except for the benefit of the State, under the conditions and procedure laid down in a special law, in which case the public nature of the property cannot be altered by the State in whose favour the property right is transferred. Public municipal property can be encumbered with limited real rights only in the cases determined with a law.

The municipality can certify its right of title over real estate through a ‘municipal property act’.

Public Law Restrictions on Private Property

In a modern society, even the owner cannot exercise rights in real estate without considering public interest. There are specific requirements, especially towards construction on land and various administrative rules, defining the zoning and the allowed use of land, the requirements towards construction, environmental protection (Black Sea coastal line, Natura 2000), utility grids, utility easements, airport security and others. Most important and of general application are the *Cadastre and Property Register Act* (2000, as amended and supplemented), regulating, among other aspects, the location,

boundaries, enduring use of the territory and the manner of permanent use of the real estate; and the *Spatial Development Act* (2011, as amended and supplemented) regulating the public relations linked to the structure of the territory, the investment design and construction in the Republic of Bulgaria and the restrictions of ownership for development purposes.

V. TRANSACTIONS IN REAL ESTATE – OBJECTS, FORMS, PERFECTION. MORTGAGE AND REGISTERED PLEDGE ON LAND

Transactions in real estate generally follow standard contracts, known since Roman Law times, as set out in the *Obligations and Contracts Act*⁵ ('OCA', sale, exchange, donation, lease/rent). Except for lease, all other contracts transfer title. Sales transfer title in consideration of a price, exchange transfers title in exchange to title over other asset(s) and donation transfers title for free (gratuitous transfer). In-kind contribution of assets into the estate of an entity is closer to exchange, as the contributor receives capital/share in the entity in exchange of the asset, title to which goes to the entity. Disposal instructions may be made through testament, effective *post mortem*. Bulgarian practice also recognizes transfer in lieu of personal care and maintenance (*dogovor za gledane i izdrazhka* in Bulgarian), where the transferee has to attend to the needs of the transferor for his/her lifetime, but does not owe consideration for the real estate. Lease or rent comprises temporary divestiture of the right to inhabit or use real estate or chattel for consideration (the rental price). It is also possible to grant gratuitous use of the assets and, in respect of real estate, such contract does not need to meet the requirements for right of habitation as limited right in real estate (*in rem*).

There are also specific contracts regulated elsewhere by Parliamentary legislation, such as long-term lease of rural land and/or buildings and chattels (*arenda*) and long-term use of state- or municipality-owned land or assets (*concessions*, already mentioned).

⁵ Promulgated 1950, as corrected, amended and supplemented.

Real estate is a registrable asset (as well as some vehicles) and transactions (including charges and liens) in real estate require (except for lease/rent) a notary deed as a form for validity of transactions, and further perfection by way of registration in the relevant register (typically, the Property Register Office with the Registry Agency at the location of the real estate). *Arenda* contracts are registered with the local municipal office of agriculture. Vehicles (and transactions, including charges and liens) are registered with the relevant offices – the relevant district Road Police Directorate for cars, trucks and similar; the registry at the airport of domicile for aircrafts; the registry at the port of domicile – for boats and ships.

Real estate can be used by its owner also as collateral through *mortgage* or *registered pledge* (by merchants only). The substantive law regime of the mortgage is laid down in general civil law – the OCA. There is some scholarly debate as to the legal nature of the mortgage (hypothecation), because it is possible only on real estate and some argue it thence constitutes a right *in rem*. Others say it is a contractual right because it is typically established through a contract, but there is also mortgage by operation of the law. Third take the view that the mortgage is a procedural instrument, as it allows enforcement without further consent of the owner. Mortgages can serve as collateral to debt performance (of the owner or of another debtor) and can be enforced by the bailiff through auction sale to satisfy creditors. Importantly, an agreement to obtain title in case of default is invalid by operation of the law, unless such agreement was made only after the default occurred (a sort of *datio in solutum*).

It is possible to impose a mortgage by operation of the law – most often under Article 60(4) of the Credit Institutions Act, in case of acquisition of real estate through secured bank loan, and also under general law (e.g., Article 168 OCA) and some special laws. Such mortgage is much cheaper in terms of registration fees than the contractual mortgage.

Registered pledge over the enterprise of a merchant allows for registration of the pledge over real estate assets (if any) within the enterprise, without establishing a mortgage. The effect is similar (enforcement may result in the sale of the real estate in case of default), but the registration cost is much lower, so merchants usually opt for such pledge, instead of mortgage.

Preliminary contracts are not legally defined, but are described in Article 18 OCA. A written format is the minimum required for real estate (as final contracts are to be notarized). Preliminary contracts, when having the necessary and complete content, can be determined to be final through a court decision, which replaces the need for the reluctant party to draw up the contract in the form of a notary deed.

The OCA (Article 91) further defines special *retention right* over chattels. This is a form of permitted self-help, where a non-owner creditor can legitimately refuse to deliver to the owner until the debt is settled, and the owner is thus motivated to perform.

VI. NON-CONTRACTUAL ACQUISITION OF TITLE (LAPSE OF TIME, INHERITANCE, ORIGINATION, AMALGAMATION)

There are means to acquire title, different from transactions, some of which are based on *title origination* and some are *derivative*, such as contracts. In the case of origination of title, the previous title (if any) is legally irrelevant, and in the case of derivative means that the former title matters and may affect validity of acquisition.

Title origination is typically associated with possession (rebuttal of the owner's title by the exercise of possession for a period of time with the intention to acquire title). Origination is also the means to obtain title when there is natural accrual (accretion) to someone's property (*prirashtenie*, Article 92 and 93 PA) the classic example for real estate is the extension of land at the riverbank by river sediments, eruption or some sort of calamity, reshaping the land). Origination is also relevant to *usus fructus*, as title to new derivative assets – e.g., title to new-born animal goes to the owner of the mother, title to fruits on trees goes to the owner of the trees, rent belongs to the owner.

By lapse of time (*acquisitive prescription*, *pridobivna davnost* in Bulgarian) title passes upon 10 years of uninterrupted possession (over real estate in bad faith) or 5 years (over real estate in good faith, and over chattels, except for crime). Remember to differentiate between lapse of

time in contract law – prescription, which extinguishes the right to claim in contract law (*pogasitelna davnost* in Bulgarian), where a creditor loses a right; and lapse of time in real estate law (*pridobivna davnost* in Bulgarian), which results in the acquisition of a right.

In the case of *amalgamation of properties* (typically chattels) where by way of *processing* or *incorporating*, i.e., adding chattels to each other, someone creates a new asset, typically the title goes to the owner of the main chattel or to the owner of the materials. There are different hypotheses set out in Articles 94–98 PA: whoever produces something from someone else’s material, becomes the owner only if he/she was unaware that the material belongs to another r (i.e., the tailor will not become the owner of the suit, as he/she is aware that the client provided the cloth for the suit); where materials belong to different owners, the main material draws title and if this rule cannot be applied, then joint ownership arises by operation of law; an asset incorporated into a main asset becomes part of the main asset and thus title transfers by operation of the law.

Finding a lost or a hidden asset does not give legal title (Article 87–91 PA). Found chattels (where the owner is unknown) must be delivered to the municipality (the Municipal Property Office), and the owner is entitled to reclaim them within one year for a fee of 10 % of the asset’s value plus storage and transportation costs (the court may decrease the fee, if too high). After the year elapses, the municipality becomes the owner of the asset, which is a departure from the general rule of Article 78 (2) PA that the owner of a stolen or lost chattel is entitled to reclaim it from any good faith holder within 3 years. As to hidden chattels (buried in the land, embedded into walls and similar, usually treasures) of an unknown owner who cannot be identified, title directly goes to the state by operation of the law and there is 25 % finder’s fee, payable by the state to the person who found the treasure.

**VII. CLAIMS OF RIGHTS OVER REAL ESTATE.
PERFECTION OF CLAIMS. DIVIDING REAL
ESTATE BETWEEN CO-OWNERS.**

As stated in Article 17(1) of the Constitution, the right to property and inheritance is guaranteed and protected by law. The most popular form of guarantee is the right to obtain protection by the court and enforcement of rights. Claims comprise a complex civil process and the full review of claims, complications and court practices are beyond the scope of this chapter. What you should know are the basic features of possible claims to protect property rights. Therefore, we will only look into the substantive law provisions of the PA, defining claims.

The main claim of the owner is the one under Article 108 PA – to recover the asset from any possessor or holder who has no reason to exercise such right. Known since Roman Law as *actio rei vindicatio*, this claim expresses the very nature of the absolute subjective right of ownership – to request that any person, other than the owner, complies with the rights of the owner.

The owner also has a claim under Article 109 PA to request termination of any act, which prevents or impedes the owner from exercising his/her title. Obviously, it is intended to expand the protection of the owner in scenarios where no asset has been taken away from the owner, but the exercise of the title is infringed in a different manner.

The owner is entitled to request the court to determine the boundaries of his/her real estate (Article 109a PA). The nature of this claim, introduced through a new provision of the PA, is still being discussed in legal theory, especially as nowadays it is not applicable for regulated plots and thus less popular.

In addition to title, possession is also defended by the law as legitimate expectation – Article 75 PA allows any possessor (including easement holder) to claim defence where uninterrupted possession has lasted more than 6 months. Article 76 PA provides for special protection of possessor and even holder (without the *animus* to become owner) to defend by claim, where an asset was taken away by force or in a silent manner; however,

such an interrupting possessor can counterclaim himself/herself against the claimant under Article 75 PA. Costs of improvements (if such are made in the meantime) are settled on the principles of the law of obligations – either at the rate of increased value and necessary costs (where in good faith) or necessary costs and costs of collection of accruals (fruits) but after deduction of actual or notional benefits (where in bad faith). In any case the law would not allow unjust enrichment by denying any reimbursement of the costs of improvement.

Co-owners are entitled to request from the court to divide co-owned property and thus terminate co-ownership. Where the asset is not divisible (by nature or legally), the owners can decide who should pay the value of the property to whom or may take the property to the bailiff for enforced sale and share the price.

Enforcement of mortgage and real estate subject to registered pledge is performed through enforced sale. The creditor may participate in such sale. It is possible for a creditor to obtain title upon subsequent agreement with the security grantor. However, such an agreement made at the time of the charge is invalid.

Disputes over real estate (as well as transactions in such) are subject to registration in the land register (Article 112 PA). Earlier registration overrides (Article 113 PA), thus it is material to preserve priority at the start. Some claims will not be examined by the court unless evidence of such claim is produced.

CHAPTER 13:

BULGARIAN COMPETITION LAW IN A NUTSHELL

Georgi Spasov

ABSTRACT

This chapter presents some basic issues related to the Competition Law at both European and national level, including legal framework, institutional framework of European and national authorities, prohibited agreements, acting in concert, leniency, monopoly and dominance, abuse of market standing, mergers and merger permits, mandatory filing, unfair competition and related breaches are reviewed. Some other matters are also presented such as agricultural and food products chain breaches, competition advocacy, sectoral analyses, challenging decisions of the national regulator and of the European Commission, etc.

KEY WORDS

competition law,
prohibited agreements,
unfair competition.

I. INTRODUCTION

The purpose of this chapter is to take the reader through the basic concepts and features of Bulgarian substantial law of competition, rather than reviewing related procedures and processes. The European Union ('EU') competition law will also be discussed on a need-to-mention basis. The Bulgarian national competition protection authority – the Competition Protection Commission ('CPC') has wider powers (including on public procurement and concessions), which also fall outside the scope of this chapter. The Competition Protection Act ('CPA') has more legal institutes, which are also outside the scope of the present chapter (e.g., action for damages).

To understand why competition is important we need to compare it to the alternative of planned economy and to look back in social history.

Once you start producing more than you can eat, then you need to sell, as food is a perishable item. In order to sell, you need a market. If you look into English history, you will see that ‘*market town*’ was a status, obtained by custom or royal charter, and the *Domesday Book* of 1086 (probably the first property register) listed 50 markets in England.

Competition is associated with the free market and democracy; planned economy is associated with state regulated market and socialism. The philosophy of the free market is to match demand and supply through producers of goods and services competing at market terms by producing better quality at an adequate price, and for consumers or industrial customers to determine which goods and services deserve purchasing. The philosophy of planned economy is that by planning demand and ensuring no alternative and production at say, 10 % deficit, demand is guaranteed regardless of price and quality. Historians write that nations formed around the 19th century by adding the national market to the existing features of society. Ever since (with the mentioned exception), the national market is considered a public good to be protected by law in the pursuit of social prosperity. Markets means balance, and the law has two controversial goals to achieve – to encourage business development and, conversely, to discourage business development. Encouragement is available to viable businesses, playing by the rules of fairness, including for the benefit of consumers, and discouragement is directed towards businesses trying to cheat their competitors and customers, or businesses, which have grown too large to be adequately monitored. This, therefore, is another approach toward achieving balance between rights, freedoms and social duties, including on the market.

Competition law is thus a branch of law, which is technically close to corporate and contracts law, but is so influenced by economic factors that we need to take a different view of corporate structures and contracts, which, natural, creates a different and multidimensional picture. If you visit the official web-page of the Competition Protection Commission (CPC) <http://www.cpc.bg/> and read any of the decisions, you will see that each contains a separate economic and legal analysis, and the final decision is based on a combination of both. Because of complexity, competition law is closely related to state aid law, public procurement law, consumer law (although

Bulgaria is one of the few jurisdictions, where CPC does not directly protect consumers). CPC considers the effect on consumers in a rather abstract way, but as a rule would not open a procedure upon complaint by a consumer – the plaintiff is typically a competitor that sees wrongdoing committed by a peer. Consumers need to complain elsewhere – whether before the Consumer Protection Commission, before some special mediation authority (such as the Financial Supervision Commission, in the case of retail banking, for example, depending on the nature of the complaint).

II. GLOSSARY OF KEY TERMS

Due to the above specifics, competition law has its own terminology and definitions, the major ones being set out in the supplementary provisions to the CPA. To demonstrate its specifics in comparison to other branches of the law, some of the numerous definitions under CPA are grouped in categories which are comparable to other branches: subjects of law, business, contracts and evidence.

1. Subjects

Competition law does not speak of subjects of law, but of undertakings. Pursuant to §1, Item 7 CPA¹ ‘*Undertaking*’ is every natural, legal person or a non-personified entity, which carries out a business activity, regardless of its organisational form. For the purposes of competition law, §1, 12 CPA defines ‘*Association of undertakings*’ as an association on professional basis and other forms of association of independent undertakings, which does not perform separately self-dependent business activity and respectively does not share profit. On the other side of a potential breach, we also have undertakings, but this time they are considered ‘victims’. §1, Item 25 CPA defines ‘*Injured Person*’ is a natural or legal person who has [already] suffered damage as a result of an infringement of competition law. §1, Item 4 CPA also defines potential victims as ‘*Interested person*’:

¹ The English translation of the Bulgarian legal texts is the one provided by the legal information system Ciela, version 5.1.22012.770. Copyright 2015 Ciela Norma AD & Haarlemsoft IPR B.V.

a person, undertaking or association of undertakings, whose interests **may be** impacted by an infringement of the Act. The wrongdoers are not ‘criminals’ as in criminal law, nor ‘delinquents’ as in civil law, but ‘infringers’. Under §1, Item 20 CPA ‘*Infringer*’ means the undertaking or association of undertakings which has committed an infringement of competition law, and there is also ‘*Co-infringer*’ under §1, Item 22 CPA – a participant in an infringement of competition law committed by more than one infringer. An infringer may become an ‘*Immunity recipient*’ under §1, Item 37 CPA – an undertaking which, or a natural person who, has been granted immunity from fines by a competition authority under a leniency program. Dealing with infringers is either direct or indirect – under §1, Item 41 CPA, a ‘*Direct Purchaser*’ is a natural or legal person who has acquired directly from the infringer products or services, which are subject to an infringement of competition law; and under §1, Item 42 CPA, an ‘*Indirect purchaser*’ is a natural or legal person who has acquired indirectly from the infringer, but from a direct purchaser or a subsequent purchaser products or services, which are subject to an infringement of competition law, or products or services containing or derived from such products or services. Both types of purchasers may claim damages from infringement and §1, item 38 CPA provides the starting value – ‘*Overcharge*’ is the difference between the price actually paid and the price which would have been determined in the absence of an infringement of competition law.

2. Business

As defined in §1, Item 13 CPA ‘*Business activity*’ is the activity of undertakings, the results of which are intended for exchange in the market. What is meant is actual business and not registered business objectives, as in company law. Exchange relationships (contractual structure) are vertically structured. ‘*Supply Chain*’ as per §1, Item 43 CPA: The supply chain exists when goods or services are transferred successively to different levels of trade in original or processed form, until the final product is made available on the market. The notion of good faith is transposed in §1, Item 2 CPA as ‘*Fair trade practice*’ – rules, determining market behaviour, which arise from the laws and custom trade relations and do not harm good morals. Business is done on the market, which in competition law (in

fact the only branch of law defining ‘market’) is the ‘*Relevant market*’ (§1, Item 15 CPA) which consists of:

- a) ‘*product market*’, where all goods and services which can be accepted as interchangeable with regard to their characteristics, purposes and prices are included; and,
- b) ‘*geographic market*’, which includes a definite territory where the respective interchangeable goods or services are offered and where competition conditions are equal but differ from those in neighbouring regions.

3. Contracts

Competition law looks into agreements and provides definitions which no other branch of the law provides. For example, under §1, Item 5 CPA a ‘*Cartel*’ is an agreement and/or coordinated practice between two or more undertakings in order to coordinate their competitive behaviour on the relevant market or influencing relevant competition parameters through practices, such as setting or coordinating purchase or sale prices or other trading conditions, including with regard to intellectual property rights, setting quotas for production and sales, market and customer sharing, including manipulation of public auctions or procurements, restrictions on imports or exports or anti-competitive actions against other competitors. An agreement does not need to be formal. §1, Item 14 CPA provides a definition of ‘*Concerted practice*’ – coordinated actions or inactions of two or more undertakings.

4.Evidence

Competition law has its own process and procedural rules and, as evident from the general definition of ‘evidence’ below, the standard of proof is much more flexible than the litigation standard, despite the fact that the decisions of the CPC are subject to court control. CPC has own inspection powers to collect evidence with own employees and own devices, which the courts do not do.

§1, Item 32. ‘*Evidence*’ means all types of evidence, **regardless of its source, admissible before the national court** and in particular documents

and all other items containing information, regardless of the medium on which it is stored.

§1, Item 3. ‘*Electronic evidence*’ is evidence, collected by an undertaking or association of undertakings during an **inspection**, in electronic format, by way of copying electronic documents or statements in electronic format.

§1, Item 17. ‘*Forensic evidence*’ is evidence, **collected upon on-spot inspections** through the use of **specialized technical devices** (forensic laboratory) for restoration, certification of authenticity and analysis of digital information, presenting an exact copy (forensic image) of the specific carrier of that information.

§1, Item 18. ‘*Digital evidence*’ is information of evidential quality, which is being kept or transferred in digital format. Importantly, CPC has the *powers to collect evidence itself*, including through *on-spot inspections* (Article 50 CPA) and seize evidence in any form from various sources (including private homes, vehicles, computers and social media). These inspections (figuratively named ‘*dawn-raids*’) must be precleared by Sofia District Administrative Court and the police must support CPC on demand.

5. Protection of Secrets

Competition law also has own regulations on the protection of secrets, despite the fact that confidentiality is regulated in parallel in other pieces of Parliamentary legislation, including the *Trade Secrets Protection Act*. Exchange of information between competitors is one of the prohibited behaviours under CPA. CPA introduces prohibition for disclosure of manufacture or trade secrets as a form of unfair competition in Article 37 CPA:

- ‘(1) Prohibited shall be the acquisition, usage and disclosure of manufacturing or trade secrets in contradiction to the fair trade practice.
- (2) Prohibited is the using or divulging of manufacturing or trade secrets when acquired on condition not to be used or disclosed.’

These prohibitions are supported by the special legal definitions in §1, Item 9 CPA: ‘*Production or trade secret*’ are facts, information, decisions

and data connected with the business activity, and keeping in secret of which is in the interest of the entitled persons, for which they have taken appropriate measures; and §1, Item 10 '*Professional secret* shall mean: a) any information, which the Commission creates or acquires for the purposes of the investigation under this Act or in connection with it, the dissemination of which may endanger the business interests or the prestige of the parties to the correspondence or of a third party; professional secret does not constitute an official secret within the meaning of the *Classified Information Protection Act*; b) information, exchanged between the Commission, the national competition authorities of the Member-States and the European Commission ('EC') in connection with execution of their powers and the co-operation between them.

Information, which is available to the public or is subject to public announcement according the CPA or under another Act of the Parliament shall not be considered a '*Professional secret*'. Also, pursuant to §1, Item 35 CPA '*Pre-existing information*', i.e., data which exists independently of proceedings before a competition authority regardless of whether such information is contained in the file of a competition authority, is not protected.

III. LEGAL FRAMEWORK

As an important feature of the economic structure of society, competition is dealt with in the constitutional documents of the European Union (EU), as well as in the Bulgarian Constitution. The European Commission (EC) directly enforces competition law through its *Directorate-General for Competition*. The EU 'constitutional' legal texts are set out in the *Treaty on the European Union* and *the Treaty on the Functioning of the European Union (TFEU)*:

RULES APPLYING TO UNDERTAKINGS

Article 101 (ex Article 81 TEC²)

1. The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:

(a) directly or indirectly fix purchase or selling prices or any other trading conditions;

(b) limit or control production, markets, technical development, or investment;

(c) share markets or sources of supply;

(d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

2. Any agreements or decisions prohibited pursuant to this Article shall be automatically void.

3. The provisions of paragraph 1 may, however, be declared inapplicable in the case of:

- any agreement or category of agreements between undertakings,*
- any decision or category of decisions by associations of undertakings,*
- any concerted practice or category of concerted practices,*

which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:

² Treaty Establishing the European Community.

(a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;

(b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.

Article 102 *(ex Article 82 TEC)*

Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States.

Such abuse may, in particular, consist in:

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

(b) limiting production, markets or technical development to the prejudice of consumers;

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.

The Bulgarian Constitution³ regulates the principles in the first two paragraphs of its Article 19:

Article 19(1) The economy of the Republic of Bulgaria shall be based on free economic initiative.

(2) The state shall establish and guarantee equal legal conditions for economic activity to all citizens and corporate entities by preventing any abuse of a monopoly status and unfair competition, and by protecting the consumer.

³ Prom. SG. 56/13 July 1991, amend. SG. 85/26 Sep 2003, amend. SG. 18/25 Feb 2005, amend. SG. 27/31 Mar 2006, amend. SG. 78/26 Sep 2006, amend. SG. 12/6 Feb 2007, amend. and suppl. SG. 100/18 Dec 2015.

To implement constitutional principles, the Parliament adopted the *Competition Protection Act*⁴ ('CPA'). This is the third such Act in Bulgarian legislation, following the 1991 Competition Protection Act (prom. State Gazette⁵ 29/1991, supplemented and amended), repealed through the 1998 Competition Protection Act, in turn repealed by the CPA.

IV. STRUCTURE AND COMPETENCES OF NATIONAL BODIES. TERRITORIAL COMPETENCES. REFERRALS BETWEEN THE NATIONAL BODY AND THE EC. SANCTIONS.

1. National Authority

Because of the different standing of the competition regulator in the various EU member states, EU law refers to a '*national authority on competition*'. The national authority on competition of the Republic of Bulgaria, charged with implementing Community legislation in the field of competition, is the Competition Protection Commission ('CPC'). The Commission is an independent specialized state authority on budget maintenance and a first-tier authorising officer. The CPC is a legal person, seated in Sofia.

The CPC consists of 7 persons, including a Chairperson (the Chairperson of the Commission must be qualified lawyer with at least 10 years' experience in the field of law), Deputy Chairperson and 5 Members, elected and discharged directly by the National Assembly for a mandate of 5 years. The members of the Commission are elected through a public procedure and cannot be re-elected directly for an immediately subsequent mandate. CPC members must be Bulgarian citizens with higher juridical or economic education and at least 5 years working experience, with high

⁴ Prom. SG. 102/28 Nov 2008, amend. SG. 42/5 Jun 2009, amend. SG. 54/16 July 2010, amend. SG. 97/10 Dec 2010, amend. SG. 73/20 Sep 2011, amend. SG. 38/18 May 2012, amend. SG. 15/15 Feb 2013, amend. and suppl. SG. 56/24 July 2015, amend. and suppl. SG. 2/3 Jan 2018, amend. SG. 7/19 Jan 2018, amend. and suppl. SG. 77/18 Sep 2018, amend. SG. 17/26 Feb 2019, amend. SG. 28/5 Apr 2019, amend. and suppl. SG. 17/26 Feb 2021.

⁵ 'State Gazette' ['Darzhaven Vestnik'] is the Bulgarian Official Journal ('SG').

professional ethics and must have not been convicted for a premeditated crime of general nature. They cannot benefit in any form whatsoever from undertakings or to take other paid occupation, except where they practice scientific, lecturing or arbitration activities. The CPC is assisted by administration in its activities and adopts a Rulebook to set the structure and competences of its administration. In addition to its competence under CPA, the law grants the CPC the competence of reviewing challenges of awards under the *Public Procurement Act* and under the *Concessions Act*.

CPC is under the legal duty to prepare an annual activity report, submit it to the Parliament not later than 30 May of the following calendar year and publish it on its Internet site.

2. Conflict of interest

The ‘cannot benefit’ rule above is further detailed in Article 10 CPA: a Member of the CPC or an officer from its administration may not participate in a procedure under the CPA, if he/she is interested in its outcome or there are valid doubts as to his/her impartiality; and in such case must resign upon his/her initiative or upon request of the relevant parties.

3. Professional secret

Further, pursuant to Article 11 CPA, neither CPC members, nor the CPC administration may disclose information which is professional secret and such disclosure of information, representing professional secret, may be performed by CPC only in execution of its obligations of a national authority on competition of a Member State of the European Union, under the procedure of Regulation (EC) 1/2003 and/or Regulation (EC) 139/2004.

Budget of the Commission

Being a state authority on budget maintenance, CPC adopts, implements and reports its annual budget under the procedure of the *Public Finance Act*. Importantly, the budget of CPC has a performance incentive – pursuant to Article 12 (2) CPA, the budget of the Commission receives revenue from:

1. fees and charges under the CPA, the Public Procurement Act and the Concessions Act;
2. pecuniary sanctions and fines under Commission decisions which have taken effect;
3. other sources from activities permitted by law.

Therefore, CPC is financially motivated to impose sanctions and defend them in court, if challenged.

4. Territorial competence and subjects

Article 2 CPA provides for quite a broad scope of regulation by CPC both in terms of *subjects* and *territory*. Hence, CPC enjoys, at least in theory, certain extraterritorial competences to protect the Bulgarian market. Territorial dimensions are defined on two manners: a) doing business **on the territory of the Republic of Bulgaria**; or, b) **or beyond it**, if the effect is seen on the Bulgarian market (if such effect explicitly or tacitly prevents, restricts, distorts or may prevent, restrict, distort competition **in the country**). Also, there is one exemption to both a) and b) above – unless otherwise provided by an effective international agreement, to which Republic of Bulgaria is party, CPC has no competences (and CPA does not apply) to actions, resulting in actual or possible restriction or distortion of competition **in another country**.

In terms of subjects, CPC is, of course, competent in respect of business actors (i) all *undertakings and associations of undertakings* (which are typically not-for-profit entities); including (ii) *undertakings to which the state or the municipality has assigned services of public interest* (insofar as the implementation of CPA does not impede in actual or legal terms the performance of the tasks assigned to them and does not significantly affect competition in Bulgaria); but also in respect of non-business actors (iii) *state authorities, including the executive authorities and authorities of the local independent government*, if they explicitly or tacitly prevent, restrict, distort or may prevent, restrict, distort the competition in the country; and, (iv) *natural persons*, who commit or contribute to infringement of the CPA.

5. Referrals

Since the EC, as already mentioned, directly enforces competition law within the EU, there is an inevitable overlap of competences with (each of) the national authorities. In the area of merger clearance, referrals (either way) are expressly regulated within Articles 21 and 22 of *Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings* (the EC Merger Regulation).

Article 21 reserves competence for the EC on the basis of Community dimension and prohibits a member state to apply its national legislation. In such case, even if filing is made with a national authority, the latter shall refer it to the EC. Typically buyers of control file directly with the EC.

Article 22 entitles a member-state (or more than one member states) to request the EC to examine a concentration that does not have a Community dimension but affects the trade between member states and threatens to significantly affect competition within the member states making the request. EC decides whether to examine the case or not. EC may invite a member-state to submit a concentration to the EC. Historically this was seen as an instrument for assistance of national authorities (if any; the Grand Duchy of Luxembourg still does not have such) with more complex mergers, then EC adopted a policy to discourage such referrals. Subsequently Ms. Margrethe Vestager, Executive Vice-President, responsible for competition at EC, announced a change in the practice under Article 22 and EC started accepting referrals as of mid-2021 and actively encourages them (especially in the digital and pharmaceutical areas, as the EC noticed certain gaps in these areas).

There has been one attempt by the CPC to claw back a filing from the EC, arguing that its effect would be only felt in Bulgaria, but this was declined by the EC.

Competence determination also matters in terms of applicable law – where EC overtakes, national competition law is no longer applicable.

There are other instruments for cooperation in the areas of anti-trust (different from merger) between the EC and each national authority, including through reporting and local performance of dawn-raids. Also, there is exchange of information among national authorities.

6. Sanctions

The competence of CPC is well demonstrated through its powers to levy pecuniary sanctions, which can reach up to 10% of the annual turnover of the enterprise. There is, of course, a difference between *turnover* and *profit* (whether before or after tax) and these sanctions are on the turnover. Same is the case with ‘minor’ sanctions of up to 1 % that may be levied for non-cooperation in investigation. And, as mentioned, CPC is motivated because sanctions increase its budget.

Sanctions are levied on a case-by-case basis, but under the methodology adopted by CPC and are publicly available on its web-page. The mechanism of determining sanctions is based on a two-step approach: first, determining the basic amount; and, second, making adjustments to reach the final amount. The final amount is always subject to the already mentioned 10 % cap. The basis (the turnover) is the volume of sales in Bulgaria for the last financial year, preceding the imposition of the sanction. In theory, where just part of the turnover is attributable to the breach, it is this part only that should be considered as the relevant turnover, but CPC is not overly keen on applying such a carve-out. Only Chapter 7b CPA provides for absolute sums and not percentages, capped at BGN 300,000. The sanctions under the now repealed Chapter 7a were also expressed in percentages for the undertakings. In its methodology CPC has determined three categories, based on the type of breach, the gravity of the breach (light, medium and grave) as found by CPC, and two groups of subjects (undertakings and non-profit entities), summarised in the below table (which is not fully complete, as it does not show all possible sanctions):

Undertakings	Chapters 3&4	Chapter 5	Chapter 7	Chapter 7b
Light breach	up to 5 %	up to 5 %	up to 2 %	up to BGN 100,000
Medium breach	up to 8 %	up to 7 %	up to 5 %	up to BGN 200,000
Grave breach	up to 10 %	up to 10 %	up to 8%	up to BGN 300,000
Non-Profit	See also the comments on Article 100(3) below		If no sales	-
Light breach	Up to BGN 50K	-	Up to BGN 10K	-

Undertakings	Chapters 3&4	Chapter 5	Chapter 7	Chapter 7b
Medium breach	Up to BGN 100K	-	Up to BGN 30K	-
Grave breach	Up to BGN 150K	-	Up to BGN 50K	-

CPC is also entitled to apply periodical sanctions for incompliance and sanctions to individuals, which are outside the scope of this review.

In addition, CPC is entitled to apply mandatory structural measures (sanctions), most typically a demerger order (in case of unpermitted merger).

Pursuant to the 2021 amendments to CPA, the powers of CPC to levy sanctions, have substantially increased.

Article 100 (3) provides that in case of breach of Chapter 3 CPA (and/or Article 101 and Article 102 TFEU) by an association of undertakings, related to the activities of its members, CPC shall impose a pecuniary sanction **on the association of up to 10 % of the total turnover of each member of the association operating on the market affected by the violation** for the previous financial year (save for the turnover of members, which have already been fined by CPC for this breach – Article 100 (4) CPA).

Pursuant to Article 100 (14) CPA fines for breach of Chapter 3 CPA (and/or Article 101 and Article 102 TFEU) may also be imposed on a person that:

1. *exercises control* over the infringing undertaking, or
2. *has acquired its assets* as a result of a transformation in which the infringing undertaking has ceased to exist as a legal entity, or
3. is an *economic legal successor of the activity*, through which the violation has been committed.

V. PROHIBITED AGREEMENTS. ACTING IN CONCERT. LENIENCY. (*ANTITRUST – CONTRACTUAL*)

In the ‘classic’ antitrust (excluding mergers – Chapter 5 CPA) there are two forms of potential breaches: contractual (Chapter 3 CPA, transposing Article 101 TFEU, see text above) and structural (Chapter 4 CPA, transposing Article 102 TFEU, see text above). The contractual one is based on arrangements which do not need to take the form of valid contracts, and the making of decisions, i.e., in this case you need more than one wrongdoer. While it is not directly seen in the CPA, these wrongdoers need to be independent undertakings (i.e., not members of the same corporate group), which coordinate their market behaviour as if they were not independent and are usually competitors on a horizontal market. The popular name for such arrangements is ‘*cartel*’. The associations are here because they are a very suitable media for exchange of information between such undertakings.

The relevant legal definitions under CPA are quite informative *per se*:

Under §1, Item 1 CPA: ‘*Cartel*’ is an agreement and/or coordinated practice between two or more undertakings in order to coordinate their competitive behaviour on the relevant market or influence relevant competition parameters through practices, such as fixing or coordinating purchase or selling prices or other trading conditions, including with regard to intellectual property rights, setting quotas for production and sales, market and customer sharing, including manipulation of public auctions or procurements, restrictions on imports or exports or anti-competitive actions against other competitors.

Let us not forget the CPA approach to evidence mentioned above; in observance of this method, CPC makes best use of relaxed requirements. It should be noted that as early as the 1991 Protection of Competition Act, it detected a cartel because the directors of undertakings in the same branch took the same flight to a destination abroad of Bulgaria and could have discussed business parameters on the flight (subsequently the court disagreed in the appeal).

Under §1, Item 14 CPA: ‘*Concerted practice*’ are coordinated actions or inactions of two or more undertakings.

CPC tends to see such concerted practices most often in price monitoring and following of the prices of competitors, even when these are publicly displayed, e.g., in Internet sales and at gas stations.

There is a general prohibition under Article 15(1) CPA, which tries to cover all possible arrangements, including by factual following of other undertakings and acting in the same manner. ‘Concerted practices’: *‘Prohibited shall be all kinds of agreements between undertakings, decisions of associations of undertakings, as well as concerted practices of two or more undertakings which aim the prevention, restriction or distortion of competition on the respective market.* And then the law provides a non-exclusive list of possible self-explanatory ‘clauses’, the first three of which are known as ‘core breaches’, price arrangements being the worst:

1. direct or indirect fixing of prices or any other trading conditions (non-competition on prices);

2. sharing markets or sources of supply (non-competition on customers or on suppliers);

3. restriction or control of production, trade, technical development or investments (creation of deficit or refusal of improvements);

4. application of dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at competitive disadvantage (unequal treatment of comparable competitors);

5. making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations or conclusion of supplementary contracts, which, by their nature or according to commercial usage, have no connection with the subject of the main contract or to its fulfilment (also known as ‘tying contracts’).

Pursuant to Article 15 (2) CPA such arrangements and decisions are *void* by operation of the law; however, this gives no defence to participants. Invalidity is to assist third parties, victimized by a cartel.

Unless there are ‘core breaches’ in place, there is a *de minimis* exemption under Article 16, based on the combined market share of the wrongdoers being below: a) ten percent on the respective market if the participants are competitors; or, b) fifteen percent of each of the respective markets, if the participants are not competitors.

There used to be a possibility under Article 17 CPA to, in case of doubt, pre-consult with CPC and obtain individual exemption – pre-clearance, but this is no longer applicable although it still persists in the law.

What is applicable, though, are the ‘block exemptions’ from the general prohibition under Article 18 (1) CPA: ‘Certain categories of agreements, decisions and concerted practices, which meet the requirements of Article 17, may be exempted from the prohibition of Article 15 by resolution of the Commission, which shall not be subject to appeal. It shall be published in the register referred to in Article 68.’ These exemptions are granted following EC and CPC investigations of the relevant markets and are a form of secondary legislation issued by the competition authorities. There is a set of such exemptions on distributorship agreements, which are based on the acknowledgement that a distributor could not be fully independent from the principal.

Leniency: Relief from sanction and reduction of sanctions

Confession helps in religions and also in competition law. The first confessing participant in a secret cartel may be relieved from sanctions or may benefit from reduction of sanctions upon applying for such and in reward for full cooperation to CPC, especially when procuring sufficient evidence to CPC to prove the cartel and sanction the other participants. The complex process and requirements are set out in Article 101 CPA and, pursuant to paragraph (5) of the same, CPC has adopted, through a resolution, a detailed *Programme for Relief from Sanctions or Reduction of Sanctions and its Rules of Implementation* (Leniency programme, as defined in §1, Item 33 CPA). §1, Item 34 CPA provides a legal definition of the application: ‘Leniency statement’ is an oral or written voluntary statement made before a competition authority by an undertaking or natural person or on their behalf describing their knowledge of a particular cartel

and the role of the undertaking or the natural person in it, which statement is made for the purpose of participating in a leniency programme and does not include pre-existing information; and the beneficiary of leniency is an ‘immunity recipient’ as defined in §1, Item 37 CPA: ‘an undertaking which, or a natural person who, has been granted immunity from fines by a competition authority under a leniency programme’.

In contrast to the above, EC and CPC have the practice of sanctioning only the ‘leader’ of the cartel, i.e., the most powerful participant or organiser, especially where the latter has some dominance over the others, e.g., the principal of the distributors. Such paradox – to need more than one participant to prove the existence of a cartel, and to sanction only one participant, is not mandatory and is decided on a case-by-case basis, as normally all participants should be sanctioned.

VI. MONOPOLY AND DOMINANCE. ABUSE OF MARKET STANDING. (ANTITRUST – STRUCTURAL)

You will have heard of the Golden Gate Bridge in San Francisco, CA. Before the bridge was built in 1937, there were a number of companies, owning steamboats, ferrying passengers across the bay. Gradually they started to dump prices and only 2 companies remained. Both offered free transfer, but when one started offering free snacks, the other gave up the business. The new monopolist, of course, drastically increased prices. Some authors say that this provoked the start of antitrust regulation.

This form is described as structural, because you do not need an arrangement with anyone else to complete it – you are just too big yourself and therefore have to behave better than the smaller competitors.

Article 18 (4) of the Constitution of the Republic of Bulgaria allows **monopoly** granted by law only to the State, in limited areas. Article 19(1) CPA provides a legal definition of monopoly: ‘*the position of an undertaking, which, provided by law, has the exclusive right to carry out specific business activity*’(*An undertaking’s position shall be considered monopolistic if such undertaking has by law the exclusive right to pursue a certain type of business activity*) and in Article 19 (3) CPA also states

that any other granting of such position is void. Yet a monopoly can be achieved *de facto* where one enterprise is alone on the market (remember the Golden Gate ferryboats example above) without any competitors. Among others, one powerful instrument to discourage formation of *de facto* monopolies is merger control, as exercised by CPC. Sometimes it is a matter of ‘**natural monopoly**’ (e.g., only one mine provides certain ore) or ‘**essential facility**’ – where the cost of infrastructure necessary to reach customers is so high, that its multiplication makes no economic sense (e.g., telecommunication transmission networks, where collocation duties were imposed on the incumbent operator).

There is also the notion of **oligopoly** – markets, dominated by very few suppliers or buyers, and **duopoly** – a market on which there are only two suppliers or buyers. Some of these markets may be competitive, others may be not.

Pursuant to Article 20 CPA, ‘**dominant**’ is ‘*the position of an undertaking which, considering its market share, financial sources, abilities to access the market, technological level and economic relations with other undertakings can impede competition on the respective market, since it is independent from its competitors, suppliers or buyers.*’ This quite functional definition is based on the relative weight of the undertaking on the market and not on the number of undertakings on the market. Article 21 CPA also defines ‘**joint dominancy**’ (actually oligopoly market) as ‘*two or more undertakings of joint dominant position*’.

The common feature for all the above is their independence from the market and ability to negatively influence competition on the market, which is the reason for their being under regulatory scrutiny.

The existence of a validly created monopoly or dominancy is not prohibited – what is prohibited is the **abuse** of such market position. Therefore, such undertakings have to comply with stricter rules for fair competition and business practices.

Thus, the prohibition of abuse of monopoly or dominant position in Article 21 CPA concerns ‘*behaviour of undertakings which take monopoly or dominant position, as well as of two or more undertakings of joint dominant position, which can lead to prevention, restriction or distortion*

of competition and impact the interests of consumers'. The same article provides a non-exclusive list of typical breaches, very similar to the list for cartels and concerted practices:

- '1. direct or indirect price-fixing or any other trading conditions;*
- 2. limitation or control of production, trade and technical development or to detriment of customers;*
- 3 application of dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at competitive disadvantage;*
- 4. making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations or conclusion of supplementary contracts, which, by their nature or according to commercial usage, have no connection with the subject of the main contract or to its fulfilment.*
- 5. ungrounded refusal to deliver goods or to provide service to a real or potential client, on order to hinder the performed by them business activity.'*

While the above are related to the position of an undertaking on a particular market, some jurisdictions also regulate ***abuse of stronger bargaining position***, where the standing of one of the counterparties in respect of the other counterparty is disproportionate (much like David and Goliath). Such regulation does not stem from TFEU and existed in Bulgaria between 2015 and 2021 (Chapter seven 'a' CPA, '*Abuse of a Stronger Position in Negotiations*', now repealed) and there were only few such cases. The currently effective Chapter seven 'b' CPA ('*Unfair trade practices in the agricultural and food products supply chain*') contains similar concepts, based on the assumed stronger position of the buyers of such goods.

VII. MERGERS AND MERGER PERMITS. MANDATORY FILING. PROCESS (PHASE 1 AND PHASE 2 INVESTIGATIONS).

The most important EU regulations on mergers are ***Council Regulation (EC) No 139/2004*** of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation); Commission Regulation (EC) No 802/2004 of 7 April 2004 implementing Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings; Commission Regulation (EC) No 1033/2008 Amending Regulation (EC) No 802/2004 implementing Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings and, especially, ***Commission Consolidated Jurisdictional Notice*** Under Council Regulation (EC) No 139/2004 on the control of concentrations between undertakings, which is the handbook on mergers.

Mergers (or ‘concentrations’) are controlled (Chapter 5 CPA, ‘*Control of Concentrations Between Undertakings*’) in order to prevent the formation of monopolies or dominant undertakings through acquisition of control over previously independent undertakings (concentration of resources).

Article 22(1) CPA defines ‘concentration’ through ‘***change of control on a lasting basis***’ whether by structural, contractual or other instrument (arising: ‘1. from consolidation or merger of two or more previously independent undertakings, or, 2. if one or more persons, already controlling at least one undertaking, whether by purchase of securities, shares or assets, by contract or by any other means, acquire direct or indirect control of the whole or parts of one or more other undertakings.’ The definition includes ‘creation of a joint venture, performing on a lasting basis all functions of an economically autonomous entity’. ‘Control’ is (among many other legal definitions in Bulgarian law) specifically defined in Article 22 (3) CPA: ‘Control shall be constituted by obtaining rights, concluding contracts or any other means which, either separately or in combination and having regard to the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking, in particular by obtaining: 1. ownership or the right to use all or part of the assets of an undertaking; 2. rights, including on the basis of contracts, which confer decisive influence

on the composition, voting or decisions of the bodies of an undertaking.’ In fact, control is defined in a similar manner to the general definition in commercial law as either ‘control by ownership’ or ‘control by management’. There are only few exceptions (Article 23 CPA), based on the assumption that the acquirer of control will not operate the undertaking (e.g., liquidation, enforcement of security, passive financial investment).

Where applicable, merger control, exercised by CPC, is prior to the contemplated acquisition and typically a condition precedent to closing of the transaction. Thus, the obligation to notify CPC and request permission is for the buyer and is to be fulfilled upon evidence of serious acquisition intention (usually, executed share-purchase agreement), but always before effective change of control. Any action to overtake control (typically, change in the management of the target or similar action, known as ‘gun jumping’) may be penalized by CPC as unpermitted merger.

A merger may be below the threshold for mandatory notification under Article 24 CPA and thus not subject to notification; however, in case of any doubt (and because of the potential high penalties) buyers prefer to file ‘just in case’. The filing fee is BGN 2,000 and the permission fee (if there is notifiable merger) is expressed as a percentage of the combined turnover of the participants, but capped at BGN 60,000. A merger need not be notified to CPC (but to the European Commission) if it is too large and has effects on the EU market.

The test for mandatory notification to CPC involves two steps – first, to determine the relevant (subject to several adjustments) **combined turnover** of the participants and, where the BGN 25 million threshold is hit, to apply the second step, based on the individual turnover of participants or the target. Where either of the thresholds under step two is also met, then notification is mandatory. The test is simplistically presented in the table below:

Aggregate (combined) Bulgarian Turnover	Exceeds BGN 25 million	Yes	Yes	Yes	Yes	No
The turnover of each or of at least of two of the undertakings – participants	Exceeds BGN 3 million	Yes	No	Yes	No	--
The turnover of the undertaking – object of acquisition (Bulgarian Target)	Exceeds BGN 3 million	Yes	Yes	No	No	-
Mandatory Notice		Yes	Yes	Yes	No	No

Referrals of mergers are a matter of competence

Article 21 of **Council Regulation (EC) No 139/2004** reserves competence for EC on the basis of Community dimension and *prohibits a member state from applying its national legislation*.

Article 22 of **Council Regulation (EC) No 139/2004** One or more member states may request the EC to examine a concentration that *does not have Community dimension but affects trade between member states and threatens to significantly affect competition within member state or states making the request*. EC decides whether to examine the case or not. EC may invite a member state to submit a concentration to the EC. Commissioner Margrethe Vestager announced change in the practice of discouraging referrals and EC resumed accepting referrals as of mid-2021.

The **Community dimension** is based on a similar (but more complex) cumulative two-step test, but with different figures (and one exemption). Where Test 1 is met (either of the two conditions), then Test 2 is applied (either of the four conditions, as applicable) and, where the test is ‘positive’, a notice must be filed with the EC. A concentration has a Community dimension where:

Criterion	Test 1	Test 2	U1	U2
combined aggregate worldwide turnover of all the undertakings concerned is more than	EUR 5000 M	EUR 2500 M	?	?
in each of at least three Member States, the combined aggregate turnover of all the undertakings concerned is more than		EUR 100 M	?	?
in each of at least three Member States included above, the aggregate turnover of each of at least two of the undertakings concerned is more than		EUR 25 M	?	?
aggregate Community-wide turnover of each of at least two of the undertakings concerned is more than	EUR 250 M	EUR 100 M	?	?
unless each of the undertakings concerned achieves more than two-thirds of its aggregate Community-wide turnover within one and the same Member State			?	?

Please note the so-called ‘**two-thirds exemption**’ in the last row above.

Permission for concentration

CPC decides on each notification (filing should follow a special format, approved by CPC through a decision), the decision being subject to court appeal. CPC may clear a merger notification unconditionally; permit the merger, subject it to certain conditions or prohibit the merger.

Pursuant to Article 26(1) CPA, CPC ***shall permit*** the concentration, if it *‘does not lead to creation or strengthening of dominant position, which would significantly impede the effective competence on the respective market.’* The text reads as if there were no discretion, but of course CPC is not bound in its determination of the facts.

Pursuant to Article 26(2) CPA, CPC ***may permit*** concentration, which *‘even creating or strengthening a dominant position, aims at modernization of the respective business activity, improvement of the market structures, better satisfaction of the interests of the customers and as a whole the positive effect prevails the negative impact on the competition on the respective market.’*

Where there are no issues of concern, CPC may, after assessing the proposed concentration, issue clearance under an *‘accelerated investigation’* within 25 business days or shortly afterwards (Article 80 CPA, known as *Phase 1* investigation in *acquis communautaire*).

Where, based on the assessment performed during the accelerated investigation, CPC remains in serious doubt that, as a result of the proposed merger *‘the effective competition on the market may be significantly impeded, especially through strengthening of a dominant position’*, CPC will issue a decision to open a *‘thorough investigation’* procedure (Article 83 CPA, known as *Phase 2* investigation in *acquis communautaire*), publish such notice in its electronic register and further investigate and issue a decision within 90 business days after such publication or shortly afterwards (maximum permitted extension is of a further 25 business days). In such case, CPC can either clear the merger or issue a ruling with its preliminary conclusions, to which the interested parties may respond. In the latter case, there must be an open (open for interested parties, but closed for the public) hearing session, after which CPC will close the thorough investigation and issue its decision. This decision may either: a) clear the merger; b) clear

the merger, subject to conditions (structural or behavioural) to preserve effective competition; or, c) prohibit the merger. Notably, CPC cannot prohibit a merger, nor put conditions in a Phase 1 investigation.

VIII. UNFAIR COMPETITION AND RELATED BREACHES.

1. General issues

Unfair competition does not depend on the position on the market and each undertaking may be found in breach (sometimes also individuals, usually former managers or employees). Unfair competition has many faces (special hypotheses), but, again, the list within the CPA is non-exhaustive and there is a ‘catch-all’ general prohibition for such behaviour (Article 29 CPA), which is available for application by CPC on a stand-alone basis and CPC can qualify thereunder any behaviour, which is not specially addressed by other provisions of Chapter seven CPA and also find cumulative breach, where a special provision is breached together with this general provision. The general prohibition sets the ‘moral code’ for active or passive behaviour of undertakings and individuals: *‘Prohibited shall be every activity or lack of activity in carrying out economic operations which contradicts good will trade practices and harms or could harm the interests of the competitors.’*

Article 30 CPA is also somewhat general as it prohibits *‘harming the good name and the trust in the competitors’*, and also prohibits misrepresentation of the *goods and services* offered by competitors by *stating or spreading false information, as well as by presentation of facts in a distorted manner.*

Although it does not expressly read so, the prohibition on *misleading* (Article 31 CPA) is rather towards misleading *customers* (not competitors) and thus harming competition by promoting in undue manner *own goods or services* (as misrepresentation of competitors’ goods and services qualifies under Article 30 CPA). Thus, misleading regarding *‘substantial qualities of the goods and services or regarding the way of using the commodities*

or providing the services through stating false information or through extortion of facts' is expressly prohibited.

It is worth discussing *imitation* here as it is quite close to the above. As per Article 35 CPA, which prohibits three forms of imitation (based on appearance and actual quality of goods and services and the unlawful use of other's intellectual property rights to delude consumers and harm competitors by taking away customers in such manner, namely:

a) offering or advertising of goods or services with appearance, packing, marking, name or other attributes which mislead or could mislead regarding their origin, the producer, the seller, the manner and the place of production, the source and the place of acquisition or using, the consumer qualities and other substantial characteristics of the goods or service;

b) usage of firm, mark or geographical indication, identical or similar to those of other persons, in a way which could lead to harming the interests of competitors;

c) *usage of a domain or external design of an Internet page, identical or similar to these of other persons, in a manner which can lead to misleading and/or harm the interests of competitors.*

2. Advertising

Advertising is a risky matter, as it is directly addressed to customers and it is easy to breach the specific rules and other rules in creating and disbursing advertisements. Advertising is also regulated elsewhere than CPA, for example, there are special requirements in the *Radio and Television Act* (specific goods, time-limits, general morals, etc.) and the *Advocacy Act* (prohibition to advertise legal services in a commercial manner). As per the definition in §1, Item 11 CPA "Advertisement' is *any message in connection with trade, craft or a profession, which aims to encourage the realisation of goods and services, including real property, rights and obligations.*'

Article 32(1) CPA prohibits *misleading* advertising (which is separate from misleading above), as well as the *forbidden comparative* advertising. There are two important elements that should be highlighted here: a)

the advertiser (the ultimate beneficiary of the advertisement) and the advertising agency, which prepared the advertisement (the author of the advertisement) are **both liable** for misleading or forbidden comparative advertisement (Article 32 (2) CPA), but despite this, the issue is not defined as *joint* liability; in practice the advertiser has no good defence that the agency was actually in default; and, b) under Article 95 CPA, unlike in general process law and even CPA process, the advertiser bears the **burden of proof of negative facts** – i.e., needs to prove that the advertisement **does not contain** aspects, which make it prohibited (and it is not for CPC to prove the positive fact that there was a breach).

Article 33(1)CPA defines misleading advertising as ‘*any advertisement, which in any manner, including in the manner of its presentation, misleads, or could mislead persons, to whom it is addressed or whom it reaches, and due to this may influence their economical behaviour or for these reasons harms or may harm a competitor*’. Again, similarly to Article 31 CPA, this is addressed to the customers (harmed by the lie), but there is also different harm to competitors – erosion of their clientele. Given the broad scope of this definition, Article 33 (2) CPA gives some non-exclusive guidelines on how to judge whether misleading is in place: features and pricing of the goods and services and identity and features of the advertiser:

‘1. characteristics of goods and services, such as: availability, kind, manufacture, composition, manner and date of production of goods and provision of services, fitness to use, method of usage, quantity, geographical or trade origin, expected results and substantial characteristics from testing the goods and services; 2. the price and pricing method and conditions of delivery of goods and performance of services; 3. data about the advertiser and the advertising agent, such as: name or firm, address or seat, address of management, assets, intangible rights or obtained awards and honours.’

Note that *imitation*, discussed above, also entails *advertising* as a form of breach.

Comparative advertising is based on the comparative and superlative adjectives in grammar, and the use of *better*, *best* or *worse* and *worst* in respect of competitors is easy to qualify as a breach of competition law.

In Article 34(1) CPA *comparative advertising* is defined as ‘*any advertising which directly or indirectly identifies the competitor or goods or services offered by the competitor*’. Note that such comparison may not necessarily be direct and that in fact the prohibition is not absolute (there are exemptions under Article 34 (2) CPA). However, any comparison outside the express exemptions (the list here is exhaustive) is a breach, which will be penalized.

Comparative advertising is considered allowed, where it:

1. is *not misleading* within the meaning of Article 33 CPA and *does not constitute unfair trade practice* within the meaning of Article 68e, Article 68f, Article 68g of the *Consumer Protection Act*;

2. compares goods and services, *which satisfy one and the same need or are designed for one and the same purpose*;

3. compares *impartially one or more typical characteristics of the goods and the services, which are substantial, comparable and representative for these goods and services*, including their purposes;

4. *does not lead to confusing of the advertiser with its competitors or trademarks, trade names, other distinctive features, goods or services of the advertiser with those of its competitors*;

5. *does not lead to discrediting or harming trademarks, trade names or other distinctive attributes, goods, services, activities or position of the competitors*;

6. compares goods of *one and the same name and origin*;

7. *does not obtain unfair advantage from the popularity of the trade mark, trade name or other distinctive attributes of the competitors or from the designation of origin of competitive goods*;

8. does not promote goods and services as an *imitation or copy of goods or services with a registered trade mark or name*.

Obviously, the above criteria are sufficiently vague as to allow for different qualifications of the same facts and do not provide sufficient comfort to involve in comparisons without fear.

3. Unfair attraction of customers

Competition is a fight for customers, but civilized fights have rules. Attraction of customers is the legitimate aim of each undertaking and does entail breaking of relationships between new customers and their former suppliers; it should, however, be fair. Unfair attraction of customers is a breach sanctioned by competition law.

CPA provides for one general rule in Article 36(1) '*unfair competition aimed at attracting customers, as a result of which concluded contracts of competitors are terminated or broken, or conclusion of contracts with competitors is prevented*'; and for three separate prohibitions:

- a) *erosion of the sale price* through presents (similar format to the *tying contracts*, mentioned above) '*offering or attachment of extras to the sold commodity or service gratuitously or against fictitious price of other commodity or service with the exception of: advertising objects of insignificant value and with clearly identified advertising undertaking; subjects or commodities which, according to the trade practice are an accessory to the sold commodity or offered sale; commodities or services as a discount in the sale of bigger quantities.*' Note the '*insignificant value*' exemption and the '*volume discount*' practice, which are expressly recognized by the law;
- b) *erosion of the sale price* through expectations for inadequate prizes from lotteries, tests and similar and inviting subsequent sales through collections: '*sale, when together with it something is offered or promised, the obtaining of which depends on: solving puzzles, tasks, answering questions, riddles; collecting series of coupons and other similar; games with cash or material awards, whose value considerably exceeds the price of the sold commodity or service.*'. Note, again, the '*materiality rule*' of comparing the value of the purchase to the value of the prize. CPC should have adopted rules to quantify exactly when the promised prize significantly exceeds the price of sold goods or service, but has not yet adopted such;
- c) '*dumping*' of prices – absent express legal definition, which is construed on the basis of the prohibition wording within Article 36

(4) CPA – selling (at the home market) of ‘*considerable quantities on a lasting basis at prices lower than the expenses for their production and realisation with the purpose of unfair attraction of customers*’. There are clearly three objective elements here: a) **amount** (not insignificant); b) **time** (long period) and c) **price** (below production and sale costs); which are considered cumulative, and form the unfair element as this is clearly not standard behaviour on the market. There is one subjective element ‘*intention to attract customers*’ which would be difficult to prove under general process law, but in practice is actually assumed on the basis of the objective elements (especially as there is hardly any other reasonable explanation for such behaviour).

In all the above cases, in theory, the customers will benefit, but prohibitions are in place to support normal competition on the market (and prevent another ‘Golden Gate ferryboat’ situation).

4. Prohibition for disclosure of manufacture or trade secrets

Within the unfair competition hypotheses, CPA introduces, in Article 37, flat prohibitions on *acquisition, usage and disclosure* of manufacturing and trade secrets, and *the using or divulging of manufacturing or trade secrets* (where acquisition is not a breach *per se*, but the secrets were acquired *on condition not to be used or disclosed*. This prohibition is applicable to intentional ‘commercial espionage’ and to individuals (usually former managers or employees, who transferred to a competitor) and they can be also sanctioned for breaches.

IX. OTHER ISSUES

A new development from 2021, Chapter seven ‘b’ CPA entitled ‘*Unfair trade practices in the agricultural and food products supply chain*’ responded to political demands and specific needs of society, stemming from unequal bargaining power of food producers and distributors. The rules are quite complex (include absolute and conditional prohibitions,

apply to undertakings exceeding certain turnover thresholds, and contain further exemptions). In light of the thresholds, the amendments are sometimes referred to as ‘*the superstore rules*’ and there are very few reported practices yet. Sanctions are expressed in capped amounts and not in percentage of the turnover. Article 94a CPA provides for alternative dispute resolution, where during the proceedings, but before its final ruling, CPC may propose to the parties to use mediation or another alternative way of voluntary settlement of the dispute.

1. Competition advocacy

Competition advocacy is in fact the single (except, possibly, group exemptions) preventive instrument of CPC, which does not entail sanctions. As set out in Article 28 CPA, with the aim of protecting initiative in business and to prevent restriction and distortion of competition, CPC carries out assessment of compliance to the provisions of CPA of:

1. drafts of normative or normative administrative and general administrative acts;
2. effective normative or normative administrative and general administrative acts
3. drafts of acts of associations of undertakings, which regulate the activity of their members.

There is no enforcement of these assessments *per se*, but eligible organisations typically comply in line with sound governance practices.

2. Sector analyses of competition environment

Furthermore, CPC has the competence, pursuant to Article 27 (1) CPA, to carry out sector analysis in the cases where competition in a specific sector, branch, sub-branch or region *could be* hindered, restricted or distorted. In such analyses CPC may determine the relevant markets and inspect their features and structure, entry barriers, the degree of market concentration, the dynamics in the sector, the legal frame, self-regulations, and make conclusions on the status of the competition environment.

While these analyses are not enforceable *per se*, it would not be appropriate to qualify them as actually preventive, because, as a matter of fact: a) CPC would not invest resources in the analysis, unless it already suspects there is some sort of breach; and b) very often, on the basis of the information collected for the purposes of the analysis, CPC charges some undertakings with breaches of competition law.

3. Appeals

The purpose of this chapter is to give you a taste of substantive law concepts and their general implementation. Therefore, the procedural aspect is not within its scope and will be mentioned only briefly. We will not go into the procedures at CPC (which differ), nor discuss liability for damages. Yet CPC decisions and rulings (except those under Article 18 CPA) are not exempt from appeal in court. After a 2019 change of the law, the first court instance is the Sofia District Administrative Court (single judge) and its decision is subject to cassation appeal with the Supreme Administrative Court (three-member panel), which is the final and binding decision. A decision of the EC can be appealed before the General Court (the Court of First Instance) and further before the European Court of Justice.

CHAPTER 14:

INTRODUCTION TO INTELLECTUAL PROPERTY (IP) LAW

Simona Veleva

ABSTRACT	KEY WORDS
The chapter presents key aspects of the intellectual property legal framework. It explores the main types of intellectual property, including copyright and neighbouring rights, patents, trademarks, geographical indications, trade secrets, and utility models. The chapter also includes the main legal aspects of AI regulation in the light of copyright protected works. While intellectual property law safeguards artists' rights, it also faces the difficult task of maintaining public access to knowledge while promoting innovation. This chapter examines the current discussion about this balance.	intellectual property, copyright and neighbouring rights, trademarks, geographical indications, patents, utility models, trade secrets;

I. INTRODUCTION

Nowadays, more than ever, especially in the digital sphere, in the fast-evolving landscape of innovation and creativity, Intellectual Property (IP) law stands as a crucial framework to protect the creations of human intellect. The current chapter aims to introduce the main concepts and contemporary problems related to IP law, preparing and offering the main legal tools for navigation, protection, and lawful usage of intellectual property. The chapter explores the main pillars of Intellectual Property by introducing the legal framework at international, European Union, and national levels. It gives the main legal definitions and includes practical case law, which navigates and provides answers to basic competing values related to copyright, trademarks, patents, and trade secrets.

At its core, intellectual property encompasses all works of art and literature, inventions, innovations, names, designs, and images used for commercial purposes. The purpose of intellectual property law is to give inventors and creators exclusive rights to their works, creating an environment that encourages balance and ongoing creativity.

II. COPYRIGHT AND RELATED RIGHTS

1. Copyright and related rights are one of the most universal rights on a global scale, due to the fact that in today's digital and borderless realms equal protection is needed both in terms of scope and duration. Copyright law is the cornerstone of the legal protection of creative works, providing creators with exclusive rights to their intellectual creations. Copyright is based on the main principle that creative expression deserves protection. Copyright guarantees that the creators will have exclusive rights to control the reproduction, distribution, performance, and adaptation of their original works. These works include literary, artistic, musical, and dramatic creations, as well as architectural designs and software.

1.1. Although all countries have their own copyright and neighbouring rights legislation, one of the oldest international treaties that aims to set the same legal standards among member states is the Berne Convention for Protection of Literary and Artistic Works (The Berne Convention).¹ Along with it, there are many other relevant legal acts that further unify and set the minimum standards in the field of copyright and neighbouring rights. Such an act is the Rome Convention,² as well as the 'TRIPS' Agreement,³ all of

¹ The Berne Convention was originally adopted back in 1886 and has been amended several times, most recently in 1979, with the aim of protecting the works and the rights of authors. It is now one of the main international acts that sets minimum standards of protection for 181 states, which have adopted it as of November 2022; most of these countries have also ratified the Paris Act of 1971 (latest amendments to the Convention).

² International Convention for Protection of Performers, Producers of Phonograms and Broadcasting Organisations, signed on October 26, 1961 in Rome.

³ Agreement on Trade-Related Aspects of Intellectual Property Rights, the TRIPS Agreement, is Annex 1C of the Marrakesh Agreement Establishing the World Trade Organisation, signed in Marrakesh, Morocco on 15 April 1994 [Accessed on 15 October 2023].

which are administered by the World Intellectual Property Organisation (WIPO).⁴ It administers 26 treaties in the field of intellectual property, including the WIPO Convention.⁵ An essential part of the international legal framework is the two Internet Treaties (The WIPO Copyright Treaty⁶ and WIPO Performances and Phonograms Treaty⁷). The European Union has adopted numerous acts over the years that establish a harmonised legal framework in the field of copyright and neighbouring rights. Their basis is Article 26 and Article 114 of the Treaty on the Functioning of the European Union ('TFEU'). Currently, this framework consists of 13 directives⁸ and

⁴ World Intellectual Property Organisation dates back to 1883 when first the Paris Convention for the Protection of Industrial Property and then the Berne Convention (1886) were adopted. Both established an International Bureau. In 1893 the two bureaus merged and in 1970 with the adoption of the WIPO Convention (signed in Stockholm, July 14, 1967), it became what we know nowadays as World Intellectual Property Organisation. [Accessed on 15 October 2023].

⁵ Convention Establishing the World Intellectual Property Organisation (as amended on September 28, 1979).

⁶ WIPO Copyright Treaty (WCT) (1996) is a specific agreement under the Berne Convention that gives protection of the works and rights of authors in the digital realm. [Accessed on 15 October 2023].

⁷ WIPO Performances and Phonograms Treaty (WPPT) (1996) established the rights of two kinds of beneficiaries in the digital environment – performers and producers of phonograms. [Accessed on 15 October 2023].

⁸ Directive on the harmonisation of certain aspects of copyright and related rights in the information society ('InfoSoc Directive'), 22 May 2001 (*OJ L 167*, 22.6.2001, 10–19); Directive on rental right and lending right and on certain rights related to copyright in the field of intellectual property ('Rental and Lending Directive'), 12 December 2006 (*OJ L 376*, 27.12.2006, 28–35); Directive on the resale right for the benefit of the author of an original work of art ('Resale Right Directive'), 27 September 2001 (*OJ L 272*, 13.10.2001, 32–36); Directive on the coordination of certain rules concerning copyright and rights related to copyright applicable to satellite broadcasting and cable retransmission ('Satellite and Cable Directive'), 27 September 1993 (*OJ L 248*, 6.10.1993, 15–21); Directive on the legal protection of computer programs ('Software Directive'), 23 April 2009 (*OJ L 111*, 5.5.2009, 16–22); Directive on the enforcement of intellectual property right ('IPRED'), 29 April 2004 (*OJ L 157*, 30.4.2004, 45–8); Directive on the legal protection of databases ('Database Directive'), 11 March 1996 (*OJ L 77*, 27.3.1996, 20–28); Directive on the term of protection of copyright and certain related rights amending the previous 2006 Directive ('Term Directive'), 27 September 2011 (*OJ L 372*, 27.12.2006, 12–18); Directive on certain permitted uses of orphan works ('Orphan Works Directive'), 25 October 2012 (*OJ L 299*, 27.10.2012, 5–12); Directive on collective management of copyright and related rights and multi-territorial licensing of rights in musical works for online use in

2 regulations,⁹ which harmonise among Member States the main rights of authors, performers, producers, etc. In 2023, Bulgaria adopted major changes in its own Copyright and Neighbouring Rights Act (Закон за авторското право и сродните му права)¹⁰ in order to be in compliance with the latest Copyright Directive – Directive 2019/790 of the European Parliament and of the Council of 17 April 2019 on copyright and related rights in the Digital Single Market and amending Directives 96/9/EC and 2001/29/EC.¹¹

All of this said, copyright applies to a wide range of creative, intellectual, or artistic forms. The Bulgarian Constitution stipulates that everyone shall have the right to avail themselves of national and universal human cultural values and to develop their own culture in accordance with their ethnic self-identification, which shall be recognised and guaranteed by the law (Article 54(1)). Artistic, scientific, and technological creativity shall be recognised and guaranteed by the law (Article 54(2)). The state shall protect all inventors' rights, copyrights, and related rights (Article 54(3))

1.2. Therefore, the Bulgarian Copyright and Neighbouring Rights Act (CNRA) establishes protection over any literary, artistic, and scientific work resulting from a creative endeavour and expressed in any mode and

the internal market ('CRM Directive'), 26 February 2014 (*OJ L 84, 20.3.2014, 72–98*); Directive on certain permitted uses of certain works and other subject matter protected by copyright and related rights for the benefit of persons who are blind, visually impaired, or otherwise print-disabled (Directive implementing the Marrakech Treaty in the EU), 13 September 2017 (*OJ L 242, 20.9.2017, 6–13*); Directive on copyright and related rights in the Digital Single Market ('DSM Directive'), 17 April 2019 (*OJ L 130, 17.5.2019, 92–125*); Directive on the exercise of copyright and related rights applicable to certain online transmissions of broadcasting organisations and retransmissions of television and radio programmes ('Satellite and Cable II'), 17 April 2019 (*OJ L 130, 17.5.2019, 82–91*). [Accessed on 15 October 2023].

⁹ Regulation on the cross-border exchange between the Union and third countries of accessible format copies of certain works and other subject matter protected by copyright and related rights for the benefit of persons who are blind, visually impaired or otherwise print-disabled (Regulation implementing the Marrakech Treaty in the EU), 13 September 2017 (*OJ L 242, 20.9.2017, 1–5*); Regulation on cross-border portability of online content services in the internal market ('Portability Regulation'), 14 June 2017 (*OJ L 168, 30.6.2017, 1–11*). [Accessed on 15 October 2023].

¹⁰ Prom. SG. 56/29 June 1993, last amend. and suppl. SG. 100/1 Dec 2023.

¹¹ OJ L 130, 17.5.2019, 92–125.

in any objective form. Such protection is given to literary works, including works of scientific and technical literature, publicism and computer software; musical works; performing arts works: dramatic or dramatico-musical works, entertainments in dumb show, choreography, etc.; films and other audio-visual material; works of fine art, including works of applied art, design and crafts; architectural works; photographic works and works created in a manner analogous to the photographic process; blueprints, maps, sketches, plans and others related to architecture, urban planning, geography, topography, museum research and any other area of science and technology; graphic design of publications; cadastral maps and state topographic maps (Article 3(1) CNRA). Objects of copyright are also translations and adaptations of existing works and folklore, including works with an expired copyright term; arrangements of musical works and folklore; periodicals, encyclopaedias, collected works, anthologies, bibliographies, databases, and other similar objects that include two or more works or products. Parts of works under the above items, such as drawings, diagrams, etc., may also be objects of copyright (Article 3(2) and 3 CNRA). Software – the code and design of computer programmes – are also protected by copyright. An important note is that, usually, unless agreed upon otherwise, copyright over computer software and databases developed under an employment contract belongs to the employer.

Fine art and architectural works are also protected by copyright law, which ensures the creator's rights even if the works are another person's property. There are also exceptions (Article 4 CNRA), and they are stipulated in regard to regulatory and individual acts of state government bodies, acts of the courts of justice, and official translations thereof; ideas and concepts; works of folklore; news, facts, information, and data; and materials obtained by reproduction of some works (like fine art, photographic works, maps, schemes, plans, graphic design of publications, and maps).

The primary legal tenet is that copyright protections belong to the person who produced these creative conceptions. In particular, the author's claim to fine art or photography, including that of a non-creator, is emphasised in Article 13 of the Bulgarian Copyright and Neighbouring Rights Act. This provision grants the author exclusive rights. It is important

to keep in mind that copyright protection is granted instantly upon the creation of the artistic work. Registration is not necessary. The copyright protection arises from the moment of creation of the qualifying work.

The scope of copyright protection is limited. There is a time limit, after which the work becomes public domain and is open for use by anybody. The length of copyright protection varies according to the type of work and the country, although it usually lasts for the creator's lifetime plus an additional number of years. In the majority of EU Member States this period is 70 years after the creator's passing, including in Bulgaria (Article 27(1) CNRA). This temporal restriction guarantees equilibrium by gradually releasing works into the public domain, fostering a wealth of shared cultural and intellectual heritage.

The copyright holder is considered the person whose name or other identifying mark is inscribed in the customary manner on the original of a work, replicas, or copies (Article 6 CNRA). The copyrighted work might be made available to the public under a pseudonym or anonymously. The law also establishes joined authorship, when two or more people create a scientific, literary, or artistic work, whether the said works constitute one indivisible entity or consist of separate parts each having individual significance.

Copyright protection encompasses a broad range of exclusive rights, allowing creators to control how their works are used. The law establishes two major types of rights for copyright holders – moral rights (non-economic rights) and economic rights.

1.3. Moral (non-economic) rights are related to the recognition of the author as such and the future use of the work. The author holds a spectrum of entitlements encompassing the decision-making authority on the public availability of their work, determining the time, place, and manner of such release. Notably, exceptions exist for certain objects (films and other audiovisual material, architectural works, blueprints, maps, sketches, plans, and others related to architecture), where contractual arrangements dictate the corresponding rights.

This prerogative extends to the assertion of copyright, the discretion to present works anonymously or pseudonymously, and the right to demand

proper attribution when their work is utilised. When it comes to the essence of moral rights, its main aspects are the preservation of the work's entirety, safeguarding against unauthorised alterations, and the protection of the author's legitimate interests and personal dignity. These are some of the integral components of the author's moral rights. The author has the right to introduce alterations in the work without compromising the rights acquired by others and retains access to the original piece, even when it is held by another party. Furthermore, the author can suspend use of the work due to changes in personal beliefs, except for previously implemented architectural works, with compensation for lawful users. Additionally, in the realm of architectural design, the author lacks the authority to oppose an owner's decisions regarding destruction, reconstruction, or modifications in compliance with existing regulations.

Some non-economic rights are non-transferable, like the claim of copyright over a specific work. The author of a book will always remain its author, even long after their death, for example. This is why the right to require that his name, pseudonym, or other identifying mark be identified in a suitable manner whenever his work is used is also non-transferable.

Other than that, after the death of the author and until expiration of the term of copyright protection, the non-economic rights are exercised by the author's heirs.

1.4. Economic rights are the other major group of rights that lead to specific economic benefits for their holders. They include a wide range of rights, but mainly the exclusive right to use the work created by them and to permit its use by other persons, except in very specific cases. These rights include the reproduction of the work, the creation of derivative works, distribution, public performance, and public display, as well as the transmission of the work and the provision of electronic access to the work or part of it. Further, under economic rights comes the translation of the work into another language. However, the translator has copyright over the translation itself. Economic rights also include revision of the work. Revision is the adapting of the work and the introduction of any modifications thereto, as well as the use of the work to create a new derivative work; the implementation of an architectural design through the building or

manufacture of the object described in it; import or export of production specimens in commercial quantity. With the amendments from 2023 adopted in Bulgaria, broadcasting of the work and transmission and retransmission of the work are also specifically included as economic rights.

Most importantly, the author has the right to compensation for all types of use of his work and for each successive use of the same type (Article 19 CNRA). Therefore, the law establishes numerous rules for different types of payments, including royalties upon resale (see Article 20a CNRA) or under permitted transmission by different means (telecommunications, satellite, cable transmissions, etc.).

In this sense, upon resale of an original work of art, when one of the parties to the transaction or the intermediary is an art dealer, including an art gallery or auction house, the author of the work will be entitled to receive royalty on the sale price. The Bulgarian Copyright and Neighbouring Rights Act establishes that an ‘original work of art’ means works of graphic or plastic art such as pictures, collages, paintings, drawings, engravings, prints, lithographs, sculptures, tapestries, ceramics, glassware, and photographs, provided that they are made by the artist himself or are copies considered to be original works of art.

In terms of just remuneration for authors and performers, Member States of the European Union (EU) have a responsibility to adopt provisions that guarantee reasonable and proportionate payment. This is especially important in cases in which the writer or performer has granted permission for a third party, such as a publisher or producer, to use their work. In this regard, writers and artists have a right to regular, thorough, and up-to-date information about how their works and performances have been used. This information should be given at least once a year. Furthermore, in the event that the work or performance is not utilised, these individuals may exercise their right of revocation, which can be done after a fair amount of time. A new exhaustion of the right of distribution was recently adopted, which provides that the first sale or other transaction on the territory of the Member States of the European Union made by the owner of the copyright or with their consent that transfers the ownership of the original or copy of the work will lead to exhaustion of the right of distribution on this territory

without prejudice to the right to permit further leasing (Article 18a). This new right has some specific exceptions regarding pieces of art or renting of musical or audio-visual work.

Furthermore, contractual dynamics are subject to modification in favour of authors and performers. The negotiation rights of these creative entities are bolstered, affording them the entitlement to seek appropriate and fair additional remuneration from the contracting party responsible for rights exploitation. This claim becomes pertinent when the initially agreed-upon remuneration is deemed unreasonably low in comparison to subsequent income derived from the exploitation of the works. This provision marks a notable enhancement of the negotiating position of authors and performers in contractual engagements related to rights exploitation.

Copyright is designed to balance the interests of creators on the one hand with public interest on the other. Fair use or fair dealing provisions allow the use of copyrighted material without permission for a limited amount of time or in limited volume. The use could be for purposes such as criticism, commentary, news reporting, teaching, scholarship, or research.

In certain situations, permission from the author is not required. This includes the temporary use of works if such use is transitional, incidental, or does not have independent economic significance. The same holds if the use involves an inalienable and vital part of the technical process and is conducted solely for enabling network transfer through an intermediary or other permissible use. Additionally, the use of quotations from previously disclosed works for critical appraisals or reviews is allowed, provided proper attribution is given, except where such attribution is impossible. The utilisation of parts of published works or a moderate number of small works in other works for analysis, commentary, or scientific research is permissible for scientific or educational purposes, with due reference to the source. Current news reporting in the press and other media, reproduction by various means for news coverage related to current events, and the use of works on permanent display in public places for informational or non-commercial purposes are also exempt from authorisation, given proper attribution. Public presentations or performances of published works in educational institutions, non-profit reproduction by libraries,

research institutions, museums, and archives for educational purposes or preservation, and reproduction of works in Braille script or similar methods for non-profit purposes are permitted (see Article 24 CNRA).

1.5. The latest amendments in the Bulgarian Copyright and Neighbouring Rights Act, as of November 2023, transposing the Copyright Directive (Copyright and related rights in the Digital Single Market), update these exceptions in compliance with the EU legal framework in order to guarantee essential copyright exceptions aimed at broadening access to protected materials for various purposes, particularly in the context of knowledge dissemination. These exceptions encompass text- and data-mining, digital use of works for educational illustration, and the preservation of cultural heritage. Furthermore, the directive facilitates broader access through licensing mechanisms, including a streamlined system for cultural heritage institutions to digitise and disseminate out-of-commerce works online across EU borders. It also establishes specific rules regarding extended collective licensing and negotiation mechanisms to facilitate agreements for audiovisual works on video-on-demand platforms. The directive also clarifies that, under certain conditions, works of art in the public domain can be freely used and shared.

In regard to the protection of press publications for online use, the directive grants new rights to EU-based press publishers for the digital utilisation of their publications. However, these rights are applicable exclusively to online service providers and do not extend to private or non-commercial individual uses. Hyperlinking and short extracts from press publications are exempt from these new rights, and authors of works incorporated in press publications are entitled to a fair share of the income generated from their use.¹²

In the context of online content-sharing platforms, the directive establishes that providers must obtain permission from rights holders to make user-uploaded works publicly available. In the absence of a licensing agreement, these platforms benefit from a liability-mitigation mechanism

¹² See **Rosati, E.** Article 15 – Protection of Press Publications Concerning Online Uses, Copyright in the Digital Single Market: Article-by-Article Commentary to the Provisions of Directive 2019/790. Online edition, Oxford Academic, (2021), <https://doi.org/10.1093/oso/9780198858591.003.0016>, 250–294 [Accessed on 15 October 2023].

contingent on making ‘best efforts’ to prevent unauthorised content on their websites. Users are permitted to post content for specific purposes, such as quotation, criticism, review, caricature, parody, or pastiche. Moreover, users have recourse to complaint and redress mechanisms in cases of disputes arising from erroneously blocked or removed content on these platforms (see recital 70).¹³

In some particular cases, compensation needs to be paid to the authors, even in cases of free use. An example are the cases of authors of works recorded on sound or video media, as well as the performers whose performances have been recorded, phonogram producers, and the producers of the initial recording of recorded films. They are entitled to compensation whenever their recordings are recorded for personal use. Such compensation is also due to the authors and publishers of all types of printed works when these works have been reproduced reprographically for personal use (Article 26 CNRA).

2. Proprietors and Objects of Neighbouring Rights are specific categories of rights given in cases where the rightsholder is not the author but the law grants him/her additional protection. The CNRA grants this protection to performing artists over their performances, the producers of phonograms over their recordings, the producers of the initial recording of a film or another audio-visual work over the original copy, as well as over the copies produced as a result of this recording. Protection is given to radio and television organisations over their programmes as well as, with the latest amendments, to the publishers of press publications, on their press publications. Neighbouring rights may not be exercised in a manner that might result in infringing upon or restricting copyrights. Mainly, all of the above have the right to both recognition and compensation when their protected work is used.

Although the above-mentioned rights might look quite well established in a practical manner, it is not so easy for authors and other

¹³ See **Geiger, C. and Bernd Justin Jütte**, Platform Liability Under Article 17 of the Copyright in the Digital Single Market Directive, Automated Filtering and Fundamental Rights: An Impossible Match. – In: PIJIP/TLS Research Paper Series, 2021, № 64, 8–9. <https://digitalcommons.wcl.american.edu/research/64>, [Accessed on 15 October 2023];

creators to pursue and protect their rights. Therefore, an essential part of copyright and neighbouring rights protection is played by the collective management organisations (CMOs), which operate on both national and international level.

3. Collective management organisations play an important role in the ecosystem of intellectual property management, acting as intermediaries between the creators and the users of copyrighted works. These organisations are crucial entities entrusted with the task of collectively administering and licensing the rights of a multitude of rightsholders, such as authors, composers, performers, and publishers. The primary objective of CMOs is to moderate and facilitate the licensing process for copyrighted works. In this way, there is a centralised mechanism that facilitates efficient negotiations and agreements for the use of copyrighted works. CMOs strengthen the negotiation process on behalf of the artists. The latter entrust to CMOs to exercise and enforce their rights, including the collection of royalties and the distribution of fair and equitable remuneration to rightsholders. CMOs' existence and effectiveness rely on the complexity of copyright management in contemporary societies, where the volume and diversity of creative pieces require organised structures for the collective administration of intellectual property rights.¹⁴ In Bulgaria, there are around 10 CMOs.¹⁵ They maintain contracts with other CMOs worldwide and are a part of international networks, through which the copyrights and neighbouring rights of foreign creators are guaranteed.

In the digital age, copyright law faces some unique challenges related to piracy, digital rights management, and the balance between protecting creators and guaranteeing open access, as well as the navigation of the public domain. Despite the extensive legal framework and the different mechanisms for protection, artificial intelligence (AI), although not new, creates some additional challenges for the protection of copyright and neighbouring rights.

¹⁴ See **Leska, R.** *Managing Copyright: Emerging Business Models in the Individual and Collective Management of Rights*. The Netherlands, Wolters Kluwer, 2023, 25–32.

¹⁵ The Ministry of Culture provides a list of registered CMOs: <https://mc.government.bg/page.php?p=52&s=447&sp=676&t=0&z=0> [Accessed on 15 October 2023].

4. Copyright and AI are major challenges, which the European Union is also trying to address. Although AI has been developing for years, after the emergence of Chat GPT and other AI systems, different corporations are using them more often for marketing, product development, and other purposes where they would usually hire an artist. At the same time, the EU pursued efforts for a new AI regulation that was adopted in May 2024, the Artificial Intelligence Act.¹⁶ The AI Act aims to establish a new legal framework that provides stability and foreseeability when it comes to AI systems and answers concerns regarding some high-risk AI systems.¹⁷ Notably, the AI Act uses a risk-based approach, which provides a classification of AI systems based on risks and prohibited AI practices. The AI Act identifies four types of risks. The first type is unacceptable risk (e.g., cognitive behavioural manipulation, social scoring, biometric identification and categorization of people (Article 5), and real-time and remote biometric identification systems, such as facial recognition). Some exceptions are allowed for purposes related to law enforcement. As high-risk AI systems are identified, they are used in product placement, which falls within the EU's product safety legislation¹⁸ (mainly toys, aviation, medical devices, cars, etc.), and AI systems, which fall within specific categories and need to be registered in a special EU database (management of critical infrastructure, education and vocation training, employment, migration, law enforcement, etc.). The AI Act also categorises risks as minimal (the majority of AI applications currently on the EU single market, such as spam filters, AI video games, etc.) or no risk. Both minimal and no risk AI are not regulated. High-risk AI systems must comply with various standards related to transparency and accountability. The EU AI Regulation also provides protection of fundamental rights, including non-discrimination and data privacy. In June 2023 the European Parliament adopted a position

¹⁶ See Regulation of the European Parliament and of the Council laying down harmonised rules on artificial intelligence (Artificial Intelligence Act) and amending certain union legislative acts.

¹⁷ See Regulation (EU) 2021/694 of the European Parliament and of the Council of 29 April 2021 establishing the Digital Europe Programme and repealing Decision (EU) 2015/2240, OJ L 166, 11.5.2021, 1–34.

¹⁸ Directive 2001/95/EC of the European Parliament and of the Council of 3 December 2001 on general product safety (OJ L 011 15.1.2002, p. 4).

on the AI Act.¹⁹ As AI systems increasingly infiltrate the realm of intellectual property, questions related to ethics,²⁰ liability²¹ but also copyright²² were discussed by the EU Parliament. For instance, on August 18, 2023, the United States District Court for the District of Columbia affirmed that AI-generated artworks are not subject to copyrights.²³ This decision aligned with the position of the United States Copyright Office (USCO), which consistently rejects copyright requests for AI-generated pieces. The rationale behind this denial, supported by the court, stands on the argument for the absence of a ‘guiding human hand’ in AI-generated works. The USCO’s recently published Guidelines on Artificial Intelligence, posit that in an AI-generated work of art, ‘traditional’[artistic choices are made by algorithms rather than the people who use them.²⁴

Different European courts also adopt this understanding. Such an example is the French Supreme Court, which, in one of its rulings in 2015, adopted that the authorship of AI-generated works can be exclusively attributed to natural persons.²⁵

In summary, copyright law guarantees the balance between fair remuneration and recognition of creators, on the one hand, and access to cultural and artistic pursuits for the wider public, on the other. The complexity of these values and their perseverance intensify with

¹⁹ Amendments adopted by the European Parliament on 14 June 2023 on the proposal for a regulation of the European Parliament and of the Council on laying down harmonised rules on artificial intelligence (Artificial Intelligence Act) and amending certain Union legislative acts (COM(2021)0206 – C9-0146/2021 – 2021/0106(COD).

²⁰ European Parliament resolution of 20 October 2020 on a framework of ethical aspects of artificial intelligence, robotics and related technologies, 2020/2012(INL) .

²¹ European Parliament resolution of 20 October 2020 on a civil liability regime for artificial intelligence, 2020/2014(INL).

²² European Parliament resolution of 20 October 2020 on intellectual property rights for the development of artificial intelligence technologies, 2020/2015(INI).

²³ See U.S. District Court for the District of Columbia, in *Thaler v. Perlmutter*, Case No. 1:22-cv-01564, (D.D.C. 2022).

²⁴ Copyright Registration Guidance: Works Containing Material Generated by Artificial Intelligence, available at: https://www.copyright.gov/ai/ai_policy_guidance.pdf [Accessed on 15 October 2023].

²⁵ See French Supreme Court, Cass. 1re civ., 15 janv. 2015, n° 13-23.566.

digitalization and their implementation in the online environment, which creates additional challenges for law.

III. TRADEMARKS AND GEOGRAPHICAL INDICATIONS

1. **‘A trademark** is a specific sign or symbol that is used by a person, a business, or an organisation in order to identify and distinguish their goods or services from those of others. Trademarks are a form of intellectual property and can take various forms, shapes, and variations. Each national law has its own legislation which regulates trademarks and usually requires registration. However, there are also several international treaties and agreements that aim to harmonise trademark protection across borders.

1.1. Typically, trademarks are registered with national intellectual property offices. A registration guarantees an exclusive right to use the mark in association with specific goods or services. When it comes to the protection of trademarks, the main principle is to prevent confusion among consumers regarding the origin of goods or services. Trademark owners can enforce their rights through litigation processes in national courts. Remedies for infringement may include injunctions, damages, and, in some cases, criminal penalties. One of the main international treaties is the Paris Convention for the Protection of Industrial Property from 1883. It is one of the earliest international treaties on intellectual property. It provides for priority right, allowing an applicant to claim priority based on an earlier filing in another member country.²⁶ An essential international treaty is the Madrid Agreement Concerning the International Registration of Marks (1891)²⁷ and the Madrid Protocol (1989).²⁸ They facilitate the international registration of trademarks and allow a trademark owner to file

²⁶ Paris Convention for the Protection of Industrial Property, adopted March 20, 1883 (as amended on September 28, 1979) [Accessed on 15 October 2023].

²⁷ Madrid Agreement Concerning the International Registration of Marks, adopted April 14, 1891 (as amended on September 28, 1979) [Accessed on 15 October 2023].

²⁸ Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks, adopted June 27, 1989 (as amended on November 12, 2007) [Accessed on 15 October 2023].

a single international application to protect their mark in multiple member countries. There are 130 countries covered by Madrid's system. All of those treaties are administered by WIPO, including the Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks (1957).²⁹ It establishes a classification system for goods and services for the purpose of trademark registration. The already mentioned TRIPS Agreement (Trade-Related Aspects of Intellectual Property Rights) under the World Trade Organisation (WTO) sets minimum standards for the protection of intellectual property rights, including trademarks, by requiring member countries, among other methods, to provide effective enforcement mechanisms. The Lisbon Agreement for the Protection of Appellations of Origin and Their International Registration (1958)³⁰ focuses on the protection of appellations of origin, a special kind of trademark that identifies the geographical origin of goods. The Singapore Treaty on the Law of Trademarks (2006)³¹ and the Protocol Relating to the Madrid Agreement Concerning the International Registration of Marks³² both aim to streamline and simplify administrative procedures for trademarks. The framework adds up to another important treaty – the Hague Agreement Concerning the International Registration of Industrial Designs,³³ which, while primarily focused on industrial designs, has implications for the international registration of trademarks, as well. These treaties foster international cooperation, reduce administrative barriers, and provide a framework for the protection of trademarks on a global scale. Countries that are parties to these treaties agree to uphold

²⁹ Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks, adopted June 15, 1957 (as amended on September 28, 1979).[Accessed on 15 October 2023].

³⁰ Lisbon Agreement for the Protection of Appellations of Origin and their International Registration, adopted October 31, 1958 (as amended on September 28, 1979) [Accessed on 15 October 2023].

³¹ Singapore Treaty on the Law of Trademarks, adopted March 27, 2006.[Accessed on 15 October 2023]

³² Common Regulations under the Madrid Agreement Concerning the International Registration of Marks and the Protocol Relating to That Agreement (as in force on February 1, 2019).[Accessed on 15 October 2023].

³³ Common Regulations Under the 1999 Act and the 1960 Act of the Hague Agreement (as in force on April 1, 2023).[Accessed on 15 October 2023].

certain standards and implement certain procedures, making it easier for businesses to protect their trademarks internationally.

1.2. The European Union has also adopted a certain number of rules in order to unify and ease the process of trademark registration within the Union. The main EU acts are the European Union trade mark regulation,³⁴ the European Union trade mark implementing regulation³⁵ and the European Union trade mark delegated regulation.³⁶ The entire process of registration is governed by the European Union Intellectual Property Office (EUIPO), which is responsible for managing the EU trade mark and the registered Community design, based in Alicante, Spain.

Within the European Union (EU), the process of trademark registration encompasses a dual system, offering two primary avenues for protection. The first entails national registration through the industrial property offices of individual EU member countries. Alternatively, entities may pursue registration at the EU level, designating their mark as a ‘European Union trade mark’ (EUTM) through the EUIPO.

National and EUTM registrations coexist within a complementary framework. The same trademark can be registered at either the EU or national level. The EUTM system prescribes the process through a unified registration procedure, affording the trademark owner exclusive rights across all EU member states. This dual-system approach accommodates the diverse needs of enterprises, considering factors such as size, market scope, and geographic presence. Small and medium-sized enterprises (SMEs) or local businesses, for instance, may find national trademarks more fitting, especially if EU-wide protection is unnecessary. Harmonisation of laws governing national trademark registration in the EU commenced in

³⁴ Regulation (EU) 2017/1001 of the European Parliament and of the Council of 14 June 2017 on the European Union trade mark, OJ L 154, 16.6.2017, 1–99.

³⁵ Commission Implementing Regulation (EU) 2018/626 of 5 March 2018 laying down detailed rules for implementing certain provisions of Regulation (EU) 2017/1001 of the European Parliament and of the Council on the European Union trade mark, and repealing Implementing Regulation (EU) 2017/1431, OJ L 104, 24.4.2018, 37–56.

³⁶ Commission Delegated Regulation (EU) 2018/625 of 5 March 2018 supplementing Regulation (EU) 2017/1001 of the European Parliament and of the Council on the European Union trade mark, and repealing Delegated Regulation (EU) 2017/1430, OJ L 104, 24.4.2018, 1–36.

1989, with the establishment of the EU trade mark in 1994. Trademarks can be registered as a word mark, figurative mark, shape mark (shape of a bottle, for example), position mark (logo, positioned on a specific place on a sneaker, for example), pattern mark, and even colour or sound mark.³⁷ Often, the trademark is also registered as the domain name of a website.³⁸

1.3. The Bulgarian Trademarks and Geographical Indications Act (TGIA)(Закон за марките и географските означения) further develops the national legal framework by setting the rules regarding the registration and protection of both trademarks and geographical indications. The Bulgarian law establishes that a trademark is a sign capable of distinguishing the goods or services of one person from those of others and may be presented in the State Register of Trademarks in such a way that it is possible to clearly and accurately determine the subject of the protection granted by the registration. Such signs may include, for example, words, including the names of persons, letters, numbers, drawings, figures, the shape of the goods or their packaging, colours, sounds, or any combination of such signs. A trade mark can be a trademark, collective mark, or certification mark (Article 9 TGIA).

The Bulgarian State Register of Trademarks is kept and maintained by the Patent Office and includes specific information, which identifies and distinguishes the different types of trademarks (e.g., date of submission of the application for registration of the trademark; information that the application is the result of a European Union application or transformation of international trade mark registration; type and kind of the trademark; presentation and trademark; a list of the goods or services, for which the trademark was filed or registered, protected colours, protected elements and the class number under the Nice Agreement on the International Classification of Goods and Services for the Registration of Trademarks of 15 June 1957, etc.).

³⁷ Examples can be found on the office page of EUIPO: <https://euipo.europa.eu/ohimportal/en/trade-marks-examples> [Accessed on 15 October 2023]

³⁸ **Захариев, М., Десислава Кръстева.** Правна същност на домейн имената. // Данъци Тита, 2020, № 132, URL: <https://www.tita.bg/free/commercial-law/706>, ISSN 1314-6505 (online); **Захариев, М.,** Защита на търговска марка срещу недобросъвестна регистрация на домейни // Computerworld. Архивиран от оригинала на 16.02.2017.

Not every sign or shape can be registered. There are specific absolute grounds on which the Patent Office may refuse to register the trademark, for example, in cases in which the mark is not distinctive or consists exclusively of signs or indications that have become customary in the spoken language or in established commercial practice in the Republic of Bulgaria in respect of the goods or services claimed;³⁹ a sign consisting exclusively of the shape of the goods or any other characteristic that arises from the nature of the goods itself. Other examples are a mark that is contrary to public policy or to good morals and a mark that may mislead consumers as to the nature, quality, geographical origin, or other characteristics of the goods or services (Article 11 TGIA). Other relative grounds for refusal of registration are also established, and they are mainly related to an earlier registration of the same trademark.

Usually, the registration is valid for 10 years and may be renewed indefinitely for subsequent 10-year periods. The legal protection includes a variety of rights, but mainly the right of its holder to use it, to dispose of it, and to prohibit third parties from using in trade any sign of goods and/or services that are identical or similar to the trademark without their consent. Further, the rightsholder can prohibit preparatory actions, like affixing a mark identical or similar to the trademark on the packaging, labels, markings, elements or devices of security or authenticity, offering for sale, placing on the market, keeping for these purposes, import or export of packaging, labels, markings, etc. The rightsholder, however, also has an obligation to use the trademark within 5 years after its registration.

2. Geographical indications (GIs) are specific indications that identify the origin of a product and its association with a specific geographical area, where a particular quality, reputation, or other characteristic of the product is essentially linked to its geographical origin. Under the legal framework for GIs in the EU, the protection of GIs differs based on the association between a product's qualities and its geographical origin. This distinction falls into two categories: a 'protected designation of origin' (PDO) or a 'protected geographical indication' (PGI). Different factors determine the

³⁹ **Mihaylova-Goleminova, S.** Electronic commerce and its legal framework. // The EU and Bulgaria – AmCham Bulgaria Magazine, **2002**, No. 33, 12–14.

strength of this connection. Such a factor, for example, is the proportion of the product's raw materials and its origin in a specific geographic area and the extent to which the production process occurs within the specified region. Here are some examples of EU geographical indications:

Examples of Geographic indications within the European Union		
Parmigiano Reggiano (PDO)	Origin: Italy	A high-quality, hard, granular cheese produced in specific regions of Italy, including Parma, Reggio Emilia, and Modena.
Roquefort (PDO)	Origin: France	A type of blue cheese made from sheep's milk in the caves of the Combalou mountain in the Roquefort-sur-Soulzon region.
Champagne (PDO)	Origin: France	Sparkling wine produced in the Champagne region of France.
Feta (PDO)	Origin: Greece	A brined curd white cheese made from sheep's milk or a mixture of sheep and goat milk.
Prosciutto di Parma (PDO)	Origin: Italy	A dry-cured ham produced in the Parma region of Italy.
Българско кисело мляко/ Bulgarsko kiselo mlyako (PDO)	Origin: Bulgaria	soured milk product made from raw milk obtained from sheep, cows, buffalos, goats or a mixture thereof produced in Bulgaria, and a symbiotic starter from the bacteria <i>Lactobacillus delbrueckii</i> subsp. <i>bulgaricus</i> and <i>Streptococcus thermophilus</i> not subjected to genetic modification

The European Union protects these geographical indications and this protection guarantees that products produced in the specific geographical areas and according to specific criteria can use the protected names. In this way, the reputation and quality of these products is preserved. GIs also support local economies tied to their production. This means no other product with the same characteristics can be identified with the same name.

IV. PATENTS, UTILITY MODELS AND TRADE SECRETS

1. A patent is a form of intellectual property that grants an inventor or assignee exclusive rights to an invention for a limited period of time, typically 20 years from the date of filing the patent application. The patent holder holds exclusive rights which prevent others from making, using, selling, or importing the patented invention without their permission.

There are a few international treaties that guarantee the protection of patents and establish common standards and procedures for the protection of inventions across borders. These treaties include the above-mentioned Paris Convention for the Protection of Industrial Property (1883), which establishes the principle of national treatment, meaning that each member country must provide the same level of protection to the intellectual property of foreign nationals as it provides to its own citizens, and this includes patents as well. The Paris Convention also stipulates the right of priority, which allows an applicant to claim priority based on an earlier filing in another member country. Maybe one of the most significant international treaties is the Patent Cooperation Treaty (PCT),⁴⁰ which is also administered by the WIPO. It facilitates the filing of patent applications with an international effect and allows applicants to seek patent protection for an invention simultaneously in multiple member countries by filing a single international application. The TRIPS Agreement (1994), administered by the World Trade Organisation, which was already discussed above, sets minimum standards for the protection of intellectual property, including patents. The Patent Law Treaty (PLT) (2000)⁴¹ aims to harmonise and comprehend formal procedures for patent applications and patents. It simplifies and standardises certain formal requirements, making the patent system more user-friendly. Further, the Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure (the Budapest Treat)⁴² concerns a specific topic in the international patent process: microorganisms. Another

⁴⁰ Patent Cooperation Treaty, adopted June 19, 1970 (as modified on October 3, 2001) [Accessed on 15 October 2023].

⁴¹ Patent Law Treaty, adopted June 1, 2000 [Accessed on 15 October 2023].

⁴² Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure, adopted April 28, 1977 (as amended on September 26, 1980) [Accessed on 15 October 2023].

important treaty is the Strasbourg Agreement Concerning the International Patent Classification (IPC), which facilitates the categorisation and retrieval of patent information on a global scale.⁴³ On a European Union level, there is the European Patent Office and two EU regulations that provide the legal framework of the Unitary Patent System. The first one⁴⁴ creates a ‘European patent with unitary effect’ commonly called a ‘unitary patent,’ and the second one establishes the translation arrangements for unitary Patents.⁴⁵

Patents also encourage innovation and the development of new technologies. Inventors can register and exploit their inventions through registration, which allows them to receive profit from anyone using their patent in the fields of engineering, technology, medicine, food, optics, etc.

In order for an invention to be eligible for a patent, it must meet certain criteria, including being novel, non-obvious, and useful. The patent application process involves submitting a detailed description of the invention to a government patent office, which examines the application to determine if it meets the necessary requirements. In Bulgaria, this is the Patent Office of the Republic of Bulgaria. The Patents and Utility Models Registration Act (PUMRA) (Закон за патентите и регистрацията на полезните модели)⁴⁶ provides the general rules regarding patent registration in Bulgaria. According to the law, the person who has created an invention or utility model, is its inventor. When the invention or the utility model is created by several persons, these are considered co-inventors (Article 2(2) (PUMRA)). The Patent Office maintains a State Register of patents, a State Register of utility models and a State Register of supplementary protection certificates. In order for an invention to be registered, it needs to be ‘patentable’. This means inventions from all technical fields that are new, have an inventive step and are industrially applicable are patentable and they need to meet certain requirements, prescribed by law. (Article 6 (PUMRA)) The following categories are not considered inventions – discoveries,

⁴³ Strasbourg Agreement Concerning the International Patent Classification, adopted March 24, 1971 (as amended on September 28, 1979).[Accessed on 15 October 2023].

⁴⁴ EU Regulation No 1257/2012 (OJ EPO 2013, 111).

⁴⁵ EU Regulation No 1260/2012 (OJ EPO 2013, 132).

⁴⁶ Prom. SG. 27/2 April 1993, last amend. and suppl. SG. 102/23 Dec 2022.

scientific theories and mathematical methods; results of artistic creativity; plans, rules and methods for intellectual activity, for games or for business activity and computer programs; presentation of information. The human body, at the various stages of its formation and development, as well as the simple discovery of one of its elements, including the sequence or the partial sequence of a gene, may not constitute a patentable invention. An element isolated from the human body or otherwise obtained by a technical process, including a sequence or partial sequence of a gene, may constitute a patentable invention, even if the structure of that element is identical to that of a natural element (Article 6(2) and (4) PUMRA).

Patents can cover a wide range of inventions, including products, processes, machines, compositions, and improvements to existing technologies. There are different types of patents, such as utility patents (new and useful inventions), design patents (new, original, and ornamental designs for an item), and plant patents (new varieties of asexually reproduced plants). The specific type of patent depends on the nature of the invention.

It is important to note that patent rights are territorial, meaning they are only enforceable within the jurisdiction where the patent is granted. To obtain protection in multiple countries, inventors often use some of the international agreements.

Along with patents, another category of intellectual property is the utility model.

2. A utility model is a form of intellectual property protection for inventions that is similar to, but distinct from, patents. Utility models are also known by different names in various jurisdictions, such as ‘petty patents’ and ‘innovation patents’. Different countries have different ‘petty patents’ or ‘minor patents’. There are fewer requirements when it comes to utility models, and they are usually simpler compared to patents. The novelty and inventiveness requirements may be less rigid. Utility models usually have also a shorter protection duration than patents. While patents’ term is usually 20 years, utility models might have terms ranging from 6 to 15 years, depending on the country. Utility models usually require a faster and less complex registration process in comparison to patents. They are simpler in their essence and also when it comes to the application of

their use. This allows inventors to obtain protection quicker. Accordingly, the protection of patents is wider and stronger as well. Utility models often cover minor and simpler innovations rather than groundbreaking inventions. Utility models are often suitable for protecting inventions that do not meet the complex criteria for patentability but still represent practical and useful innovations. Utility models can be used to protect inventions such as new and useful devices, tools, or processes. In some countries, there are exceptions for pharmaceuticals or biotechnological processes, for example. It is important to note that utility models are not available in all jurisdictions, and their characteristics can vary widely. In some countries, the terms ‘utility model’ and ‘patent’ may be used interchangeably, while in others, they represent different forms of intellectual property protection. Inventors and businesses should consult the laws and regulations of the specific jurisdiction where they seek protection to understand the availability and requirements of utility models. According to the PUMRA, it is considered that the utility model involves an inventive step if a person with common knowledge and capabilities in the field is not able to easily produce it on the basis of the state of the art.

3. Trade Secret is also a form of intellectual property. It includes proprietary and confidential business information, which often provides a competitive advantage to its owner. This information may include specifics about the manufacturing processes, formulas, designs, business plans, and customer lists, as well as other types of confidential information that are not publicly known.

The legal regime governing trade secrets varies by jurisdiction, but there are common principles and international standards. Until 2016, there were no harmonised laws related to trade secrets within the EU. However, Directive (EU) 2016/943 of the European Parliament and of the Council of 8 June 2016 on the protection of undisclosed know-how and business information (trade secrets)⁴⁷ was adopted.

For an information to qualify as a trade secret, it must be kept confidential. This means that the owner must take reasonable measures

⁴⁷ OJ L 157, 15.6.2016, 1–18.

to ensure that the information is not generally known or readily ascertainable by others. The Bulgarian Trade Secret Protection Act⁴⁸ stipulates that a trade secret is any commercial information, know-how and technological information that simultaneously meets the following requirements: constitutes a secret in such a way that, as a whole or in its precise configuration and set of elements, is not generally known or readily available to persons in the circles who normally use this kind of information; has commercial value due to its secret nature, and in respect of it, measures have been taken to keep it secret from the person who has control over the information.

The information must have economic value related to the protected secret characteristics. This means that the information provides a competitive advantage to its owner. However, owners of trade secrets are also usually required to take reasonable efforts to maintain the secrecy of the information. Examples of such measures are confidentiality agreements, restriction to access, as well as other security measures.

Trade secrets provide protection against unauthorised acquisition, use, or disclosure of the trade secret by someone who has obtained the information without authorisation, breached a duty of confidentiality, or engaged in other unfair practices. The owner of the trade secret can seek compensation for damages through a civil case. They can also seek injunctive relief to prevent further disclosure or use. The legal framework for trade secrets aims to find a balance between protecting innovation and fostering competition while safeguarding the interests of businesses that rely on maintaining the secrecy of certain valuable information. The Trade Secret Directive⁴⁹ sets out rules on protection against unlawful acquisition, use and disclosure of trade secrets. Lawful acquisition (Article 3) is obtained by independent discovery or creation; observation, study, disassembly or testing of a product or object that has been made available to the public or that is lawfully in the possession of the acquirer of the information who is free from any legally valid duty to limit the acquisition of the trade secret; exercise of the right of workers or

⁴⁸ Prom. SG. 28/5 Apr. 2019.

⁴⁹ Directive (EU) 2016/943 of the European Parliament and of the Council of 8 June 2016 on the protection of undisclosed know-how and business information (trade secrets) against their unlawful acquisition, use and disclosure, OJ L 157, 15.6.2016, 1–18.

workers' representatives to information and consultation in accordance with Union law and national laws and practices; any other practice which, under the circumstances, is in conformity with honest commercial practices.

Acquisition, use, or disclosure of a trade secret is also lawful when it is required or allowed by EU or national law. The Directive also sets out rules for the unlawful acquisition, use, and disclosure of trade secrets. Acquiring a trade secret without the consent of the trade secret owner is unlawful if it is acquired by unauthorised access, appropriation of, or copying of documents, objects, materials, substances or electronic files lawfully under the control of the trade secret holder; or any other conduct that, under the circumstances, is considered contrary to honest commercial practices. Use or disclosure of the trade secret without the owner's consent is unlawful if a person: acquires the trade secret unlawfully; is in breach of a confidentiality agreement or other duty not to disclose the trade secret; is in breach of a contractual or other duty to limit the use of the trade secret. The acquisition, use, or disclosure will also be unlawful if the person concerned knew or ought to have known that the trade secret had been obtained directly or indirectly from another person who was using or disclosing the trade secret unlawfully. There are also a few exceptions (Article 5). The pursuit of claims should not exceed 6 years.

CHAPTER 15:

DATA PROTECTION LEGISLATION IN THE EUROPEAN UNION AND IN THE REPUBLIC OF BULGARIA

Nevin Feti

ABSTRACT	KEY WORDS
Article 8 of the Charter of Fundamental Rights of the European Union guarantees the right to protection of personal data for every individual whatever their nationality or place of residence. The concept of this right requires that personal data be ‘processed fairly for specified purposes and on the basis of the consent of the person concerned or some other legitimate basis laid down by law’. The right to protection of personal data also ensures that everyone has the right of access to data that has been collected concerning him or her, and the right to have it rectified.	personal data, processing, general data protection regulation (GDPR), controller, processor

I. INTRODUCTION

The legal term ‘personal data’ means any information relating to an identified or an identifiable natural person/individual (‘data subject’). In particular, a natural person can be identified directly or indirectly by an identifier such as a name, an identification number, location data, an online identifier or by one or more characteristics specific to the physical, physiological, genetic, mental, economic, cultural or social identity of that person. Therefore, a piece of information can be defined as personal data if there are indications that it ‘relates’ ‘to a natural person’ and allows, at least, the possibility of identifying the natural person.

‘Data relates to an individual if it refers to the identity, characteristics or behaviour of an individual or if such information is used to determine

or influence the way in which that person is treated or evaluated.’¹ There are three elements involved: content, purpose and result. An individual is ‘identified’ when he/she is described in such a way that he/she differs from others and is recognizable as an individual. ‘To determine whether a natural person is identifiable, account should be taken of all the means reasonably likely to be used, such as singling out, either by the controller or by another person to identify the natural person directly or indirectly. To ascertain whether means are reasonably likely to be used to identify the natural person, account should be taken of all objective factors, such as the costs of and the amount of time required for identification, taking into consideration the available technology at the time of the processing and technological developments. The principles of data protection should therefore not apply to anonymous information, namely information which does not relate to an identified or identifiable natural person or to personal data rendered anonymous in such a manner that the data subject is not or no longer identifiable.’²

‘Processing’ of personal data means any operation or set of operations which is performed on personal data or on sets of personal data, whether or not by automated means, such as collection, recording, organisation, structuring, storage, adaptation or alteration, retrieval, consultation, use, disclosure by transmission, dissemination or otherwise making available, alignment or combination, restriction, erasure or destruction.

The processing of personal data affects a number of natural persons’ rights, amongst which the inviolability of the person, his/her private and family life, the right to equality, secrecy of correspondence. Placing the processing within certain legal requirements aims to guarantee the rights of natural persons. Convention No. 108 of the Council of Europe of 28.01.1981 for the protection of individuals in the automated processing of personal data is the first legally binding international instrument in the field of data protection that gives a broad understanding of the concept of personal data

¹ Article 29 Data Protection Working Party, Opinion 4/2007 on the concept of personal data, p. 9, https://ec.europa.eu/justice/article-29/documentation/opinion-recommendation/files/2007/wp136_en.pdf.

² Recital 26 of the Regulation (EU) 2016/679, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32016R0679&qid=1702294389248>

as any information relating to an identified or identifiable individual (‘data subject’) and lists the principles upon which the processing of personal data must be carried out.³

The so-called special categories of personal data refer to personal data revealing racial or ethnic origin, political opinions, religious or philosophical beliefs, or trade union membership, and the processing of genetic data, biometric data for the purpose of uniquely identifying a natural person, data concerning health or data concerning a natural person’s sex life or sexual orientation. Under Article 9 GDPR processing of such data is prohibited unless a relevant legal ground for exemption under paragraph (2) exists. The ‘modernised Convention 108 includes personal data relating to offences, criminal proceedings and convictions, and related security measures in the list of special categories of personal data. Within the framework of GDPR, personal data relating to criminal convictions and offences or related security measures are not mentioned as such in the list of special categories of data, but are dealt with in a separate article’⁴ (namely, Article 10 GDPR).

Within the European Union, the first legal act specifically aimed at setting up the requirements for processing of personal data is Directive 95/46/EC. The scope of the protection of natural persons in relation to the processing of their personal data is outlined by the conceptual approach that the protection of individuals should apply equally both to automated data processing and to manual data processing.

The legal framework for the protection of personal data in the EU marks a new stage of development after proclaiming the right to the protection of personal data as an independent right under the Charter of Fundamental Rights.

³ The Council of Europe considered necessary to modernise Convention 108 as its landmark instrument to deal with challenges resulting from the use of new information and communication technologies, and to strengthen the Convention’s effective implementation. More about the modernised Convention 108+ on <https://www.coe.int/en/web/data-protection/convention108/modernised>.

⁴ Council of Europe, European Court of Human Rights, European Data Protection Supervisor, European Union Agency for Fundamental Rights. Handbook on European data protection law. 2018, 95–96. Publications Office of the European Union. <https://data.europa.eu/doi/10.2811/343461>.

In early 2012, the European Commission proposed a comprehensive reform aimed at building a modern, stable, coordinated, and comprehensive legal framework for data protection. Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation)⁵ was adopted as a result of the joint efforts of EU institutions and following extensive four-year debates. The Regulation applies directly in the Member States as from 25 May 2018, providing updated rules and elevated standards for data protection based on over two decades of experience in implementing data protection requirements accumulated under the now-repealed Directive 95/46/EC of the European Parliament and of the Council.

The GDPR strengthens the protection of personal data in the EU by:⁶

- Providing a harmonized legal framework ensuring the uniform application of rules in the EU;
- Creating equal conditions for all companies operating in the EU market;
- Guaranteeing innovative solutions to address data protection issues through the principles of data protection by design and by default;
- Enhancing the rights of individuals by introducing new requirements for transparency and more control over their personal sphere;
- Providing stronger protection against breaches of personal data security;
- Unifying the powers of data protection supervisory authorities;
- Clarifying the obligations of those processing personal data and the responsibility of data controllers when choosing data processors;

⁵ OJ L 119, 4.5.2016, 1–88.

⁶ Communication from the Commission to the European Parliament and the Council. Stronger protection, new opportunities – Commission guidance on the direct application of the General Data Protection Regulation as of 25 May 2018, COM (2018) 043 final, 2–5, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018DC0043>.

- Introducing a modern management system to ensure that the rules are applied more consistently and decisively;
- Preserving the high level of personal data protection when transferring them outside the EU while simultaneously expanding the number of alternative transfer tools.

As evident from its name, the GDPR regulates the protection of personal data in a general manner and, thus, is not the only EU legal act existing in this field. To accurately determine its scope of application, a careful analysis is required in each specific case of personal data processing. This analysis depends on who is processing the data, for what purposes, and what specific rules govern the relevant processing activity.

The evolution of legislation in the field of personal data protection in the European Union reflects the central importance of respecting human rights among the values upon which the Union is based. The goal is to protect the rights of individuals in relation to the processing of personal data and the free movement of data, taking into account the non-absolute nature of the right to protection of personal data and the balance with other fundamental rights in accordance with the principle of proportionality. In this context, the protection of personal data is not only a distinctive feature of European Union law but outlines this protection as a global standard that must be adhered to in any transfer of personal data to third countries and international organisations.

II. SCOPE OF APPLICATION GDPR

The scope of application of GDPR is determined by the provisions regulating its material and territorial scope.

1. Material scope GDPR

Within the material scope GDPR fall all cases of personal data processing, regardless of whether the processing is done by automated means or not. Article 2(1) of the Regulation establishes a specificity of EU law in the field of personal data, regulating the process of personal

data processing, regardless of whether it is entirely or partially based on automated means or carried out by other means. The application of data protection is conditioned not on how personal data is processed but on how they are structured in view of the purposes of processing.

The GDPR applies to the processing of personal data that are part of a filing system or intended to be part of such filing system.⁷ According to the terminology used, the latter means that the GDPR applies in all cases where there is a structured set of personal data which can be accessible according to specific – functional, geographical, centralised, and decentralised.

For example, employers are obliged to apply data protection rules not only regarding the data of all their employees and workers that they have already collected at the time of establishment of the employment/employment relationship. They must also comply with those rules in relation to the data they would require from its employees and workers or would create in the future in the course of the employment process. In this sense, if the data of employees and workers are part of the filing system that the employer processes (e.g., Human resources filing system), this system must comply with the requirements arising from the GDPR, regardless of how small the structure of the employer may be. The difference in the volume of data may affect the application of some obligations but does not exclude the application of the fundamental requirements ensuring the protection of personal data as a fundamental right in the EU.

Another example of a structured set of personal data is the one that consists of data obtained during real-time video surveillance, where the data from the images becomes accessible or a recording of the performed video surveillance is stored, the purpose of which is the protection of life and health of employees from unlawful attacks and/or protection of employer's property (Video surveillance filing system). Such a filing system would cover not only the data of employees but also those of visitors entering the controller's premises or falling into the territorial scope of the surveillance cameras. The establishment of this data into a separate filing system is justified for the purposes of processing, the automated manner

⁷ For more detail on the concept of a 'personal data filing system' see Judgment of 10 July 2018, Grand Chamber, *Jehovan Todistajat*, C-25/17, EU:C:2018:551, paragraph 62.

of the processing, and the specifics of the legal grounds for processing and data retention periods. For comparison, if the data is not intended to be part of a filing system, for example, in the case of a video conference where no recording is stored, it will not be treated as falling within the scope of the Regulation.⁸ Explicitly, Recital 15 GDPR clarifies that files or groups of files, as well as their cover pages, not structured according to specific criteria should not fall within the scope of the Regulation.

2. Exemptions from the material scope GDPR

Despite of the establishment of rules for the protection of personal data in the EU in a general and comprehensive manner, there are several areas outside the scope GDPR where personal data is also processed. These areas are mainly outlined in Article 2, paragraphs 2-4, and Article 95 of the Regulation, and compliance arising thereof has important practical consequences.

The General Data Protection Regulation (GDPR) does not apply in the following cases:

- *Processing of personal data in activities that fall outside the scope of EU law (Article 2(2), point 'a' GDPR).* Based on that legal provision, the GDPR will not affect processing carried out in the course of activities related to the national security of Member States. For example, in the procedures for reliability checks aimed at determining whether an individual meets the requirements for issuing a permit for access to classified information, it is the rules of the Protection of Classified Information Act and its subordinate regulatory acts (secondary legislation) in this area that will apply. This is explicitly provided for in Article 70(3) of the Protection of Classified Information Act, according to which data contained in reliability check files constitute classified information and are used for the purposes of the Act. The above example regarding the protection of classified information does not exhaust the range of activities carried out for the protection of national security but is indicative of the need to consider the nature of the activities involving the processing of personal data in every single case.

⁸ See in more detail **Тошкова-Николова Д., Невин Фети.** Защита на личните данни, София, ИК Труд и право, 2019, 27–28.

- *Processing of personal data under activities which fall within the scope of Chapter 2 of Title V of the Treaty on European Union (Article 2(2), point 'b' GDPR).* Chapter 2, Title V of the TEU encompasses specific provisions regarding the external policy and security policy of the EU. 'In the field of foreign policy, the body that makes final decisions in the EU is the European Council, composed of the heads of state or government of the member countries. Most decisions in the field of foreign policy and security policy require the consent of all EU countries.'⁹ In the given context, activities carried out by Member States related to the processing of personal data will not be regulated by the rules GDPR. The exception in question allows them to shape their positions on issues of foreign policy and security policy while taking into account all relevant information. The wording of Article 2(2), point 'b' of the Regulation gives the impression that only the processing carried out by Member States in connection with the common foreign and security policy is excluded from its scope. This is also stated in recital 17, but the GDPR will not apply to the processing of personal data carried out by the institutions and bodies of the EU. Pursuant to Article 2(3) in conjunction with Article 98 GDPR, this processing is subject to legal regulation under Regulation (EU) 2018/1725.
- *Processing of personal data by an individual in the course of a purely personal or household activity (Article 2(2), point 'c' GDPR).* The exception from the scope of the Regulation applies solely to those activities that are part of the personal or family life of individuals and does not extend to activities that, being related to the professional or economic activity of the same person, involve the processing of personal data (e.g., publishing data for their dissemination to an indefinite number of people). Recital 18 GDPR provides examples of processing activities that fall within the scope of 'purely personal or household activities': 'correspondence and the holding of addresses, or social networking and online activity undertaken within the context of such activities.' Going beyond the boundaries of purely personal activities or activities within the household leads to the consequence that the individual processing of personal data

⁹https://european-union.europa.eu/priorities-and-actions/actions-topic/foreign-and-security-policy_en

may not invoke the exception under the Regulation. Furthermore, individuals who provide the means for processing personal data in the course of personal activities or activities within the household of other individuals may not rely on the provision of Article 2(2), point 'c' GDPR. According to Recital 18 GDPR, such individuals have the status of a data controller or processor, and, therefore, the GDPR applies to them. The fact that certain data processing activities carried out by individuals do not fall within the exception of the scope of the Regulation under Article 2(2), point 'c' does not mean that their performance is prohibited. The inapplicability of the exception means that the consequence of processing personal data by such individuals is that they acquire the status of a 'data controller' with all the obligations arising from the GDPR.

- *Processing of personal data by competent authorities for the purposes of the prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties, including the safeguarding against and the prevention of threats to public security (Article 2(2), point 'd' GDPR).* This type of processing in the EU is subject to special rules, namely Directive (EU) 2016/680 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data by competent authorities for the purposes of the prevention, investigation, detection or prosecution of criminal offences or the execution of criminal penalties, and on the free movement of such data, and repealing Council Framework Decision 2008/977/JHA¹⁰. Directive (EU) 2016/680 has been transposed into Bulgarian legislation with amendments to Chapter Eight of the Personal Data Protection Act. Competent authorities are not excluded from the scope of application GDPR, but the latter would be applicable only in cases where personal data is processed for purposes other than those specified under the Directive (EU) 2016/680, such as providing public information about their activities.
- *Processing of personal data by the Union institutions, bodies, offices and agencies (Article 2(3) GDPR).* This processing is governed by Regulation (EU) 2018/1725 of the European Parliament and of the

¹⁰ OJ L 119, 4.5.2016, 132-149.

Council of 23 October 2018 on the protection of natural persons with regard to the processing of personal data by the Union institutions, bodies, offices and agencies and on the free movement of such data, and repealing Regulation (EC) No 45/2001 and Decision No 1247/2002/EC.¹¹

- *Processing of personal data in connection with the provision of publicly available electronic communications services in public communication networks in the Union* in relation to matters for which they are subject to specific obligations with the same objective as set out in Directive 2002/58/EC. According to Article 95 GDPR, the latter does not impose additional obligations on individuals or legal entities in the electronic communications sector. However, the GDPR applies to all matters related to the protection of fundamental rights and freedoms in relation to the processing of personal data that are not subject to special obligations under Directive 2002/58/EC.¹²
- *The use of passenger name record (PNR) data for the prevention, detection, investigation and prosecution of terrorist offences and serious crime.* Directive (EU) 2016/681 of the European Parliament and of the Council of 27 April 2016 on the use of PNR data for the purposes of the prevention, detection, investigation and prosecution of terrorist offenses and serious crime (PNR Directive)¹³ stipulates special rules for the protection of personal data. They do not affect the applicability GDPR to the processing of personal data by air carriers, in particular their obligations to take appropriate technical and organisational measures to ensure the security and confidentiality of personal data. The directive covers the transmission by air carriers of passenger reservation data on non-EU flights and the processing of this data for the purpose of countering terrorist crimes and serious crimes. Each Member

¹¹ OJ L 295, 21.11.2018, 39-98.

¹² On 10.01.2017 the European Commission proposed a new approach in the regulation of personal data protection through the Proposal for a Regulation of the European Parliament and of the Council concerning the respect for private life and the protection of personal data in electronic communications and repealing Directive 2002/58/EC. (Regulation on Privacy and Electronic Communications) COM/2017/010 final - 2017/03 (COD) <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52017PC0010>.
¹³ OJ L 119, 4.5.2016, 132–149.

State must guarantee passengers the rights deriving from Directive (EU) 2016/680, in view of which special rules for the protection of personal data arise also in this area of public relations.

- *Processing of personal data of deceased persons (Recital 27 GDPR).* Member States may provide for rules regarding the processing of personal data of deceased persons. In Bulgarian legislation, such requirements are subject to regulation, for example, in the Personal Data Protection Act, in the Civil Registration Act, in the Health Act. Where processing such data, controllers must carefully analyse applicable legislation to ensure compliance.

These examples do not exhaust all cases of special legal regulation of personal data processing which reflects on the application of the general provisions GDPR. These examples aim to present the wealth of EU law in the field of personal data protection and its ability to take into account the specifics of different fields of activity. Therefore, in any case of personal data processing, the applicable legal framework should be identified as part of planning for the relevant activity. Such an approach would be consistent with the concept of data protection by design.

3. Territorial scope of GDPR

The territorial scope of GDPR is determined on the basis of two alternative criteria – the place of establishment or the scope of processing activities related to personal data (Article 3). According to the place of establishment criterion, controllers and processors of personal data established in the EU are covered by the GDPR territorial scope, regardless of whether the processing itself takes place in the EU or not. This is because establishment implies a permanent connection and effective exercise of the activity subject to compliance with the relevant legal requirements.

Similarly, according to the establishment criterion, the application of GDPR is due with regards to controllers and processors who are not established in the EU but are established in a location where the legislation of an EU Member State applies under international law. This is the case where the law of the Member State applies under international public law, for example, in a diplomatic representation or consular service of that state.

In terms of the scope of processing activities related to personal data, the GDPR will apply in cases where individuals located in the EU are affected by the relevant data processing. It does not matter whether the controller or processor is established in the EU, hence this criterion acts independently and, in practice, expands the scope of the regulation even to controllers whose activities affect the protection of individuals in the EU. Those cases are covered by Article 3(2) GDPR and relate to the following activities:

- *Offering goods or services to individuals in the EU, irrespective of whether a payment is required or not.* The assessment of whether a controller or processor intends to offer goods or services in one or more EU member states involves examining how the activity is organised. A whole set of factors should be considered, not just the accessibility of a particular internet page/website, for example. Factors such as language usage, currency, the possibility to order goods and services in that language, delivery to an EU Member State, mentioning users located in the EU, and other similar circumstances are of significance.
- *Monitoring the behaviour of individuals as far as their behaviour takes place within the EU.* To determine whether a processing activity may be considered monitoring, it should be established whether individuals are tracked on the internet. Recital 24 GDPR clarifies that it is also necessary to specify any subsequent use of personal data processing techniques, consisting of profiling a particular individual, for example, to make decisions related to them or to analyse or predict their personal preferences, behaviour, and way of thinking.

The practical effect of the enlargement of the GDPR territorial scope compared to the previous legal framework is evident in relation to the activities of controllers and processors who offer their goods and services in the EU or engage in monitoring the behaviour of individuals within the EU, such as online stores, social networks, email services, consultancy services for individuals in the EU, etc. Such controllers and processors of personal data must appoint a representative in the EU in accordance with Article 27 GDPR.

III. REGULATORY POWERS OF MEMBER STATES

According to Article 288(2) of the Treaty on the Functioning of the European Union, a regulation is an act of general application that is binding in its entirety and directly applicable in all Member States. The direct application of the regulation in member states reflects how its content becomes part of their national legal system. For this purpose, there is no need for its transposition or incorporation into domestic legislation, and national legal or administrative measures cannot hinder its application. This does not exclude cases where national legislation needs to be adapted to enable the full implementation of the regulation, but it does not alter the principle that the regulation itself has legal effect independently of the national legal measures of the member states.

However, Recital 10 GDPR leaves a certain ‘margin of manoeuvre for Member States to specify its rules, including for the processing of special categories of personal data’. It does not preclude Member States from adapting their legislation in accordance with its provisions, establishing their national data protection authorities, choosing certification bodies, determining special cases of processing, and more precisely defining the conditions under which the processing of personal data is lawful. It is important to highlight that the actions of the Member States in this context are constrained by two essential requirements: the right to the protection of personal data, as established in Article 8 of the Charter of Fundamental Rights of the European Union, and Article 16(2) of the Treaty on the Functioning of the European Union, which stipulates that national legislation cannot hinder the free movement of personal data within the EU. ‘The interpretation of the Regulation is left to the European courts (the national courts and ultimately the European Court of Justice) and not to the Member States’ legislators. The national legislator can therefore neither copy the text of the Regulation when it is not necessary in the light of the criteria provided by the case law, nor interpret it or add additional conditions to the rules directly applicable under the Regulation. If they did, operators throughout the Union would again be faced with fragmentation and would not know which rules they have to obey.’¹⁴

¹⁴ Communication from the Commission to the European Parliament and the Council. Stronger protection, new opportunities – Commission guidance on the direct applica-

The regulatory powers of the Member States in the field of personal data protection falling within the scope GDPR have varying nature. As mentioned above, member states are obligated to determine the conditions and procedures for accrediting certification bodies in the field of personal data protection (Article 43(1)), to establish one or more independent public authorities responsible for monitoring GDPR application (Article 51(1), Article 52, paragraphs 2–4, Article 53(1), Article 54(1)), to set rules for imposing sanctions for violations (Article 84(1)), and to reconcile the right to personal data protection with the freedom of expression and the right to information, including processing for journalistic purposes and for the purposes of academic, artistic, or literary expression (Articles 85 and 86).

The decision whether to resort to the opportunities provided by other GDPR provisions for setting additional requirements or conditions in specific processing scenarios, for implementing restrictions, and introducing exceptions to certain Regulation rules rests on the discretion of the member states. The provisions of Article 6(2) and (3) may be pointed out as examples of such Member States' opportunity to decide: namely the member states have the option to maintain or introduce more specific provisions related to the processing necessary for compliance with a legal obligation, the performance of a task carried out in the public interest, or in the exercise of official authority.

Based on Article 9(2)–(4), member states may further specify the application of the rules for the protection of special categories of personal data, thereby defining additional conditions applicable to sectors where such data is processed. The possibility in question refers to the processing of special categories of data under labour law, social security, social protection (Article 9(2)'b'), processing for the purposes of preventive or occupational medicine, assessment of the working capacity of the employee, medical diagnosis, the provision of health or social care or treatment, or the management of health or social care systems and services care, based on considerations of public interest in the field of public health (Article 9(2), points 'h' and 'i'). This also applies to processing for archiving purposes in the public interest, scientific or historical research, and statistical purposes (Article 9(2), point 'j').

tion of the General Data Protection Regulation as of 25 May 2018, COM (2018) 043 final, p. 9, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018DC0043>.

Under Article 9(4), member states may maintain or introduce further conditions with regard to the processing of certain special categories of personal data. This applies to the processing of genetic data, biometric data, or data concerning health. The Member states have also the right to specify special conditions for processing their national identification number or any other identifier of general application (Article 87).

In addition, Article 23 allows, through legislative measures, the limitation of the scope of obligations and rights outlined in Articles 12-22 and Article 34 (data subjects' rights) and in Article 5 (principles related to the processing of personal data).

Although the implementation of these Member States' regulatory powers may lead to differences, it nevertheless ensures, on the basis of GDPR, a uniform minimum level of protection of the rights of natural persons. However, due attention must be paid to these differences and they must be taken into account in the course of activities of controllers and processors of the personal data.

The legislation of the Republic of Bulgaria in the field of personal data protection dates back to the beginning of 2002, when the Personal Data Protection Act came into force. It was adopted before the accession of the Republic of Bulgaria to Convention No. 108 of the Council of Europe for the protection of individuals in the automated processing of personal data as a prerequisite for its ratification. In its current version, the Act is in line with the direct effect GDPR and therefore the legal regulation it provides relates to issues that are not covered by the Regulation. In addition, Directive (EU) 2016/680 is transposed in the same Act, regardless of the different legal nature of the two EU legal acts. This approach ensures unification of the general rules for the protection of personal data in one Act, which allows for better orientation in the process of their practical application.

In accordance with the GDPR, the activities of the two supervisory bodies in the Republic of Bulgaria – the Personal Data Protection Commission and the Inspectorate of the Supreme Judicial Council (when the processing is carried out by the courts, prosecutor's offices and investigative bodies in their capacity as bodies of the judicial power) are being regulated.

A new chapter Four ‘A’, named ‘General rules for processing personal data. Special cases of personal data processing’ has been added in the Act. This Chapter regulates the areas in which the GDPR requires or enables member states to introduce/establish national regulations. Thus, the Act covers the requirements for the processing of the national identification number, the processing of personal data for journalistic purposes, for academic, artistic or literary expression, the processing of personal data in the context of employment/civil service relationships, the processing of personal data of deceased persons, the processing of personal data for the purposes of the National Archive Fund of the Republic of Bulgaria, the processing of personal data for humanitarian purposes by public bodies or humanitarian organisations. Copying of an identity document, driving license or residence permit is intended to be carried out by a controller or personal data processor only if provided for by the law. The Act provides that in cases of large-scale processing of personal data or systematic large-scale monitoring of publicly accessible areas, including video surveillance, the controller or processor must adopt and implement rules to introduce appropriate technical and organisational measures to protect the rights and freedoms of data subjects.

The presentation of the main aspects of the regulation under the Bulgarian Personal Data Protection Act as mentioned above does not represent an exhaustive list of the obligations arising therefrom. Noting them is with a view to support the conclusion that national legislations also have significant role in guaranteeing the right to the protection of personal data. They uphold the content of these rights and adapt it to the specific processing hypotheses outlined by GDPR.

IV. GDPR PRINCIPLES RELATING TO PROCESSING OF PERSONAL DATA

Article 5 GDPR establishes certain principles that must be respected in any processing of personal data that falls within its scope. They shape the appearance of the regulation and outline the main obligations of personal data controllers. Along that, the GDPR sets out some other requirements, but the principles are most essential for understanding the philosophy underlying the processing of personal data.

1. Lawfulness, fairness and transparency

As the name of this principle suggests, it has three elements. The ‘lawfulness’ element generally means that processing must be in accordance with the law. In the context of personal data protection, this element primarily requires the existence of a legal basis for data processing. Such legal grounds are provided alternatively in Article 6(1) GDPR, as follows: consent of the data subject, contract with the data subject or pre-contractual relations upon his/her initiative, compliance with a legal obligation, vital interest, public interest or execution of official powers, legitimate interest of the controller or a third party, except where such interest is overridden by the interests or fundamental rights and freedoms of the data subject.

The choice of an appropriate legal basis depends on the specific case of processing, but must be made prior to the start of the processing itself. If special categories of personal data are processed, the ‘lawfulness’ requirement must be considered through the prohibition for processing such data under Article 9(1) GDPR. Processing in this case would be allowed only upon applicable derogation under paragraph (2).

The existence of a legal basis for processing under Article 6 or Article 9, however, is not enough. In order to comply with the ‘lawfulness’ element, all actual personal data processing activities (data storage, access, transmission, disclosure of data, its deletion or destruction of its carriers) must comply with the imperative rules of the law.

The other elements of the first principle of personal data protection – good faith and transparency – are interrelated, as both are due to the data

subject and require the controller to process the data ‘fairly and transparently’. The ‘good faith’ element requires correct behaviour of the controller and due diligence on its part, so that the data are processed correctly and lawfully, in compliance with the requirements of the law and good morals, as well as in accordance with the expectations of the data subject.

The requirement for transparency is related to the concept for building trust among natural persons towards the controller’s data processing. This element requires any information and communication with data subjects in relation to processing operations to be made comprehensible to the natural person concerned. In order to be transparent, the information must be provided in a concise, understandable, clear, unambiguous and simple manner so that it is accessible to the average target audience (e.g., customers of a service provider, patients of a healthcare facility, consumers of online services). The use of professional jargon or complex terminology is incompatible with the requirement for transparency.

Ensuring transparency is not a one-time action (only in the phase of initial contact with the respective natural person), but an obligation that the controller should fulfil throughout the process of communication with the data subject. Transparency requires the information that the controller provides to data subjects to be separated from any other information not related to data processing. In addition, the information must be publicly disclosed and easily accessible and discoverable, not hidden and requiring excessive efforts to find. This requirement is particularly relevant in cases where the information owed by the controller to the data subject is published on its website. In these cases, it is advisable to use visualization whenever possible. A manifestation of the principle of transparency is the right to information of data subjects, established by Articles 13 and 14 GDPR.

2. Purpose limitation

The prevention of uncontrolled data processing implies that the purposes for which personal data are intended to be processed are determined before the actual process of their collection begins. This is the second principle for personal data processing according to the provision

of Article 5(1), point ‘b’ GDPR – ‘purpose limitation’. Compliance of processing activities with this principle requires the data to be collected for specific, explicitly specified and legitimate purposes and not further processed in a manner incompatible with these purposes.

Where the processing for a purpose other than that for which the personal data have been collected is not based on the data subject’s consent or on a Union or Member State law, ‘the controller shall, in order to ascertain whether processing for another purpose is compatible with the purpose for which the personal data are initially collected, take into account, inter alia:

- (a) any link between the purposes for which the personal data have been collected and the purposes of the intended further processing;
- (b) the context in which the personal data have been collected, in particular regarding the relationship between data subjects and the controller;
- (c) the nature of the personal data, in particular whether special categories of personal data are processed, pursuant to Article 9, or whether personal data related to criminal convictions and offences are processed, pursuant to Article 10;
- (d) the possible consequences of the intended further processing for data subjects;
- (e) the existence of appropriate safeguards, which may include encryption or pseudonymisation.’¹⁵

3. Data minimisation

According to the provision of Article 5(1), point ‘c’ GDPR, personal data must be adequate, relevant and limited to what is necessary in relation to the purposes for which they are processed. This is the third principle for the processing of personal data, which limits the type (categories) and ‘volume’ of data that will be processed only to the data that are of crucial importance for achieving the respective legal purpose and without which its realization is impossible. The controller must process the minimum of

¹⁵ Article 6(4) GDPR.

personal data – only the data that are necessary to achieve the purposes of the processing. The collection of data beyond the necessary minimum is disproportionate and excessive and, therefore, considered inadmissible.

In case where the categories of personal data intended for processing are legally defined, the controller is bound by the scope of the relevant legal act and has no right to collect any additional data at its discretion. The criteria for assessing the minimum amount of data needed is whether the relevant type (categories) and amount of data are of decisive importance for achieving the pursued goal and whether it could be realized regardless of their availability or absence. Collecting and storing data ‘just in case’ is unacceptable.

4. Accuracy

In order for data processing to be lawful, the controller must process up-to-date and accurate information about natural persons. Therefore, the provision of Article 5(1) point ‘d’ GDPR requires personal data to be accurate (correct) and, where necessary, kept up to date. This principle requires from the controller to make efforts and take every reasonable step to promptly erase or rectify incorrect and inaccurate personal data, taking into account the purposes for which the data are being processed. Depending on the context of data processing, the availability of true and accurate information may be essential for the data subject in terms of risks to his/her rights and freedoms.

5. Storage limitation

The data should be maintained in a form that permits identification of the relevant natural persons for a period no longer than is necessary for the purposes for which these data are processed. This is the principle of ‘storage limitation’ under Article 5(1), point ‘e’ GDPR. It requires the storage of the data as a processing operation to be limited to a period, which must be of minimum duration in relation to the pursued objectives. The data retention period may be precisely defined or determinable. When observing this principle, due account should be taken of whether there are any legally defined storage terms.

In addition to the storage period, controllers must also determine periods for periodic review of the need to continue the processing (storage) of the data within the initially defined storage terms. There is no statutory requirement as to at what time interval(s) the controller should carry out periodic reviews of the need for continued data storage, accordingly of the implemented data protection measures. The choice of a specific interval depends on the nature of the data that the controller processes and the specific processing context. It is expedient for the review to be carried out periodically (e.g., every two years), as well as whenever amendments in the legal framework related to the processing activities take place. Conducting a periodic review of the data is necessary in order to verify whether the legal grounds for data storage are still relevant and applicable, whether the purposes for which the data are collected have been achieved prior to the expiry of the stipulated storage periods, whether in the meantime the need to process the relevant categories of personal data has ceased to exist.

After the expiration of the personal data storage periods, the data must be deleted and their carriers destroyed. The data may be stored for longer periods only for achieving purposes in the public interest, for scientific or historical research or for statistical purposes, provided that appropriate guarantees for the rights and freedoms of natural persons are applied. Such measures may include pseudonymization or anonymization of data.

6. Integrity and confidentiality

The provision of article 5(1), point ‘f’ GDPR introduces the principle of ‘integrity and confidentiality’. It requires controllers to process personal data in a manner that ensures an appropriate level of security. The purpose of the principle in question is to oblige controllers to process data in such a manner as to ensure an appropriate level of security against unauthorised or unlawful processing, against accidental loss, destruction or damage. Compliance with the principle of ‘integrity and confidentiality’ is achieved by taking appropriate technical and organisational measures for data protection. The latter aim to prevent the occurrence of the above-mentioned adverse consequences or, in the event of their eventual occurrence, to minimize their negative effect on the rights and freedoms of natural persons. The assessment as to what (type of) measures are

appropriate (the GDPR does not contain an exhaustive list of appropriate measures, but only an exemplary listing of several possible measures – Article 32) is entirely up to the controller. ‘...the appropriateness of the technical and organisational measures implemented by the controller under that article must be assessed by the national courts in a concrete manner, by taking into account the risks associated with the processing concerned and by assessing whether the nature, content and implementation of those measures are appropriate to those risks.’¹⁶

When defining specific measures that are suitable for the respective case, the controller must take into account the following parameters: the state of the art, the costs of implementing the measures, the nature of the personal data, the scope, the context and the purposes of the processing. It is also necessary to take into account the risks for the rights and freedoms of natural persons. Thus, certain technical and organisational measures may be considered appropriate within one context of personal data processing and inappropriate in relation to another. The assessment is always case-by-case specific.

Similarly to any other principles for data processing, the requirement of integrity and confidentiality is not a one-time action by the controller, but an obligation that should be fulfilled throughout the life cycle of the data.

7. Accountability

The content of the principle of accountability has two manifestations directed towards the controller of personal data – to comply with all the principles specified in Article 5(1) GDPR and to be able to demonstrate compliance with them. Ensuring the protection of natural persons in connection with the processing of their personal data is a continuous process requiring periodic review of the level of compliance with regulatory requirements, of the effectiveness of the measures taken for protection of the rights of data subjects and the security of processing.¹⁷ Given that, the

¹⁶ Judgment of 14 December 2023, *Natsionalna agentsia za prihodite*, C-340/21, EU:C:2023:986, paragraph 47.

¹⁷ For more details on principle of accountability, see **Целков, В., Деян Петков, Георги Средков, Пламен Георгиев.** *Защита на данните – Принципи и практики.* София, „За буквите – О писменехъ“, 2019, 122–144.

principle of accountability calls for controllers to introduce appropriate policies for periodic monitoring and evaluation of the level of compliance with the Regulation as well as of the specific technical and organisational measures and procedures taken for its implementation.

V. DESIGNATION OF THE DATA CONTROLLER AND DATA PROCESSOR

‘The concepts of controller, joint controller and processor play a crucial role in the application of the General Data Protection Regulation 2016/679 (GDPR), since they determine who shall be responsible for compliance with different data protection rules, and how data subjects can exercise their rights in practice.’¹⁸

According to the definition in Article 4, p. 7 GDPR ‘controller’ means the natural or legal person, public authority, agency or other body which, alone or jointly with others, determines the purposes and means of the processing of personal data; where the purposes and means of such processing are determined by Union or Member State law, the controller or the specific criteria for its nomination may be provided for by Union or Member State law. The definition contains two criteria for determining the controller:

a) Organisational – related to the legal-organisational form, which, however, is not decisive, given the broad boundaries within which it may vary, and

b) Functional – related to the determination of the purposes and the means of data processing, which is decisive for defining the controller. Based on the functional criterion, two groups of controllers may be distinguished: controllers whose status arises as such from the law – when the law determines the purposes and means of processing, most often in the public sector, and controllers whose status arises from the activities they perform, most commonly in the private sector. The characteristic

¹⁸ European Data Protection Board, Guidelines 07/2020 on the concepts of controller and processor in the GDPR, https://edpb.europa.eu/system/files/2023-10/EDPB_guidelines_202007_controllerprocessor_final_en.pdf.

that is decisive for controllers, regardless of which of the two groups they belong to, is their responsibility for determining the purposes and means of personal data processing. In other words, they play a decisive role in answering the questions ‘why’ and ‘how’ data processing activities should be determined. This situation does not change when the purposes and means of personal data processing are determined by EU or Member State law. The difference is that in these cases, the controller or the criteria by which they are to be determined are established in the respective legal act.

Based on the above, the controller is a body that decides on certain key elements of the processing such as the purposes and means of the processing, i.e., the why and how of data processing. The controller is not obliged to register, notify, or take any other action before a supervisory authority to verify or legitimize in any way their status, as the status of controller arises *ex lege*. It is also irrelevant whether the controller has taken steps to comply with data processing requirements. However, the mandatory condition for acquiring the status of a controller is the maintenance of a filing system of personal data and the performance of at least one data processing operation. For example, the bank is the data controller for the personal data of its employees and its clients. The employer is the data controller for the personal data of its workers and employees.

Joint controllers are two or more data controllers who jointly determine the purposes and means of processing. An important criterion is that the processing would not be possible without both parties’ participation meaning that the processing the two parties is inseparable, i.e., inextricably linked.

‘Processor’ means a natural or legal person, public authority, agency or other body which processes personal data on behalf of the controller (Article 4, p. 8 GDPR). For an entity to be considered a processor, two fundamental conditions must be met: the entity must be distinct from the controller, and it must handle the personal data on behalf of the controller.

A common mistake in practice is the identification of employees of a given controller with the concept of data processor. The processor is always an external structure or entity as to the controller, while the employees

of the controller or processor are referred to as ‘persons acting under the authority of the controller or of the processor, who have access to personal data’ (Article 29 GDPR). The fact that employees of the controller or processor have access to personal data does not attribute to them the status of ‘processors’ within the meaning GDPR. It simply emphasizes the fact that the processing of personal data arises from the necessity for them to fulfil their official duties or, accordingly, to process personal data in connection therewith.

The processor must not process the data otherwise than according to the controller’s instructions. The controller’s instructions may still leave a certain degree of discretion as to how to best serve the controller’s interests, allowing the processor to choose the most suitable technical and organisational means. Unlike the controller, however, the processor does not determine the purposes and the essential means¹⁹ of the processing, but follows the purposes determined by the controller. A processor infringes the GDPR, if it goes beyond the controller’s instructions and starts determining its own purposes and means of the processing. The processor will then be considered a controller in respect of that data processing and may be subject to sanctions for going beyond the controller’s instructions.

There is no obstacle for both the controller and the processor to act in a dual capacity. For instance, an employer who has defined the purposes for which the data of its employees are processed may, in turn, act as a processor for another controller, processing personal data under their mandate, for example, if the employer performs activities related to the maintenance of information systems that involve processing of personal data on behalf of another controller. However, the existence of such dual

¹⁹ In Guidelines 7/2020, the European Data Protection Board gives a very clear and precise distinction of the means of processing personal data. ‘Essential means’ are closely linked to the purpose and the scope of the processing and are traditionally and inherently reserved to the controller. Examples of essential means are the type of personal data which are processed (‘which data shall be processed?’), the duration of the processing (‘for how long shall they be processed?’), the categories of recipients (‘who shall have access to them?’) and the categories of data subjects (‘whose personal data are being processed?’). ‘Non-essential means’ concern the more practical aspects of implementation, such as the choice for a particular type of hard- or software or the detailed security measures which may be left to the processor to decide on.

capacity would always be possible in relation to different sets of personal data (different filing systems).

In its Guidelines 7/2020, the European Data Protection Board summarizes that the concepts of controller and processor are functional concepts: they aim to allocate responsibilities according to the actual roles of the parties. This implies that the legal status of an actor as either a ‘controller’ or a ‘processor’ must in principle be determined by its actual activities in a specific situation, rather than upon the formal designation of an actor as being either a ‘controller’ or ‘processor’. The concepts of controller and processor are also autonomous concepts in a sense that, although external legal sources can help identifying who is a controller, it should be interpreted mainly according to EU data protection law. The concept of controller should not be prejudiced by other – sometimes colliding or overlapping – concepts in other fields of law, such as the creator or the right holder in intellectual property rights or competition law.

CHAPTER 16:

CONSTITUTIONAL PRINCIPLES OF ECONOMICS AND FINANCE

Orlin Kolev

ABSTRACT	KEY WORDS
The chapter examines the constitutional foundations of economic and financial relations. It looks mainly at the principles shaping the economic environment, such as free enterprise and the incentive role of the State for cooperation and economic progress. A distinction is made between principles specific to economic relations and other constitutionally established principles. A link is made between them and the impact of principles in the non-economic sphere on economic processes is considered. The influence of institutes atypical of economic processes is highlighted and their impact on the economic environment is revealed. Principles peripheral to economic relations, such as social justice, social security, equality of citizens before the law, and non-undue restriction of citizens' rights, are examined and their role in economic relations is highlighted. The constitutional foundations of financial and economic relations are addressed through the operation of the universal principle of the rule of law.	economic constitution, political constitution, welfare state, principle of free enterprise, rule of law, sovereignty, and economic relations.

I. INTRODUCTION

The achievements of modern constitutionalism are in no small measure the fruit of centuries of humanity's striving and attempts to fully appropriate goods. The drive to acquire goods is driven by the need to satisfy needs, both concrete and existential, as well as possible future needs, and the drive is directed towards acquiring goods of a heterogeneous nature. The goods

that are the object of the desire may be of a material or immaterial nature and may be of a national, supranational, community, or other nature. They can satisfy economic, social, cultural, and, not least, spiritual needs. All of these inherent needs presuppose the establishment of a basic consensus ensuring satisfaction to one degree or another of all of them. Satisfying the heterogeneous nature of needs requires a basic consensus on the rules to be applied. The rules must be clearly expressed by the community from which they are to originate. Rules of particular importance are proclaimed by those concerned (the community) as principles intended to create the substantive prerequisite for protection, which positive law elevates into a legal norm. Positivists, in order to reveal the essence of the proclaimed principles of law, not infrequently assign them to one or another category or group, positioning them in the field of political, liberal or individual freedom, social, representative, or direct democracy. The typology of the different manifestations of democratic coexistence and the expression of will aims to clarify a distinct element essential to the democratic process, which has a fundamental bearing on the voluntary, necessary, useful and socially accepted coexistence. The formation of a particular set of principles and their separation from others is only for the purpose of clarifying the nature and content of a particular legal situation. In reality, principles rarely manifest themselves in isolation from one another; there is an interrelationship between them. For example, principles such as the rule of law, the guarantee of citizens' rights and freedoms, the equality of citizens before the law, humanity, proportionality, separation of powers, and popular sovereignty, which are initially used to reveal the political nature of the constitutionally established order, could be directed towards economic prosperity on a par with the principles of free enterprise and equal opportunities. The symbiosis between constitutionally established principles is the fruit of the long coexistence of the 'demos' within the 'polis'; otherwise, the modern understanding of the state and super-state formations would not have come about. The presence and manifestation of all principles in all directions of social life is a *conditio sine qua non* for coexistence within a state or a union. The combination of the individual principles and their common manifestation in all spheres of social life is the guarantee for the existence of freedom within the politically structured state.

Giovanni Sartori's understanding that the different manifestations of social, economic, political, intellectual, etc. freedoms are related to each other and at the same time relate to the same person, and that each of them reveals a certain aspect of the general question of freedom,¹ fits both the political organisation for communal existence and the achievement of economic prosperity.

Conceptual theories of freedom in its political dimension have found their place in the constitutions of modern states. In most of them, the concepts of the manifest forms of 'political freedom' as a fundamental consensus for state governance have been elevated into constitutional principles.

Stefan Stoychev points out that some of the basic principles are universal. They are applicable to both state organisation and socio-political structures. For example, the principle of legality. The state, its bodies, and political structures must respect legality.² The author unequivocally assumes that, in line with the general perception, specific constitutional principles are used to clarify one or another characteristic feature of the constitutional legal order, and could justify other constitutionally established social relations with the same degree of legitimacy.

Along these lines, it can be inferred that political and social democracy could be explained by economic democracy. And even bolder scholars, whose views can be heard in economists' circles, would accept that the leading democracy to determine and condition, should be precisely the economic democracy. It should be reflected in the constitutions of states, it should be linked to social relations, and should dominate political and social democracy.

This understanding is shared by economists who hold Marxian economic views, where political democracy is downplayed to the point of rejection and the same is entirely replaced by economic democracy. The rejection of political democracy is based on the lack of an object or goal of its own to be defended and pursued by the political environment.

¹ **Сартори Дж.** Теория на демокрацията. Класическите проблеми, Книга 2. София, Център за изследване на демокрацията, 1992, с. 66.

² **Стойчев Ст.** Конституционно право. София, Сиела, 2002, с. 102.

Politics itself is devoid of an autonomous existence; it draws its legitimate purpose from and pursues and defends values and goods whose object is specific social relations – economic, cultural, etc. According to Marxist theory, political democracy serves to defend other kinds of democracies, mainly economic and industrial democracies, through which the capitalist-bourgeois class is brought into particular focus and its domination is proclaimed, which is the basis for Marxist theory in its critique at the capitalist exploiter.

Accepting the notion of the superstructural nature of political democracy, aimed at protecting the economic, inevitably leads to an extreme that will lead to the self-sufficiency of the economic, ignoring the political entirely. Accepting the notion of the dominance of economic democracy and combining it with the quest for equality of citizens, inevitably leads to economic democracy of a communist rather than capitalist kind.

These ideological currents could perhaps have withstood and passed the test of time if they had ensured the protection of citizens' interests and goods in the immaterial sphere, where the social commitment of individuals and the individual aspiration for development come to the fore. It is the social being of citizens that determines the importance of social democracy, correlated with political democracy.

Giovanni Sartori notes that no one denies the importance of social democracy as the basis of a democratic political community, nor that basic, primary democracy is perhaps of greater value than all other aspects of democracy. Nor does he believe that economic equality and industrial democracy may be more important than anything else. But the fact remains that political democracy is the necessary condition, the necessary means to achieve any democracy or democratic end. If the supreme system, the comprehensive political system, is not democratic, social democracy will be of little value, industrial democracy will be of little use, and economic equality will resemble equality among slaves.³

³ **Сартори Дж.** Теория на демокрацията. Съвременната дискусия, Книга 1. София, Център за изследване на демокрацията, 1992, с. 24.

II. THE EVOLUTION OF ECONOMIC AND POLITICAL UNITY DETERMINED THROUGH THE CONSTITUTIONAL PRINCIPLES.

In this sense, universal constitutional principles are relevant in all structures of the political system, and others are elements of its foundations, without which the universal principles thus defined could not find the necessary application.

Although economic relations develop in a specific political environment that exerts its strong influence on their free development, their impact on society cannot be underestimated. The desire to increase wealth is universal, but not necessarily to the disadvantage of the individual, nor does it imply restrictions in the private or public sphere. The desire to increase well-being is characteristic of the individual as well as of the collective, association or state.

No matter how high they rise above earthly goods, the great philosophers of the antiquity sometimes dwell on such prosaic issues as property and wealth, notes Prof. Stefan Balamezov.⁴

From ancient times to the present day, property has continued to be a central focus and to engage the individual desire to enfranchise. Property continues to be the primary object, the main asset for achieving economic prosperity. The Chinese sage Confucius (551-479 BC), writes: ‘There is a great rule for increasing the income of both the state and the family. Those who produce income should be many, and those who waste it should be few; those who increase it by their own labour should make great efforts, and those who consume it should do so moderately ... If those who govern the state think only of accumulating wealth for their own use, they will undoubtedly attract to themselves perverse persons. These persons will make them believe that they are good and honest rulers, and they themselves, the perverted persons, will rule the state. But the administration of such unworthy officers will bring upon the government divine punishment and the vengeance of the people. And when public affairs are brought to this state, then no rulers, even the most just and the

⁴ **Баламезов Ст.** Конституционно право, част трета. София, Софи-Р, 1993, с. 381.

most virtuous, will be able to prevent misfortunes. This will mean that those who govern a state should not make the state's income their private wealth, but their only wealth should be justice and righteousness ...'⁵

Two centuries later, Meng Tzu (also called Mencius) expanded on Confucius' teachings. The new philosopher recognized only two categories of persons, equally necessary. 'The one works with his reason, the other works with his hands. Those who work with their reason rule men; those who work with their hands are ruled by men. Those who are ruled by the people feed the people; those who rule the people are fed by the people. This is the universal law of the world.' Or as Jeanne interprets it: an inseparable solidarity between those who think and those who feed, because intelligence is also labour, therefore physical labour is not obligatory for all. It is not enough to teach the people how to feed themselves, they must be taught how to enrich their minds... It is just, therefore, that those who cultivate minds should govern the people and be governed by them.

The Chinese philosopher, Balamezov points out, explains the importance of property –it leads to peace of mind and love of order; lack of property gives rise to anxiety and predisposes to disorder. Private property is endangered when its principal part is torn away by excessive taxation; then the nation is entangled in a web. Meng Tzu cruelly blames the princes, although they went to him for advice. But there is a phrase of his that makes us wonder to this day how he was not impaled, or at least imprisoned: 'The people are the most important element in a nation; the spirits of the land and grain come next; the sovereign counts for the least.'⁶

Creating the necessary conditions to satisfy the desire for expanding wealth and the legitimate establishment of boundaries that, in order to protect values and interests of a different nature, inevitably presupposes political will and foresight in defining such boundaries and shaping economic democracy, is a skilful balancing act. The non-violation of particular intangible assets, or the legitimate permissibility of their encroachment, necessitates a policy of mutual compromise and tolerance within the limits of the social circles concerned. In many cases, the imposition of

⁵ Цит. съч.

⁶ <https://www.britannica.com/biography/Mencius-Chinese-philosopher>.

restrictions should be regarded as the necessary restraint safeguarding not only intangible assets but also capital and property *per se*.

The accumulation of wealth has often been the subject of suspicion as to its rightfulness, of criticism, or of appropriation by another, and many a war has been fought for this reason. The accumulation of wealth in the concreteness of economic democracy is not observed in its purest form, but is subject mainly to economic vector relations and dependencies between economic quantities. The manifestation of the macroeconomic quantities determining the stability and predictability of the economic environment (GDP, Basic Interest Rate, inflation, employment, debt, balance of payments, budget deficit, etc.) and their projection in microeconomic expectations, reduced mainly to the volume of profit, are realised in a concrete normative environment, the fruit of political democracy.

It is no coincidence that one of the most important figures of classical economic science, Adam Smith, in the fourth and fifth books of his work, *An Inquiry into the Nature and Causes of the Wealth of Nations*,⁷ entitled respectively *Of systems of political economy* and *Of the revenue of the sovereign or commonwealth*, when examining the impact of imports, talks of balanced solutions under a negative trade balance and of the impact of the regulatory environment on imports. The conceptual recommendations of the eminent economist are that even when restrictions are to be introduced, they should be directly related to the operation of the regulatory framework. ‘The two principles being established, however, that wealth consisted in gold and silver, and that those metals could be brought into a country which had no mines, only by the balance of trade, or by exporting to a greater value than it imported; it necessarily became the great object of political economy to diminish as much as possible the importation of foreign goods for home consumption, and to increase as much as possible the exportation of the produce of domestic industry. Its two great engines for enriching the country, therefore, were restraints upon importation, and encouragement to exportation.

The restraints upon importation were of two kinds.

⁷ **Smith Adam**, *An Inquiry into the Nature and Causes of the Wealth of Nations*. London, W. Strahan and T. Cadell, London, 1776.

First, restraints upon the importation of such foreign goods for home consumption as could be produced at home, from whatever country they were imported.

Secondly, restraints upon the importation of goods of almost all kinds, from those particular countries with which the balance of trade was supposed to be disadvantageous.

Those different restraints consisted sometimes in high duties, and sometimes in absolute prohibitions.

Bounties were given for the encouragement either of some beginning manufactures, or of such sorts of industry of other kinds as were supposed to deserve particular favour.⁸

Increasing wealth has been a major driving force toward development and progress, but also often towards decline, ruin, or cyclical crises. Well-being, whether private or public, develops in the same direction as the social and political freedom of society and the individual. The heterogeneous nature of the interests of different social circles has created conditions for the unfolding of patterns of wealth accumulation. The symbiosis between the separate interests of the rulers and the ruled, between the holders and the expressers of power, between the growth of capital and the establishment of social security, between the stimulation of economic expansion and the prevention of social inequality, between the achievement of a balance in the satisfaction of public and private interest, creates an environment in which the social aspect establishes rules by which it is guided in its coexistence.

Chronologically, in terms of historical facts, the expansion of economic processes, the development of technology, industrialization and nowadays electronization and digitalization have acted as grounds for revising existing principles or introducing new ones to meet new economic realities. What is special in this case is that in periods of economic expansion and evolutionary leaps in industrialisation and technology, the principles that originally explained the political foundations are adapted in favour of the economic reality. For example, the principle of the separation of powers,

⁸ See: www.gutenberg.org, **Smith, A.** *An Inquiry into the Nature and Causes of the Wealth of Nations*. Book IV, Chapter I. Release date: June 1, 2002.

from the time of Aristotle and his views on the three types of authorities, the first creating the rules in the state, the second being the executive, and the third the judiciary, are functionally directed to the exercise of public power in the *polis*, not allowing the concentration of power in the hands of a single authority. The idea of the principle of separation of powers has its deep political genesis. It is intended to serve the public in and on the occasion of the exercise of power in its understanding of imperium. Subsequently, the theory of separation of powers was developed by John Locke, Charles Montesquieu, Benjamin Constant, and others. In the context of the functioning of the state, the principle of separation of powers is directly related to the principle of equality, legitimacy, and sovereignty. The principle of separation of powers implies a state governance where there is no concentration of power in a single authority,⁹ and the functional separation of powers implies interaction and checks and balances between authorities, also known as the checks and balances model.

Political freedom has in many cases also been understood as the freedom of the individual whose economic situation allows him to look ahead in the realisation of his needs. As he satisfies his existential needs and reaches a situation that allows him to think freely in directions other than the satisfaction of his biological needs, the desire for active participation in public life and government emerges. Examples in this direction are not lacking. Leaving aside the ancient world and omitting the period of slavery, where property rights were enjoyed mainly by the *dominus*, the achievement of political freedom was in some cases accompanied by economic preconditions. Thus, the modern world has faced the introduction of property and educational qualifications for participation in the electoral process. It should be clarified that during the period of censorship of the right to vote, it was mainly wealthy people who were able to obtain an education, which highlights the economic prerequisite for the realisation of political rights. The symbiosis between politics and economics was nothing alien in the past.

During the Middle Ages, when feudalism prevailed on the European continent, there was a fusion of power and property. Society had not yet

⁹ A striking example in the opposite direction is the Council of State under the 1971 Constitution.

become functionally differentiated, in the absence of a system specialised in the exercise of political dominion to the exclusion of all other systems. The tasks of domination were distributed among multiple interdependent vehicles with respect to subject matter, function, and physical location. Under these circumstances, closed political units could not be formed, and the power to govern related primarily to persons, not territories. The bearers of this power did not exercise it as an independent function, but as an adjunct to, and in addition to, a specific status as head of a family, landowner, or member of a social class or corporation. Under these circumstances, what is now distinguished as private and public constituted a tangle of different functions, preventing any autonomous public right from forming.¹⁰

Subsequent events culminating in the Glorious Revolution of 1688 led to the recognition of the idea of personal rights including rights against fiscal plunder, hence in turn the belief that Parliament protected the rights of citizens in all spheres of public life. The rights and freedoms of English citizens were recognised in the Bill of Rights of 1689. In this way, the State was able to generate a high level of public confidence in its undertakings.¹¹

During this period, two realities confronted each other in a political sense. One referred to the status quo of absolutism, implying a concentration of power and the other referred to the concept of separation of powers from each other. The feudal concept of concentration of both political power and the means of production and property in the hands of the ruler is the hallmark of medieval feudalism.

The Norman conquest of Britain in 1066 led to the creation of a strong centralised state power, hierarchically constructed and based on feudal relationships between the various estates of the kingdom, with the entire territory of the kingdom seen as the patrimony of the ruler. The sovereign

¹⁰ See: **Grimm, D.** The origins and Transformations of the Concept of the Constitution, p. 4, цитиран от **Близнашки, Г.** *Общо учение за конституцията*. София, УИ „Св. Кл. Охридски“, 2019, 605–608.

¹¹ See: **Thornhill C.** A sociology of Constitutions. Constitutions and State Legitimacy in Historical – Sociological Perspective. Cambridge, Cambridge University Press, 2011, 148–149, цитиран от **Близнашки, Г.** *Общо учение за конституцията*. София, УИ „Св. Кл. Охридски“, 2019, с. 609.

granted land ownership to his barons, who in turn landed their supporters known as knights, thus creating a small elite that ruled the mass of the population.¹²

The understanding that the sovereign owns everything and distributes economic and social goods, thus shaping the political environment, was not alien to other countries dictating world trends at the time.

The understanding that everything material and immaterial belonged to the monarch became so popular that the French King Louis XIV went so far as to say ‘The State, it is me’, which testifies to the unity of the state with the personification of the monarch.

The absolutism imposed by the Sun King, Louis XIV, had an enormous resonance and its influence spread to the monarchies of the old continent as well as to cardinals and large merchants. His greatness and absolute power were compromised by internal tensions caused by the desire of his cronies to accumulate ever greater economic potential and property ownership.

It is accepted that one of the earliest signs of opposition to monarchical absolutism was the Petition of Right in 1629 by Edward Coke in the English Parliament. Significantly, with the adoption of the petition on the fundamental rights of English citizens, emphasis was placed on organising the absolute fiscal discretion of the monarch in setting taxes. A restriction was placed on the introduction of new taxes without the consent of Parliament, where, in addition to the wishes of the monarch and the aristocracy, the consent of the feudal lords, who replenished the treasury, was necessary. Significantly, political means such as the adoption of the Petition of Right, based on Magna Carta, achieved an impact in the economic sphere that in practice reinforced the interdependence of political and economic origins.

Different philosophical currents of economic thought dwell to varying degrees on particular premises relevant to economic relations and, by focusing on one or a select group of them, seek to analyse the particular economic situation. The analysis is most often done by examining the economic relationships, dependencies, and links in economically

¹² Цит. Близнашки, Г. *Общо учение за конституцията*. София, УИ „Св. Кл. Охридски“, 2019, с. 146.

developed countries at the time. By summarising the effect of individual economic preconditions, emphasising some, and relating them to others, world economic thought derives some general, timeless patterns dating from antiquity to modern times.

Prof. Katya Bekyarova writes that in the third millennium BC countries such as Egypt, Babylonia, Syria, India, and China not only had a leading role in the political and cultural life of the nations but also stood at the forefront of the civilized world. Many original and valuable socio-political and economic ideas were expressed by eminent representatives of these peoples, revealing to us a rich treasure trove of talents, thinkers, and discoverers who continue to arouse justified admiration to this day. Referring to Gordon Childe, it is accepted that the achievements of Ancient East can be regarded as a kind of ‘prelude’ to the prehistory of Europe, with the English researcher saying ‘...the prehistoric and protohistoric archaeology of the Ancient East is therefore an indispensable prelude to the true appreciation of European prehistory. The latter is at first mainly the story of the *imitation*, or at best adaptation, of oriental achievements’.¹³

In all periods of the development of mankind and of ideological-philosophical economic currents, it is recognized that the basis of economic relations is property, its reproduction, and the well-being it leads to.

Researchers of Ancient East are impressed by the fact that even in this early ancient period the inviolability and sacredness of the property of the aristocrats was strongly emphasised in tomb inscriptions and the incantations of priests. Elements of a peculiar ideology were emerging: the acceptance that private ownership of the means of production was granted by nature or by God. The property rights of the nobility were asserted by the power of the pharaohs. Their mines, irrigation systems, and lands were worked by thousands of slaves. During this period, life in ancient Egypt was largely determined by and dependant on the use of irrigation systems and especially the inundation of a great river called the Nile, proclaimed by the Egyptians as the ‘father of fertility’.¹⁴

¹³ **Бекярова, К., Боян Велев, Иван Пипев.** Икономически теории. Икономическата мисъл от древността до наши дни. София, Хермес, 2015, с. 7.

¹⁴ Цит. съч., с. 8.

Later classical economic science in the person of Adam Smith, David Ricardo, Thomas Malthus, Jean-Baptiste Say, James Mill gave a broader and more complex analysis of economic processes. Building on property as a starting point and the possibility of deriving wealth from it, economic classicism considered in great detail a number of economic factors which, depending on proper management, bolstered by the necessary legal framework, can contribute significantly to increasing wealth. Economists of classical economic science, placed in the context of developed intra- and inter-state capitalist relations in times of industrial upsurge and non-existent political and social instability, were forced to take into account the manifestation of fundamental political, social and religious freedoms and relate them to the new economic realities. Their philosophical economic views were inevitably shaped, to one degree or another, in accordance with the basic constitutional principles defining the political and social environment. Economic regularities were viewed primarily through the manifestation of the principle of legality, equality of opportunity, permissible competition, and basic social equality. Within this range of multiple factors, the views for division of labour, the theory of value and price, and policies related to basic income – wages and rents, capital and profit – stand out.

Smith overcame the limited notion of ‘capital’ of the Physiocrats, who considered the only productive, value-growing capital to be that employed in agriculture. However, he also lumped together all types of capital and saw no distinction between capital employed in the sphere of production and capital functioning in the sphere of circulation (commercial capital). For him, all capital was a source of income, whereas, for the Physiocrats, trade captured only a part of what capital in agriculture had already created. Smith failed to see that capital passed through three forms in its movement – monetary, productive, and commodity. He was therefore unfamiliar with the notion of commercial capital, whose source of self-growth ultimately derives from the sphere of production and the functioning of productive capital.¹⁵

Smith’s analysis of ‘core’ and ‘circulating’ capital, through which he sought to supplement his theory, proved the subject of criticism and in

¹⁵ Цит. съч., с. 184.

some ways can be seen as irrational. Insofar as what is relevant to the value of what is produced is the type and amount of costs that constitute the value of what is produced, Smith's understanding that the difference between 'working' and 'fixed' capital comes down to a carry-over of profit is rightly criticized. Working capital is fully included in the value of what is produced, insofar as fixed capital, depending on its natural or normative deterioration (depreciation in the broad sense), participates partially in the cost of production.

In the context of general welfare, correlated with the political environment and subject to political constitutional principles enjoying their universal character, Smith assumes that through the realisation of all commodity capital (all commodities produced by all individual capitalists), production will continue to reproduce itself. The realisation of all commodity capital, which in practice depends on consumption, will lead to the individual reproduction of commodities. As we have explained, Smith's idea of the reproduction of social capital cannot be considered in isolation. It depends mainly on consumption, which can be broadly reduced to individual/household and industrial, for the production of other kinds of goods. Without going into the details of the process of reproduction of capital, for the purposes of this study it should be pointed out that consumption takes place in a protected environment. There are at least two constraints protecting consumption, whether individual or industrial, and these are: the prevention of unfair competition and consumer protection. The latter has a wide scope, ranging from avoiding unfairness and misleading the consumer to protecting the consumer's health and dignity. The protection of the dignity and integrity of the consumer's personal and social status is mainly achieved in the digital realm and is primarily linked to intangible assets that may be offered by economic operators. These intangible assets are mainly related to the prohibition of the use of personal data, electronic surveillance, the right to be forgotten and not to have one's good name violated, the non-dissemination of false information, etc.

In many places in *The Wealth of Nations*, Smith makes it unmistakably clear that he understands all this well. Moreover, Smith contributes much to clarifying the problem of the reproduction of social capital by introducing the concepts of 'gross' and 'net' income. By 'gross' income he means the

entire annual commodity product of the inhabitants of a land and labour, and includes in it all material costs, including raw materials and supplies in the subsequent stages of their processing. By 'net' income Smith means what remains after deducting the cost of fixed and circulating capital, i.e., this is the national income, treated by him exclusively as a fund ('stock') for private consumption.

The aggregate social commodity product is thus broken down into two major elements: various means of production and various items of personal consumption. Accordingly, the total social capital employed in the branches of production is subdivided into capital employed in the branches producing the means of production and capital employed in the branches producing articles of consumption. In this situation, for example, a simple reproduction of social capital is reduced to the realisation of the commodity product of the means of production and of the articles of consumption so as to ensure the acquisition of the means of production necessary for the restoration of the capital stock and circulating capital employed in all branches, the acquisition by the workers and capitalists of all branches and by the landowners of the articles of personal consumption, for the purchase of which wages, profits, and rent are respectively expended.

In principle, the fruitful reasoning set out in the concepts of 'gross' and 'net' product is not developed by Smith in the direction presented in the analysis of reproduction. On the contrary, he repeatedly returns to the thesis that since the value of an individual commodity consists of the three incomes, the value of the annual commodity product consists of wages, profits, and rent. And the question of the carry-over value of the means of production (for, in this form, the aggregate product does not actually include it) Smith, true to his dogma, resolves thus: even if there is an element in the price of the commodity which does not immediately decompose into income, on the national economic scale such elements ultimately represent one's income derived in the preceding stages of processing. 'A fourth part, it may perhaps be thought,' writes Smith, 'is necessary for replacing the stock of the farmer, or for compensating the wear and tear of his labouring cattle, and other instruments of husbandry. But it must be considered that the price of any instrument of husbandry, such as a labouring horse, is itself made up of the same three parts; the

rent of the land upon which he is reared, the labour of tending and rearing him, and the profits of the farmer who advances both the rent of this land, and the wages of this labour. Though the price of the corn, therefore, may pay the price as well as the maintenance of the horse, the whole price still resolves itself either immediately or ultimately into the same three parts of rent, labour, and profit.’¹⁶

The relationship of economic processes to the political environment, shaped and limited by constitutional norms, provides the basis for the deployment of David Ricardo’s conceptual ideas. He devoted his writings to monetary policy, money supply, and currency stability. At first glance, one would assign this strictly specific part (money supply and monetary policy) of economic relations entirely to economic analysis. It is abstract and seemingly inconsistent. During this period, the period of industrial upsurge coinciding with the bourgeois revolution in France, there was no detailed regulation of how banknotes were to be offered. The practice accepted by banks was to exchange banknotes for gold coins. Industrial expansion and the need of entrepreneurs for fixed and working capital on the one hand, and the real possibility of generating revenue for the fisc on the other, made questions of monetary policy fundamental, i.e., constitutional questions. Thus, in 1797, the government of England, influenced by the need to provide a monetary resource to the growing industrialization, liberalized the money supply by allowing banks to freely exchange their money, not just for gold coins. This decision of the English government had constitutional significance in the sphere of money supply. The liberalisation of the money supply led to a depreciation of the price of money and an increase in the price of gold. These logical economic consequences did not escape Ricardo’s attention, as he, through his work *The High Price of Bullion, a Proof of the Depreciation of Bank Notes*, criticized and made suggestions to stop the devaluation of money. Ricardo argued that the quantity of money in the economy directly influences price increases for goods and services and can negatively affect monetary circulation. Undoubtedly, the analysis was made from an economic perspective, but Ricardo was clearly aware of the social effects of money depreciation and inflation and how these economic processes

¹⁶ Цит. съч., 186–187.

affect the political-social environment. In all his writings, Ricardo also examined the impact of economic processes on society through the lens of individual political freedom. Considering the economic and political-social environment in their cohesive relationship, Ricardo vividly reflected this relationship in his major work in economics, *On the Principles of Political Economy and Taxation*.¹⁷ Deeply convinced of the reciprocal nature of the political and economic relations underlying society, he founded the London Club of Political Economy. He did not accept Bantam's thesis that citizens pursuing their self-interest contributed to social welfare, since the thesis did not take social inequality into account.

'Ricardo divides society into classes, assigning them different roles. He believes that some classes drive social development and others restrain it. He favours the interests of the business class, the industrial bourgeoisie carrying out the industrial revolution, and he is resolutely opposed, even though he himself became a landowner, to the interests of the land rentier class. Ricardo does not condemn the workers' unions and associations, but neither does he attach any serious importance to them. He does not accept Robert Owen's utopias for the destruction of private property, considering them deeply mistaken, but he calls Owen himself a highly moral and virtuous man.

Ricardo assigns to the class structure of society a certain role in the functioning of the economy. From this, he derives the main task of political economy, which, according to him, is the establishment of laws for the distribution of the 'product of the land' (i.e., national income and national wealth) among the three main classes in society – wage-labourers, capitalists, landlords.'

Ricardo overcame to a considerable extent the collision in Smith's dualism and succeeded in explaining economic processes through the so-called 'labour theory of value', noting that the value of a commodity is determined by labour time.

Based on the view that commodities have use and exchange value, he justifies value not only by its utility but also by the effort invested in creating it.

¹⁷ The work was published in 1817.

‘Utility is certainly the foundation of value, but the degree of utility can never be the measure by which to estimate value. A commodity difficult of production will always be more valuable than one which is easily produced although all men should agree that the latter is more useful than the former. A commodity must be useful to have value but the difficulty of its production is the true measure of its value. For this reason, iron though more useful is of less value than gold.’¹⁸

His point about the disparity between utility and value can be argued by giving other examples from objective reality to support the point that goods like water, air and food abundantly useful but are worth many times less than diamonds or computer software programs that are not vital.

An additional argument that utility does not independently determine the price of a good is derived from the principle that price is dictated by competition between producers and not by buyers consuming the goods they find useful.

Ricardo does not explain all economic issues. For example, ‘Ricardo’s unresolved issue regarding the mode of transfer of the capital value of the means of production to the value of the commodity does not allow him to determine the full composition of the magnitude of value on a social scale, i.e., of the value of the aggregate commodity product of society, sharing on this issue the position of A. Smith, known as ‘Smith’s dogma’. The latter, as is well known, by representing the value of a commodity as formed by the three incomes, actually omits from it the carry-over value of the means of production. Ricardo rejects Smith’s inconsistent view, but, assuming, at one point, that the magnitude of value is determined by the total amount of labour for its production (past labour, labour invested in the means of production, and immediate labour), he, at another point, decomposes this value at the level of the aggregate social commodity product once again into incomes only (wages, profit, and rent) and in fact repeats ‘Smith’s dogma’, omitting the carry-over value of the means of production, falling into apparent contradiction. However, by posing the problem of the influence of capital and the means of production on the process of price formation, Ricardo deduces one of the basic contradictions of labour

¹⁸ **Рикардо, Д.**, Сочинения, т. V, Москва, Госполитиздат, 1955, с. 263.

theory, which Marx later tried to resolve by declaring that natural price is ‘a transformed market form of value’ as a consequence of its distribution among capitalists resulting from their competitive struggle for a more profitable investment of capital.’¹⁹

Apart from factors such as profit, capital, monetary policy exports, and inflation, the main focus of economic analysis is the human factor. The human factor is the ground from which, on whose behalf, and for whose benefit economic processes take place and economic relations are manifested. Economic doctrines are not inferior to political ones in this case either. The manifestation of economic relations with the other fundamental constitutional relations, the fruit of the political constitution, can also be seen through the prism of the manifestation of principles. The constitutionally enshrined principle of sovereignty manifests itself through the familiar triad that the citizen is the source, expresser, and beneficiary of sovereignty, just as capitalist constitutional principles (most often the principle of free enterprise) dictate that economic relations are derived from, exercised on behalf of and for the benefit of the individual and the society in which he lives.

However, human rights and their bearers, as fundamental factors in economic relations, have been examined rather ambiguously by economic thinkers.

For example, the protectionist policies introduced through increased tariffs and aimed at protecting meat producers (the human factor) end up distorting the market and harming consumers, government revenues, the economy as a whole, and harming producers themselves. In this sense, D. Ricardo assumes that even at the cost of cutting labour (again, the human factor), international trade can be freed from protectionist levels of import tariffs. In the end, even with job losses, the economic advantages in specific cases would completely and justifiably outweigh the apparent benefits of job retention, which in the medium and long term would prove more favourable to citizens (the human factor).

Driven by the limitation of resources and the poverty that can result from increased consumption, Thomas Robert Malthus expressed a rather

¹⁹ **Бекярова, К., Боян Велев, Иван Пипев.** Икономически теории. Икономическата мисъл от древността до наши дни. София, Хермес, 2015, с. 203.

inhuman and utopian view that the human population should be held within resource limits, i.e., at such levels that could be fed by the land. In analogy to the animal and plant world in which population is regulated, he assumes that this is also applicable to man. He identifies various groups of limiters that may contribute in a natural or man-made way to limiting the human population in order to feed it. Such limiters, according to him, can be wars, epidemics, abstinence, etc. Malthus's theory does not take into account the development of technology in the process of feeding the population, and to a large extent human dignity and rights. In this sense, Malthus's theory cannot be considered humane, especially as far as limiting birth rates (human reproduction) is concerned, and in this sense it is utopian. Robert Malthus in his major work *An Essay on the Principle of Population* gives the example of China, concluding that it would be impossible to feed its population. The example of China today shows that restrictive measures in terms of fertility do not have a positive effect on the economy – an ageing population that does not create the public good in the volume required for development and a deepening of social and migratory processes.

Malthus's theory of 'population' is based on the fact that a population is dependent on its environment and the means of subsistence it offers. On this basis, he concludes that population increases in an environment rich in resources until the limit is reached at which fertility should be restricted. Limiting fertility to the levels of subsistence possibilities is associated with external influence or restraint. In its genesis, Malthus's theory is based on his understanding that the human species reproduces in a geometric progression and food resources increase in an arithmetic progression, which leads to what he sees as the necessity to limit the human population to the levels possible for sustenance.

'Population, when unchecked, increases in a geometrical ratio. Subsistence increases only in an arithmetical ratio. A slight acquaintance with numbers will shew the immensity of the first power in comparison of the second.'²⁰

²⁰ **Malthus, T.** *An Essay on the Principle of Population*, London, printed for J. Johnson, in St. Paul's Church-Yard, 1798, electronic scholarly publishing, <http://www.esp.org>, 1998, p. 4

‘But to make the argument more general and less interrupted by the partial views of emigration, let us take the whole earth, instead of one spot, and suppose that the restraints to population were universally removed. If the subsistence for man that the earth affords was to be increased every twenty-five years by a quantity equal to what the whole world at present produces, this would allow the power of production in the earth to be absolutely unlimited, and its ratio of increase much greater than we can conceive that any possible exertions of mankind could make it. Taking the population of the world at any number, a thousand million, for instance, the human species would increase in the ratio of – 1, 2, 4, 8, 16, 32, 64, 128, 256, 512, etc. and subsistence as – 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, etc. In two centuries and a quarter, the population would be to the means of subsistence as 512 to 10: in three centuries as 4096 to 13, and in two thousand years the difference would be almost incalculable, though the produce in that time would have increased to an immense extent. No limits whatever are placed to the productions of the earth; they may increase for ever and be greater than any assignable quantity. yet still the power of population being a power of a superior order, the increase of the human species can only be kept commensurate to the increase of the means of subsistence by the constant operation of the strong law of necessity acting as a check upon the greater power.’²¹

The satisfaction of human needs is at the heart of economic relations. In this sense, although under a general definition a strict dividing line is drawn between the social function of the state (spending to help the socially disadvantaged) and the creation of an economic climate, again by the state (generating resources and increasing welfare), it cannot be denied that economic relations are built on the concept of sociality insofar as it correlates with the idea of the common good. Prioritizing either concept does not preclude the other from operating and does not actually change global economic conditions. The prioritisation of either concept is directly related to the construction of a balanced budget, a deficit budget, or a surplus budget. In each case, each of the concepts, combined with specific public planning of resources, can play its part in having a positive effect on the economy, and hence on society, respectively contributing to

²¹ Ibid, p. 8

the common good. The common good, writes Mario Lozano, is a value judgment imposed on society through a legal construction by whoever holds the power.²² It is the actions expressed through power and aimed at satisfying the common good that can be subordinated to one degree or another to particular actions (policies) that stimulate economic activity. Separate economic concepts could heal and stimulate economic relations, the basis of which will always be John Locke's idea that the common good consists of the guarantee of private property.

III. THE EVOLUTION OF ECONOMIC AND POLITICAL UNITY DETERMINED THROUGH THE CONSTITUTIONAL PRINCIPLES.

The concept of the common good as a fundamental constitutionally established value is both political and economic in nature.

The second law, formulated by the classical liberal economist Jean-Baptiste Say, proclaims that individual well-being is conditional on the well-being of all together. On this basis, we can assume that even if individual well-being leads the way, it is inevitably determined by total wealth.²³ Thus, in the context of enhancing mutual well-being, Say opposes protectionist policies in the importation of goods, which he regards as a poor stimulus to domestic consumption since foreign goods are exchanged for goods that are the product of national labour. Guided by the idea of increasing the common good, Say believed that all production and consumption should be stimulated, and there would be no risk of overproduction insofar as free pricing would correct the scale of production.

²² **Марно Лозано**, Големите юридически системи. София Изток-Запад, 2018, с. 428.

²³ Say's thesis should be considered in the context of the democratic state. It would not hold true for totalitarian or oligarchic societies where access to the means of production is granted to a certain circle of individuals, which reflects on the distribution of wealth, the concentration of capital and the dictates of wages. All this leads to a distortion of the market, removing the economy from its natural environment of development and placing it in an artificial, highly regulated one, leading to social injustice.

The scientific fate of Say's law is generally considered to be controversial. After more than a century of its dominance, J. M. Keynes, provoked by the Great Depression, 'abrogated' its unconditional validity concerning periodic crises of overproduction. Their inevitability in free market economies is the living refutation of Keynes' Law. However, as to the problem of permanent stagnation, or indeed the problem which Say principally treats – namely, whether the capitalist market economy is capable of creating its own market and absorbing the permanent growth of production, and whether market economy has any inherent capacity for gradual development at all without leaving its limits – on this fundamental question Keynes is incorrectly silent, while Say's Law and its aftermath, despite the prophecies, provide an affirmative answer!²⁴

The accumulation of wealth in society as a prerequisite for the creation and increase of individual wealth is also highlighted by Nassau William Senior.

- N. W. Senior presents political economy as a science primarily of the category of wealth, and studies its nature, production, and distribution in society. He assumes that 1) every man desires to obtain additional wealth with as little sacrifice as possible; 2) the population of the world is limited by fear of a deficiency of those articles of wealth which the habits of the individuals of each class of its inhabitants lead them to require; 3) though, with every increase of the labour bestowed, the aggregate return is increased, the increase of the return is not in proportion to the increase of the labour; (4) the powers of labour, and of the other instruments which produce wealth, may be indefinitely increased by using their products as the means of further production. This is a basic fact before which all other conclusions and generalizations are simply an illusion.²⁵

Despite the imperfections in the views held by economists, the same have, over the years, found normative regulation, including constitutional, which has directed economic processes in accordance with the direction of trends in the time in which these ideas developed.

²⁴ **Бекярова, К., Боян Велев, Иван Пипев.** Икономически теории. Икономическата мисъл от древността до наши дни. София, Хермес, 2015, с. 269.

²⁵ Цит. съч., с. 283.

Many authors summarise the views of lawyers and economists on issues concerning both fields of knowledge, many of them introducing different concepts in the study of social relations common to both sciences.

Tony Prosser summarises the concepts in the different perceptions of the widespread notion of ‘economic constitution’.²⁶

The economic constitution is part of the basic consensus on the common values that the constitution should protect.

In this sense, constitutionalism is intrinsically linked to the development of economic relations, on the one hand through the development of production, on the other through the discovery of new prospects in the era of digitalization.

Mario Lozano²⁷ assumes that the fundamental laws created in Britain are the progenitors of a new era in political-economic relations aimed at limiting absolute monarchical power. It is this conceptually philosophical and conceptually realised platform that the legal world at large calls ‘constitutionalism’. At the same time, by opposing and combining common law and statute law, ways are sought to meet the new realities dictated primarily by evolving economic processes. The era of the rise of industrialization not only questioned feudal orders, but also imposed the objective necessity of changing the economic environment in which the concept of feudalism was absent.

Roger Osborne points out that the English Revolution was an excruciatingly long but ultimately successful attempt by Parliament to rid the country of absolute monarchy, and to end Catholicism’s covert intentions to take over England. It lasted from 1642, when the Civil War broke out, until the signing of the Bill of Rights in 1689 and the passing of the Act of Succession in 1701. The roots of the conflict have been variously interpreted, but essentially it is associated with the refusal of the kings of the Stuart dynasty, in particular Charles I, to accept the role of the monarch as servant of the state. Both Charles I and his father, James I, behaved as absolute monarchs, not understanding that this role could

²⁶ **Prosser, T.** The economic constitution. Oxford university press, 2014.

²⁷ See: **Лозано, М.**, Големите юридически системи. Въведение в европейското и извъневропейското. София, Изток-Запад, 2018, с. 80.

only be fulfilled if the monarch agreed to personally personify the state, however paradoxical this might seem.

After a series of conflicts between the King and Parliament, a civil war broke out, resulting in Charles I being dethroned, convicted of treason, and executed on the scaffold in central London. The most amazing element of the English Civil War is that it was fought to preserve or restore old traditions. The fact is that both sides in the Civil War emphatically invoked the old tradition, each justifying its own cause. The Royalists believed that the challenge to the monarchy destroyed the long-cherished idea of divine order, while the Parliamentarians insisted on restoring the old rights which English common law granted them and which the King and his predecessors had brought to a humiliating decline.²⁸

Following the execution of Charles I, England was ruled by Parliament for over 10 years – a period in which England is assumed to have ceased to be a monarchy, and what is known as the English Republic was established, the period of republican rule being called the ‘interregnum’ and lasting until 1660, including the Protectorate period associated with the dictatorship of Oliver Cromwell.

Targeted societal changes are clearly linked to the existence of new economic realities and society’s desire to accumulate wealth. The accumulation of wealth should not be burdened by repression of the state, which is implicit in the understanding of the next evolutionary stage of democratic civilizational development – liberal constitutionalism. Here, too, the role of economic welfare is strongly advocated.

Modern constitutionalism, writes G. Bliznashki, is based on the distinction between civil society on the one hand and the political state on the other. This differentiation is a *conditio sine qua non* for human self-improvement in the modern era. In the feudal age, there is a fusion of power and property, and supreme authority functions as patrimonial rule resting on personal dependence. At the same time, no distinction is made between private and public spheres due to the corporatist organisation

²⁸ **Озбърн, Р.** Цивилизацията. Новата история на западния свят. София, Прозорец, 2009, с. 80, цитиран от **Близнашки, Г.** Общо учение за конституцията. София, УИ „Св. Кл. Охридски“, 2019, с. 171.

of collective interests. The overcoming of feudalism, which is based on natural exchange, is the result of the expansion of commodity-money relations and the extension of the scope of private property. Put differently, the development of the market economy decomposes and destroys feudalism.²⁹

The development of constitutionalism is associated not only with the exercise of public power but also with the development of rights – civil (personal), cultural, social, and economic. Constitutionalism is confronted with its basic function, through the prism of the principle of legality, to safeguard and protect fundamental human rights and interests, of which economic rights and interests are an integral part. The development of democracy and constitutionalism does not turn its back on the rights that have been won so far, in particular economic rights, but seeks to consolidate them. As Karl Marx accepts, ‘Democracy treats all other forms of government as its old covenant. In democracy, man does not exist for law’s sake, law exists for man’s sake; it is human existence, whereas for the others man is a legal existence.’³⁰

The development of constitutionalism aims neither to destroy nor to limit the capitalist economic system. In his article *The Crisis of Democracy* Otto Bauer writes ‘Democracy is born out of the class struggles in capitalist society. It was born in the context of the capitalist social order. Capitalism survives in this society.’ There is no reorganisation or restructuring of either property and its holder, or of capitalism’s general idea of realising the greatest possible profit in the face of scarce resources.

Under liberal constitutionalism, the individual is free to realise his economic initiative both through protected liberty and through the absence of obstacles to the achievement of goals and through the possibility of choice in the achievement of goals.

Protected economic freedom is reduced to state protection and the creation of guarantees for the existence of economic democracy. This protection aims to create the conditions for economically active citizens

²⁹ **Близнашки, Г.** *Общо учение за конституцията*. София, УИ „Св. Кл. Охридски“, 2019, с. 203.

³⁰ **Bryce, J.** *Modern Democracies*, Vol. 1. New York, Macmillan, 1921, p. 4.

to carry out their economic intentions, the condition here being that they receive protection from the state as the weaker party in relations with it. What is also necessary for an economically protective environment is the establishment of rules on the one hand to protect the economically weaker actor from the economically stronger actor, and on the other hand – the creation of conditions that preclude opposition between economic actors of different strengths.

The element of choice in economic freedom should be understood as the possibility of performing economic activities in different spheres, and also as the choice of methods of performing economic activities within the same sphere.

These dimensions of economic democracy are possible in an environment where there are no obstacles to the performance of economic activity. Thomas Hobbes's understanding of freedom, that it consists in the absence of obstacles, should not be applied literally, because this borders on anarchy, and such a social organisation is unthinkable when we have the affirmation and protection of human rights as a starting point. Obstacles should be considered in the context of the free choice of economic activity without prejudice to other non-economic rights, the possibility of developing, modernising, clustering and segmenting economic activity, and the absence of an obligation to engage in economic activity if the economic operator is unwilling.

Viewed through negative and positive dimensions, economic freedom can be outlined through Clinton Rossiter's four concepts of freedom³¹, defined as independence, privacy, power, and opportunity; and according to Giovanni Sartori, by 'power' Rossiter means 'ability' in the sense of skill, thus the dimensions become five – independence, privacy, ability, opportunity, and power. According to Rossiter, independence and solitude define negative freedom, while power and opportunity define positive freedom. In this context, independence can be assumed to represent a state in which economic agents are placed under minimal external constraints,

³¹ **Konvitz, M., Clinton Rossiter.** Patterns of Liberty – In: Aspects of Liberty, 16–18, цитирано от **Сартори Дж.**, Теория на демокрацията. Класически проблеми. Книга 2. София, Център за изследване на демокрацията, 1992, 72–73.

and privacy as autonomy in decision-making and the achievement of economic intentions. Rossiter concludes that 'The emphasis of classical liberalism is on the negative aspects of freedom. Freedom is thought of only as a state of independence and privacy. But this is precisely one of the aspects of classical liberalism that prevents it from serving us (if it has ever been able to serve us at all) as a perfectly adequate instrument for defining the place of the free man in a free society.'

Sartori points out that the derived concepts are in a relation between premise and effect and therefore a procedural relation.³²

The fundamental prerequisites for political freedom to exist in society by no means define it as dominant and more significant than economic freedom. Many examples could be given in which economic processes have reshaped social relations. The desire of the individual economic agent and technological progress often leave the regulatory base unprepared to meet new economic challenges. The expansion of economic relations is the catalyst for change in the political environment. The reshaping of the political environment dictated by economic preconditions and realities takes place in order to extract the maximum good for society and the individual.

To the extent that there is a prevailing understanding that there cannot be a domination of any kind of freedom, some identify political freedom as the basis without which other freedoms cannot exist.

Political freedom is by no means the only kind of freedom, nor is it necessarily the one to be valued most highly. But as far as procedure is concerned, it is the initial one, since it is a necessary condition for all other freedoms. Therefore, to speak of 'independence from' as an insufficient concept of freedom, as we are prone to do, is simply wrong. Taken individually, the other freedoms are equally insufficient. Full conformity is given by the whole series, and by the whole series arranged in a particular order. It is not enough for our minds to be free if our tongues are not. The ability to govern our own lives would make very little sense if we were prevented from doing so. How could the so-called positive freedoms be sufficient if an

³² **Сартори Дж.**, Теория на демокрацията. Класически проблеми. Книга 2. София, Център за изследване на демокрацията, 1992, с. 73.

overbearing master restricted their unfolding? To assert that negative liberty is insufficient is to assert the obvious, but not to assert that we need ‘freedom *from*’ in order to achieve ‘freedom *to*’ is to miss the point.³³

The freedom of the individual and civil society from state power is not absolute. Under modern limited government and the principle of the rule of law, everyone’s liberty must meet certain conditions which are common limits for all fundamental rights and for liberty in general.

From a formal legal point of view, freedom, even when it expresses natural rights in civil society, is not absolute and its minimum limits are two. First and foremost, the requirement of compliance with the law, understood in its broad sense as the body of applicable law, applies to all legal subjects. In this sense, the provision of Article 58(1) of the Constitution of the Republic of Bulgaria, although the text explicitly mentions the basic duty of citizens to respect only the Constitution and the laws. The principle of the rule of law implies the submission of all, both the State and officials, and citizens, to the laws. This understanding is reflected in the ideas of Montesquieu, Rousseau, the French Enlightenment, the Declaration of the Rights of Man and of the Citizen of 1789 and 1793, and later in German legal doctrine through the construction of the rule of law. In the United States, it is grounded in the thought of J. Adams and J. Madison as a prerequisite for the principle of the rule of law, whose antipode is arbitrariness or the domination of some people over others (rule of men) and over laws.

Secondly, as a general limit of rights and freedom in the course of civilization, the requirement has emerged for respect for the rights of other members of society. In the spirit of the Christian-Jewish tradition, and also in the teachings of I. Kant, the condition emerges of not doing to others what you do not wish to be done to you.

Due to the multi-layered and multi-component nature of social freedom, in civil society we can distinguish at least three levels of freedom, which in their interaction determine the realisation of fundamental rights. In the internal-psychological plane, the individual himself sets the limits of freedom. Within the nation-state, the Constitution, legislation, and autonomous legal

³³ Цит. съч., с. 74.

regulation create legal guarantees of freedom by regulating and establishing the rules in civil society. Internationally, international human rights covenants create international guarantees of rights for states and nations as members of the international community. The primacy of modern international law, recognized by the democratic community of states governed by the rule of law, establishes common standards in the area of fundamental rights that should be respected in national law.³⁴

The rule of law is the necessary condition for the realisation of the individual within a particular level and for a legitimate and protected transition and relationship between levels. The rule of law is the necessary condition for the democratic development of all social relations, including economic relations.

The economy as a driving force of social relations and the environment in which it develops in the individual sovereign state, created by the legal framework and directly related to the principle of the rule of law is the same strong driving force in inter-state relations. There is an evident economic aspect to the establishment of the latest interstate entity on the old continent, the European Union. The initial steps in the creation of the EU involved the establishment of three communities with a distinctly economic purpose of interstate cooperation – the European Coal and Steel Community, the European Economic Community, and the European Atomic Energy Community. The creation of the three communities formed the European Economic Community (EEC). The Communities were created by treaties concluded between states, which EU law calls founding treaties, and which constitute the regulatory basis for cooperation and are an expression of the principle of the rule of law and integration.

Jean Monnet, writes Atanas Semov, proposes a fundamentally different approach: not megalomaniac federalist projects and vain hopes, not international treaties, which are always the first casualty of war, but a gradual and evolutionary unification, entirely in the economy – but through a new type of legal instruments (supranational), which should start from a small but important area, and if successful – expand gradually.

³⁴ Авторски колектив, Основни права на човека. София, Юриспрес, УИ „Св. Климент Охридски“, 2002, 81–83.

In just two pages, Monnet lays out his ingenious and simple idea: that the mining and processing of coal and steel in ‘France, Germany and the other acceding countries’ be placed under a common national leadership – thus laying the foundations for economic convergence between them, and making a new war virtually impossible: none of the participating countries can now produce arms without the decision of the new Supreme Authority, and the engineering and energy industries depend entirely on coal and steel, also under the authority of the Supreme Authority.³⁵

The subsequent steps of the creation of the EU involved building on the already established basis for economic cooperation and broadening integration. The Maastricht Treaty (in force as of 01.11.1993), representing the second major revision of the above-mentioned founding treaties in the construction of the EU, introduced the integration process in economic relations by creating an economic and monetary union with a common currency.

Economic relations can exist and sustainably develop in an enabling environment that, in addition to a relevant economic legal framework, requires the creation of a peripheral, in many cases non-economic environment that supports the existence of the economic one. In this context, the Maastricht Treaty, in addition to creating an economic and monetary union, extends the enabling environment by creating a favourable non-economic sphere for integration. The Maastricht Treaty created the European Union, and the union of the European Economic Community evolved into the European Community (EC), which incorporated the economic and political spheres of the integration process.

The integration process is dependent on the manifestation of general integration principles that correspond to the constitutional ones. It is important in this case that the constitutional principles operate equally strongly so that the development of a particular area does not lag behind the others, which would frustrate the achievement of objectives.

The complementarity of constitutional principles, which place the political principle in close connection with the principles of the

³⁵ **Семов, А.**, Най-важното за правото на ЕС. Наръчник. София, Институт по европейско право, 2021, с. 6.

functioning of economic and financial relations, is beyond any doubt. The interdependence of the principles, despite their seemingly disparate nature, aimed at the promotion of different assets, have the same root, which is why they simultaneously manifest themselves independently of the sphere and nature of human relations. Their common root is none other than the satisfaction of the needs of the individual. We could not separate the political origin from the economic, cultural, or social process, nor could we assume that the economic, cultural, and social pursuit of progress would have a significant effect on and reshape the political course. The understanding of a constitution of private and public law justifies the simultaneous manifestation of the individual principles and their interrelationship, in which each principle draws its justification from the others; otherwise, its full manifestation would be impossible.³⁶

The separation of powers,³⁷ popular sovereignty, the rule of law³⁸, the welfare³⁹ state, and free enterprise are the principles⁴⁰ that form the framework of economic and financial relations.⁴¹

³⁶ See: **Бойчев Г.** *Правова държава. Философски аспекти.* София, Юриспрес, УИ „Св. Кл. Охридски“, 2003, с. 126.

³⁷ For more on the principle of separation of power, see **Радев Д.** *Принципът за разделение на властите.* София, Лик, 2002.

³⁸ For more on the principle of rule of law, see **Бойчев Г.** *Правова държава философски аспекти.* София, Юриспрес, УИ „Св. Кл. Охридски“, 2003.

³⁹ For more for the principle of the social state, see **Шамов М.** *Социалната държава,* София, СУ „Кл. Охридски“, 2023.

⁴⁰ For more on the philosophical content of the principals of law, see **Маринова С.** *Принципите на правото.* София, УИ „Стопанство“, 2011.

⁴¹ For more on financial relations in public institutions, see: **Михайлова-Големинова С.** *Финансови правни отношения в системата на публичните средства от европейските структурни и инвестиционни фондове.* София, Сиела, 2017, с. 276; също така **Mihaylova-Goleminova, S.** *Challenges Facing Member States and Candidate Countries of the European Union in the Field of Taxation.* Sofia, Ciela, 2018; **Mihailova-Goleminova, S., Desislava Kalcheva.** *Local government finance and taxation in selected countries.* Wojciech Gonet and Barttomiej Suhodolski, University of Siedlce, 2024, 23–40; **Kalcheva D.** *How to increase local revenue in Bulgaria – mission im(possible).* // *Review of Economic and Business Studies.* Volume 15, 2022, No. 1, 101–121; **Kalcheva D.** *The Debt of Municipalities – Threat or Opportunity.* // *Economics and Management,* Volume XVII, 2020, No. 1, 58–67.

These principles play a fundamental role in determining the functioning of the different parts of the otherwise unified constitutional system.

In this sense, Dimitar Radev defines that as a mechanism the separation of powers is an orderly, state-established and legally protected system of power relations, which are regulated by the supreme legal act – the Constitution. Each of the elements of this system fulfils the purpose defined by the constitution. This purpose relates to the preservation of society and the guarantee of law. The mechanism organises state life and subjects it to common legally established rules. The system acts as a single mechanism because each of the elements has its own competence, strictly regulated.⁴²

The principle of the rule of law is fundamental to every sphere of life. It is a guarantee for peace and understanding in society. Rule of law provides the free political platform necessary for society to participate in every sphere of social life, of which the economic and financial environment is an immanent part. It is through the rule of law that citizens can express their supreme will and objectify it in law. The law, in turn, serves as an instrument of civil society through which it can subordinate all state power. The law thus guarantees the supremacy and independence of civil society vis-à-vis the will of the state.

Under the rule of law, the degree of lawfulness of society determines the degree of legality. This is the legality guaranteed by the rule of law. The state of legality, including with regard to the activities of administrative bodies, corresponds to the state of the rule of law. On this basis and in this sense, the rule of law is a state of legality. It is a state not of any lawfulness but of lawfulness constituting an element of the lawfulness of society.⁴³

As for the social character of the state, the solution to this problem is also conditioned by the state of economic relations in civil society. The pace of development of the social character of the state will be determined to a large extent by the state from which society emerges. All

⁴² See **Радев Д.**, Разделението на властите в модерната държава. София, УИ „Св. Кл. Охридски“, 1994, р. 53.

⁴³ See **Бойчев Г.**, Правова държава философски аспекти. София, Юриспрес, УИ „Св. Кл. Охридски“, 2003, с. 135.

this means that objective conditions today determine the necessity of the manifestation of the state as liberal-social. In perspective, the more the economic possibilities of civil society improve as a result of the conditions created by the liberal-social state itself, the more favourable conditions will be created for the strengthening of its social character. Thus, a gradual transition from a liberal-social to a social-liberal state will be possible.⁴⁴

Resourcing of public policies is carried out by the community. In this plan, the community manifests itself as a resource provider and as a resource consumer. As a provider, the community accumulates financial resources through the public economic sector, through taxes and personal contributions. The burden of financial resource accumulation falls on income withdrawal through direct and indirect taxes.⁴⁵

We can assume that the principles manifested in economic and financial relations are the same principles that form the structure of the entire legal system, because they reflect the values of society and are aimed at satisfying its needs.

⁴⁴ Цит. съч., с. 128.

⁴⁵ Виж **Шамов М.** Социалната държава. София, СУ „Св. Кл. Охридски“, 2023, 125–126.

CHAPTER 17:

CONSTITUTIONAL FOUNDATIONS OF CORPORATE AND FINANCIAL LAW

Orlin Kolev

ABSTRACT

This chapter examines the constitutional foundations of corporate and financial law. It examines the basic principles that determine the functioning of the economic system. It also considers the relationship of the various constitutionally established systems and their interaction with the corporate and financial systems. The main systems that indirectly influence the economic environment are identified, and the impact of social and political systems on the corporate and financial environment is considered. The chapter examines the institutions of direct democracy as a possible mechanism for influencing economic processes. It also examines education as one of the main systems that could have a long-term impact on economic activity and economic processes, determined mainly by corporate and financial law. The key institutes having an immediate impact on the corporate and financial system are reviewed, with attention to the economic elements of public law such as tax setting and financial control in general, and ownership as the main mechanism driving economic activity.

KEY WORDS

economic system,
social system, political
system, economic
principles, direct
democracy and impact
on economic system,
education and impact
on economic system,
taxes, property,
financial control.

I. INTRODUCTION

The Constitution, as the main law governing all fundamental social relations, is expected to provide the basis for the economic system. The economic system, in terms of its constitutional foundation, can be examined from different angles. It can be viewed through the prism of human rights and the equality of citizens before the law and the related right to freely carry out their economic activities, through the forms of association for the achievement of economic goals in a competitive environment, through the prism of the form of state government and the related constitutional requirements for the development of regions, where the state creates conditions for a balanced development of the different regions of the country and supports territorial authorities and activities through financial, credit and investment policies.

II. THE ABSTRACT SEGMENTATION IN THE UNITY OF THE CONSTITUTIONAL FOUNDATION

Economic relations and processes can also be viewed through the prism of state participation and membership in international organisations and the associated potential opportunities and constraints that may arise from membership. The above starting points for the analysis and study of economic and financial constitutional foundations reveal the interrelationship of the different aspects of the environment in which relations between citizens are realised. Although rights, and in this sense relations, can be conditionally separated into different groups – economic, political, social, cultural, regional, and community – mainly for the purpose of clarifying their nature, they cannot be isolated from one another, since they are all realised to satisfy the needs of the same medium – the citizen. In this context, bearing the characteristics of a normative act, the Constitution has its own internal structure with synchronicity between the different constitutional norms. They follow their formal logic and continuity. In view of its internal synchronization, precluding contradiction between the individual constitutional norms and although the norms regulate separate constitutional institutes, what is sought is their unified

manifestation. Thus, an example of synchronicity between the individual constitutional norms concerning human rights and the satisfaction of the interests of citizens is that the law under which economic relations are implemented should, as a general rule, comply not only with the operation of the provisions directly relevant to the economic sphere but also with the operation of norms having universal effect. In this context, the operation of Article 19(2) of the Constitution should not exclude the operation of Article 6 thereof and the principle of equality proclaimed therein. The legislator should not, when adopting the relevant normative or other act binding on the addressee (a citizen or an association of citizens), allow limitations of rights or privileges in carrying out business activities (outside the limitations under Article 19(2) of the Constitution) based on race, nationality, ethnicity, gender, origin, religion, education, beliefs, political affiliation, personal and social status or property status. In continuation of the said constitutional provision, local self-government authorities, in their activities, should not allow any less favourable treatment of a person on the basis of the said characteristics than is being, has been, or would be accorded to another person in comparable similar circumstances. Nor should the law place citizens in a position of less favourable treatment, or place them at a particular disadvantage, arising from an apparently neutral provision, criterion, or practice, provided that the provision, criterion, or practice is not objectively justified in the light of the legitimate aim pursued, and the means of achieving the aim are appropriate and necessary – sparing the citizen.

Political rights can also be a starting point for meeting economic needs and the desire for economic progress. Apart from exercising the right to vote, through which citizens would determine the political representatives who would in turn implement the economic actions and reforms desired by citizens, active citizens can also directly implement their economic intentions and even bring about the desired normative changes in support of their economic intentions. Citizens could bring about a change in the regulatory framework both at national level and at local level (municipality, district, or town hall). Of course, it is important to stress here that citizens could bring about these changes insofar as they are permissible under national or Community law. Thus, for example, directly deciding on matters of local importance (municipality, district, or town hall) which the law has assigned to the competence of local self-government bodies or

district or town hall bodies are matters of local importance that do not concern the municipal budget; they do not concern the amount of local taxes and fees, nor do they affect the rules of the internal organisation and operation of the municipal council. Among the mentioned limitations we can name others found both in the Direct Citizen Participation in State and Local Government Act and in other statutory instruments of objective law and in the Constitution. In a national referendum, citizens can directly decide on issues, analogous to a local referendum, which are placed under various normative constraints arising from both laws and the Constitution. A national referendum can, in principle, deal with issues that are put forward within two main constraints – the issues should be within the competence of the National Assembly and they should be of national importance. By definition, the National Assembly, as the supreme and sole legislative body in the Republic of Bulgaria, should decide on issues of national importance. The two prerequisites ‘competence of the National Assembly’ and ‘national importance’ exclude issues in two areas that cannot be the subject of a national referendum and which do not depend on the competence of the National Assembly or are within its competence but are not of direct importance for society and the state. Matters on which the National Assembly may take a decision and which are not of national importance are matters concerning internal order and organisation, maintenance, the provision of the necessary conditions for the normal conduct of business, etc. The second group of issues relates to the fact that not all matters of national importance can be decided solely by the National Assembly. Respecting the principle of the separation of powers, the National Assembly should not interfere with the competence of the President, the Council of Ministers, and the Constitutional Court. Given the fact that these bodies also decide on matters of national importance, it is clear that matters relating to their competence cannot be the subject of a national referendum. The limitations imposed by the Direct Citizen Participation in State and Local Government Act directly in the sphere of economic relations are laid down in Article 9(2), points 2 and 3 of the DCPSLGA and concern the amount of taxes, fees and labour, social security payments and contributions; and matters of the State budget. In view of the limitation of Article 9(3) of the DCPSLGA and bearing in mind that codes and laws that regulate entirely the matter in a given area cannot be subjected to a national referendum in their entirety, a question

that opposes the introduction of the Euro currency in Bulgaria would also be inadmissible. Apart from the fact that such a question, however formulated, contravenes Article 4(3) of the Constitution, where Bulgaria's commitment to the construction and development of the European Union is a fundamental obligation and an established constitutional principle since 2005, the replacement of the national currency with the European currency, which is an obligation for the country, should inevitably be carried out through a legislative procedure. To do otherwise would be to violate the rule of law. However, the adoption of the necessary legal acts on the occasion of the introduction of the single European currency would also be contrary to Article 9(3) of the DCPSLGA, which precludes a legal institute regulating entirely the matter in a given area from being the subject of a national referendum. It is undeniable that the introduction of a currency into circulation and the effects that will be caused are matters of marked economic content, perhaps not exclusively but primarily.

Limiting the direct impact on the budget and the amount of taxes raises the question 'How can citizens directly decide on economic issues'. After all, the direct exercise of power is a manifestation of sovereignty and there should be no legitimate limits on the direct exercise of power by the people. Here, however, we are in the confines of another question fundamental to theory, the answer to which the various constitutional currents find in the grounds from which power derives, which is revealed by the meaning embodied in the terms 'constituent' and 'constituted' power. Emmanuel Joseph Sieyès assumes that the nation, as the holder of constituent power, creates the constitution, and on this basis all organs of the state act as constituted authorities whose powers are legally defined and therefore limited.¹ Relying on the understanding of constituent and constituted authority, the starting point revealing the sovereign's will as to the manner in which state power should be exercised, is reflected in the constitution. In this sense, the constitution is the objectified expression of the sovereign's will in the initial structuring of power. It is through the constitution that the sovereign (the founder of the power) determines the limits of the power that any public authority may exercise, which in turn determines its limits. Within the limits that the sovereign can establish in

¹ See Сийес, Емануел-Жозеф. Що е третото съсловие. София, Сиела, 2004, с. 76

the constitution, it is perfectly permissible and legitimate to limit itself in its desire to arbitrarily rearrange power in the future. The sovereign may perfectly legitimately delineate its jurisdiction and prescribe the conditions and order in which it may exercise power. Insofar as the sovereign has determined, in accordance with Article 1(2) of the Constitution, that state power is to be exercised equally by the people and by the authorities named in the Constitution, and has, through the Constitution, conferred the decision on a certain range of matters within the competence of state authorities alone and has limited itself by excluding its competence, the answer to the question originally posed should be sought only in relation to the preconditions and the creation of conditions for the exercise of economic activity. From the foregoing, it must be assumed that direct intervention in the financial and tax system through forms of direct democracy is limited by law, but that citizens can participate indirectly by creating the conditions for economic activity and changing the social environment in order to influence the economic environment. Citizens' capacities to define and restructure the social environment can be an extremely powerful tool in shaping the economic environment of a country. Of course, whether this will come to pass is a matter of civic and political foresight.

Some of the conditions that would have a direct bearing on the economic environment and would play a stimulating role can be found in the social role of the state. At first sight, the concept of developed economic relations does not correspond with the social commitment of the state, since, on the one hand, revenue-generating mechanisms are sought and on the other – there are costs. Increasingly, modern economic views advocate balanced spending, which in turn is seen as a potential for future revenue generation. Increasingly, modern economic thought argues that, in spite of the libertarian idea of 'less state' which dominates in recent years, the State, through its social policies, can be a powerful investor in future economic upswing. The concept of the enhanced role of the State in the formation of social capital is not limited within the borders of national states. These ideas find application in national economies as well as in community or regional or transcontinental groupings of states. These ideas in fact mark a whole philosophical current in economics called Keynesianism, named after the British economist John Maynard Keynes.

The social role of the state and the relation of social institutes regulated by the state itself in regard to economic and financial relations can be seen through the prism of individual groups and their place in, or relation to, society or through the prism of the separate system implemented in a particular environment.

The positioning of the individual system and its placement in a specific social environment, through the mechanisms of law, is in fact the starting point in Luhmann's concept of social relations in society, which also have an impact on the economic environment.

According to him, the fundamental relationship in the social world is not between the individual and society, but between the social system and its environment. It should be noted that Luhmann does not allude to any universal environment in which all social systems exist, but rather to the peculiar environment of each system. Modern society, according to Luhmann, 'is differentiated into the political subsystem and its environment, the economic subsystem² and its environment, the education system and its environment, etc.³

Luhmann's understanding of the legal system of society, through which the different systems are constructed and mutually correspond, is also subject to this context.

In his view, the legal system is not a set of institutions – legislative chambers, courts tribunals, lawyers' offices – which have a physical existence and are part of an organisational structure. Nor is it made up of all those people who are professionally engaged in the operation and administration of the law. In fact, it is not made up of people at all. They are, of course, necessary for the operation of the legal system, but *das Rechtssystem* is not related to their personal characteristics or even the roles they perform in the courts and other legal institutions. This system also does not consist of the 'organised legal practice, that is mainly practice in the courts, parliaments and also occasionally in administrative

² Tony Prosser summarises the concepts in the different perceptions of the widespread notion of economic constitution in **Prosser, T.** The economic constitution. Oxford university press, 2014.

³ **Майкъл К. Крис Торнхил.** Никлас Леман за правото и политиката. УИ „Св. Климент Охридски“, С. 2008, стр. 10; **King, M. Chris Thornhill.** Niklas Lehmann's theory of politics and law. Palgrave Macmillan, New York, 2003.

organisations which make law based on delegated powers and law firms which channel legal access to the courts. Law, for Luhmann, is not subject to physical or geographic boundaries or defined by the status of individuals (judge, solicitor, law lecturer, court usher).⁴

Law, in short, is the legal system; it is a system of communications which identifies itself as law and is able to distinguish between those communications which are part of itself and those which are not. Our use of 'legal system' then refers only to law as a system of communications, not to any other institutions. Law consists of communication and nothing but communication.⁵

A legal communication is any communication which is based on or relates to the distinction legal/illegal or lawful/unlawful. Law extends to all those communications that are understood as directly relating to the issue of legality or illegality.⁶

Considering social processes from objective reality, through the boundaries and content defined by law, Luhmann separates facts from values.

According to Luhmann, law's 'facts' are only ever 'limited facts'; they are facts, truth, or reality, only for the legal system and they cannot be conflated with values. Therefore, the accusation of corrupting law by detaching it from human concerns is simply a misinterpretation of how law, in his terms, constructs and explains its own reality and the extent of its validity.⁷

Social relations (the social role of the state) engendered by departmental groups or individuals with society also have their weight in determining the constitutional foundations of the corporate and financial environment.

In this sense, Elka Todorova notes that today's economic interpretations of social change explain modernisation through the processes and characteristics of societies themselves, but necessarily also emphasise the element of state governance. This is how the so-called state theory of modernization developed. According to it, the drive for technological development is not a natural quality of the human spirit (as assumed by Marx and Weber) but depends

⁴ Ibid, p. 45.

⁵ Ibid, p. 46.

⁶ Ibid.

⁷ Ibid, p. 49.

on the possibility for profit. The economic rationality of social and especially market actors who want and make sound investments, and the social and political systems of the state that guarantee their property rights and protect their actions, are the key prerequisites for social change and development.⁸

Part of the conditions that affect economic processes and in which citizens can directly intervene are issues related to education and science, which are fundamental elements for the development of society, including in economic terms.

An interesting view on the competition between libertarianism and Keynesianism and the opposition between education and religion is presented by Velcho Stoyanov, a professor in economy and finance at the University of National and World Economy. According to him, it is not only the market that should be in place, but the market, the state, and morality. He speaks of two factors that are contrary to our ‘reasonable spirituality’ and above all to moral and ethical values, norms, and laws, including justice, namely:

First, ultra-liberalism, insofar as it went beyond certain limits of deregulatory freedom and subordinated ethics and morality, including justice, to efficiency, i.e., to individual egoistic interests.

Second, the proposed and expected ‘energy economy subject to the laws of thermodynamics’, i.e., the laws of nature or natural necessity, which inevitably limits the spiritual freedom of man, of the people. However, when we speak of freedom, let us not forget what ancient authors have already established – ‘the freedom of each extends to the point where the freedom of others is violated’; only the Absolute, the Absolute Spirit, the Creator, the Almighty, has absolute freedom.

Absolute freedom of the market, and therefore of man, is contrary to religion; perhaps this is why Ayn Rand categorically rejected faith, i.e., religion as superfluous, unjustified, and irrational, while treating the market as the expression of complete, total and absolutized rationality. But is not morality a manifestation of rationality, since it does not exist in animals? Their behaviour and actions are guided solely by their instincts, connected with natural necessity.

⁸ **Тодорова, Е.** Поглед към социология на модерното общество, издателски комплекс. София, УИ „Стопанство“, 2012, стр. 166.

It is no coincidence that it is religion (or faith) that has tried to establish and maintain certain moral-spiritual values, norms, and laws; it is no coincidence that Kant justifies the necessity of a ‘moral imperative.’ However, these are in crisis, as is religion itself, conditioned mainly by the freedom of the market and the absolutisation of money, as Pope Benedict XVI has convincingly argued. Velcho Stoyanov assumes that Pope Benedict XVI is critical of ultra-liberalism, based on his statement: ‘Money and wealth become the measure of everything ..., people become commodities ..., they become alienated ..., moral destruction (or decay) occurs ..., spiritual desolation ... destruction of conscience ... the liberal market imposes its unyielding laws on all aspects of life. The whole morality of the Church, i.e., the whole spiritual and anthropological conception of Christianity, no longer finds its correspondence and understanding in today’s Western world’.⁹

Education as a social phenomenon and an important part of personal growth is perhaps the most essential element for the development of society. Since resources are limited and some of them difficult or impossible to recover, a skilful approach to their rational use will prove to be the basic prerequisite of economic and social growth. The efficient use of resources for production, including labour, has been the basis of every economic current and school from the origin of economic thought to the present day. Like any social phenomenon, education is not immune to the risk that supposed innovations in social processes may not produce the desired results.

According to Velcho Stoyanov, education and education systems have always been good mainly in developed and rich countries, and weak, of poor quality, and inefficient in developing poor countries, but every rule or principle has its exceptions.

The trouble is that the quality of education and the effectiveness of education systems are beginning to change in a negative way, both in our country and almost in the whole of the rest of the world, including the global hegemon, the USA. This happened after the ‘revolution’ and the transition from the ‘30 glorious post-war years’, during which Keynesianism was applied, resp. ‘social market economics’ and the ‘welfare state’, but

⁹ **Стоянов, В.** Пазарът – Велик социален механизъм, но и с „Велики“ недъзи. София, ИК УНСС, 2016, 255–256.

subsequently switched to libertarianism or market fundamentalism. This began initially in England under the Prime Minister known as the ‘Iron Lady’, M. Thatcher, who took office in 1979 and served two terms, and under US President R. Reagan, who assumed his presidential duties in early 1980 and also served two terms; it was during their time that the foundations were laid for ‘Reaganomics’ and ‘Thatcherism’, which meant a transition from Keynesian regulated economics to libertarianism, even to market fundamentalism. As a result, the emphasis was placed on, or moved towards:

- Idealising, absolutizing the labour market and almost deifying it, but also consciously and purposefully deforming it, both behind the scenes and officially; at the same time, the role and importance of the state began to be devalued, i.e., a striving for a maximum market and a minimum state took place; moreover, even the state began to be treated as inherent to the market and to be argued that it should be commercialised and ‘absorbed’; the famous American author, Fr. Fukuyama even doomed it to extinction, but eventually corrected himself.
- The onset of a serious crisis in the spiritual-cultural sphere, which generally led to the abandonment of the quality of education and the effectiveness of the education system and to anti-culture, as designated by P. Buchanan.
- An incredible increase in the income and wealth of the dominant minority or elite class and a decrease in that of the majority serving class, a ratio which, as we have seen, is beginning to exceed 99:1.¹⁰

Educational systems are increasingly paying attention to and incorporating interdisciplinary scientific knowledge into their curricula, as well as inclusive or retraining programmes. These approaches are widely used and identified as necessary to meet new societal needs provoked by dynamic technological developments.

Modern education systems not only allow private initiative to participate in the design of learning models financed mainly by the state, but all too often the state itself allows private initiative to provide both

¹⁰ See: **Стоянов, В.** Новият световен ред – идея и дело на тайните политически общества. София, ИК УНСС, 2017, 365–366.

traditional education at different levels and to organise and provide sector-specific education for the needs of the economy.

Investing in education leads to the discovery of another important factor for the economy and capital – improving the skills of workers. Keeping employee skills high will impact competitiveness by giving, mutually, the worker and employer the advantage of adequately meeting the needs of a rapidly evolving and highly technological market. A high level of skills can become a major component in the value added to a product – good or service.

In order to make any expenditure, a person assesses its appropriateness in advance. This is even truer for private investment in education, i.e., the expenditure of an individual or his/her family to obtain further education. In such assessments, the analysis of the interrelationship between educational attainment and the corresponding wage is carried out on the basis of different variations of work experience and production experience.¹¹

III. SOCIAL CAPITAL. FREE ENTERPRISE. PROPERTY. TAXATION.

Investment in human capital can be seen as a conscious step on the one hand, and a necessary one on the other, to maintain employment levels. Investment in human capital should not be seen solely as an individual's investment in improving his or her personal competitiveness. Considered in this sense, it narrows and distorts the objective need for skills upgrading. The improvement of qualifications and competitiveness in the most isolated case affects the interest of both employee and employer. In the general case, the process is more complex, involving the worker's family members, and in some cases reflecting on other employees.

In a more generalized view, the appropriateness of a firm's investment in human capital is considered in two aspects. First, investment in human capital generally provides an increase in the marginal product of the worker concerned. Second, the firm's physical capital becomes more productive

¹¹ Дулевси Л. и колектив. Икономика на труда. София, ИК УНСС, 2016, стр. 118

as the workers' skill level increases, especially when it lags behind its level and requirements.¹²

But in addition to the individuals who are included in the production process, at every historical moment in the functioning of the capitalist production process there are individuals who are outside it – those who are waiting to be included in it for the first time (adolescents, as well as those who have decided to start working for the first time – for example, after the Second World War women in the USA entered the labour market field *en masse*), and those who have been included but are currently outside it (the unemployed). Increasing their employability must be either at the expense of the individuals themselves and their communities (families, friends, and others) or at the expense of public finances. When it is at the expense of public finances, the public authorities, whether at a national or municipal level, organise the process of accumulating knowledge and experience as a reproductive process, and then it is indeed necessary to talk about investment because it is a question of accumulating a complex of resources throughout the national community. These resources are the total capacity of the people, they represent national wealth that can be involved in the capitalist reproductive process to fulfil the goals of the nation.¹³

However, when individuals (or their families) pay for their own education, qualifications, and skills, then the question is posed differently. Individuals pay for the service of educating themselves, just as they pay a tailor to make them a suit. And just as paying a tailor is not an investment but an outlay of their personal income, the money they put into education is not an investment but also an outlay of their income. The money invested in education can also be recouped if the individual succeeds in the labour market or becomes an entrepreneur himself and organises a capitalist production process. However, if the individual fails to realise himself in the labour market, these funds will not have their return and will remain as a cost. It is this point that is 'omitted' in the

¹² Ibid, p. 125.

¹³ **Ракаджийска Т., Мариета Христова, Димитър Сивков.** Социалният капитал. София, ИК УНСС, 2017, стр. 49; also, for more on the social state see: **Шамов М.** Социалната държава, София, СУ „Кл. Охридски“, 2023.

concept of human capital and the analysis is relegated to the ideologeme that individuals need to invest in their human capital.¹⁴

In a context of scarcity of material and cultural resources¹⁵ social capital becomes particularly valuable. It is easily converted into economic not only because it reduces transaction costs. Social capital enables the transit of individual efforts through the regulated activities of various formalised (institutionalised) and informal communities and thus shortens the conversion time. It becomes an extremely valuable resource in today's dynamic and complex postmodern era, when the application of information technology to everyday life not only changes the notion of space, but also creates the possibility of transcending the spatial (including community) boundaries familiar from Modernity. If within Modernity 'cultural intimacy' was reified (objectified) mainly among spatially delimited personal networks, now it is possible in any virtual space, i.e., personal networks are not really faced with any spatial and temporal constraints, which is what makes the problem of social capital so relevant.¹⁶

¹⁴ **Ракаджийска Т., Мариета Христова, Димитър Сивков.** Социалният капитал. София, ИК УНСС, 2017, стр. 49.

¹⁵ For more on the effective and sustainable use of the resources of the regions, see: **Патарчанов П.** Географски тенденции в пространствено-териториалното развитие на централните и периферните райони в България. – В: Сборник доклади от научно-практическа конференция с международно участие "Проблемът "център – периферия" – нов поглед, нова политика". В. Търново, съставител Н. Янкова, под редакция на В. Аличкова, София, Горекс Прес, 1998, 35–42. Също така **Patarchanov, P.** Regions in Bulgaria. Land and people. Bulgaria 1999 – Almanac. Sofia, Sofia Press Agency, 1999, 113–126. Също така **Патарчанов П.** Подходи и инструменти в стратегиите за регионално развитие. „География и Туризм“ – В: Сборник доклади от научна конференция – Китев 2000. София, УИ „Св. Климент Охридски“, 2002, 83–88; също така **Патарчанов П.** Актуални проблеми на организацията и управлението на териториалните ресурси в обхвата на международните инфраструктурни коридори. – В: Сборник доклади от международна научна конференция „100 години география в Софийския университет“, София, УИ „Св. Кл. Охридски“, 1998, 229–237; също така **Патарчанов П., Емилия Патарчанова.** Класификация на проблемните територии в Югозападна България. // Годишник на Софийския Университет, ГГФ, 2001, № 2, 251–262; също така **Патарчанов П.** Географски анализ на политиката за регионално развитие на индустриално депресивните райони в България. – В: Сборник статии "Основни проблеми на географското образование във ВУЗ (в контекста на регионалната политика и регионалното развитие на България). СА „Д. Ценов“, СУ „Св. Кл. Охридски“, БГД. Свищов, Академично Издателство „Ценов“, 2001, 158–168.

¹⁶ **Ракаджийска Т., Мариета Христова, Димитър Сивков.** Социалният капитал. София, ИК УНСС, 2017, 247–248.

The foundations of corporate and financial law and of the economic system in its entirety are contained in established constitutional principles that operate simultaneously, but for a particular relationship or group of relationships, the constitution allows one of the principles to be more strongly asserted.

The basic constitutional principle in the sphere of economic relations is the principle of free economic initiative, established in Article 19(1) of the Constitution.

Free enterprise implies a capitalist form of the economic system, guided by free market processes with no unfair competition and consumer protection. There is no dispute that there is no such thing as a pure market economy or an economy that is subject only to supply and demand, without any state intervention. The Bulgarian Constitution proclaims the principle of free economic initiative, which does not completely exclude state intervention. State intervention, expressed primarily through statutory frameworks for the implementation of economic activity, is aimed at protection in several directions. Consumers are protected, unfair competition is prevented and the general restriction under Article 6(2) not to restrict rights or privileges is respected. It should be pointed out that, although not spelled out in a separate provision, by way of analysis and interpretation, it should be assumed that state interference in otherwise free economic relations may extend to the protection of national security, territorial integrity, the health of the population, and to the protection of all other constitutionally recognised values. By introducing rules for the conduct of economic activity, the principle of free economic initiative is not violated; on the contrary, guarantees are created for the protection of all other constitutionally established values.

Taxation is important for corporate and financial relations between both private and public entities. In Article 60, the Bulgarian Constitution establishes one of the basic obligations for Bulgarian citizens – to pay taxes according to their income and assets. Although the provision of the constitutional text refers only to Bulgarian citizens, the obligation to pay taxes also applies to associations of citizens, i.e., commercial companies, as well as sole traders or sole trading companies, insofar as they are established by law.

Requiring citizens to pay taxes according to their income and wealth implies both the introduction of a progressive scale of taxation and the introduction of proportional (flat) taxation. The choice of the type of taxation is left by the Constitution to the National Assembly. In relation to the fulfilment of the fundamental constitutional obligation to pay taxes, the legislature has established different types of legal liability,¹⁷ depending on the act and the offence.

So far, we have addressed some constitutionally established, and some atypical of the financial and corporate environments factors that have their place and importance in shaping public¹⁸ and private financial and economic relations.

A fundamental element in economic relations, which determines the type of economic system, the degree of consumption, the type of exchange, and the burden of taxation and welfare, is property.

¹⁷ For some aspects of liability with view of economic relations, see: **Пенев, Й.** Разкриването на престъпления против кредиторите – ново предизвикателство пред полицейските оперативно-издирвателни служби, МВР в навечерието на XXI век – предизвикателствата на реформата. – В: Сборник с доклади от юбилейната научна сесия по повод 120-годишнината от създаването на МВР. София, ГорексПрес, 2000. Също така **Пенев, Й.** Противодействие на данъчните престъпления. // Бюлетин „Полиция“, ВИПОНД-МВР, 2003, № 15.

¹⁸ For financial relations in public institutions, see: **Михайлова-Големинова С.** Финансови правни отношения в системата на публичните средства от европейските структурни и инвестиционни фондове. София, Сиела, 2017, с. 276; също така **Mihaylova-Goleminova, S.** Challenges Facing Member States and Candidate Countries of the European Union in the Field of Taxation. Sofia, Ciela Publishing, 2018, p. 296; също така **Михайлова-Големинова, С., Сашо Пенев, Юрий Кучев, Атанас Симеонов, Калин Славов, Ирена Георгиева.** Проучване на практиката по финансовото управление и контрол на средствата от ЕС. – В: Предизвикателства пред финансово управление и контрол на средствата от Европейския съюз. Доклади от международна научно-приложна конференция, проведена през ноември 2016 г. в гр. София. София, УИ „Св. Кл. Охридски“, 2016, 21–64; **Mihailova-Goleminova, S., Desislava Kalcheva.** Local government finance and taxation in selected countries. Wojciech Gonet and Barttomiej Suhodolski, University of Siedlce, 2024, 23–40; **Kalcheva D.** How to increase local revenue in Bulgaria – mission impossible. // Review of Economic and Business Studies. Volume 15, 2022, No. 1, 101–121; **Kalcheva D.** The Debt of Municipalities – Threat or Opportunity. // Economics and Management, Volume XVII, 2020, No. 1, 58–67.

The constitutional legislator creates guarantees for the protection of property. Economic relations based on the exchange of property¹⁹ are subject to the basic principles applicable in both public and private law with respect for human rights.

In addition to constitutional provisions, which have direct effect, the binding case-law of the Constitutional Court (CC), as well as the case-law of the SCC and the SAC, the CJEU and the European Court of Human Rights in Strasbourg are relevant to the issues under consideration.

Central among economic rights is the right to property as one of the fundamental rights granted and guaranteed by both the Constitution and the European Convention on Human Rights and Fundamental Freedoms. On the one hand, it underpins the development of the market economy and free enterprise and serves to satisfy the material needs of citizens. On the other hand, through the possession and exercise of the right to property, conditions are created for the satisfaction of the non-material, spiritual interests of citizens and their participation in social life.²⁰ These characteristics of the right to property predetermine its importance in the economic and social life of any socio-economic system, which is why the questions of its inviolability and security are raised with particular urgency. In the following lines I will examine some of the aspects of the right to property that have been the subject of consideration in the case law of both the Bulgarian Constitutional Court and the European Court of Human Rights.

¹⁹ For contracts with property, see: **Йосифова Т.** Противопоставимост на договорите с предмет вещни права. // Право, политика, администрация, издателство на ЮЗУ „Неофит Рилски“, т. 6, 2019, № 4, 23–28; **Йосифова Т.** Действие на договора по отношение на лицата. София, Сиби, 2019.

²⁰ See: **Петров, Вл.** Правото на собственост в българското законодателство – уредба между три конституции – В: Сборник. „Двадесет години от приемането на Конституцията на Република България. Материали от научната конференция Велико Търново 3 юни 2011 г.“ София, Софи-Р, 2011, с. 59.

The concept of property under the Constitution

The Constitutional Court in a number of its decisions emphasizes that the right to property is the only complete right *in rem*²¹ – Decision No. 2 of 8.07.1993 under Case No. 12/1993,²² Decision No. 8 of 19.06.1995 under Case No. 12/95, Judgment No. 4 of 27.02.1996 in Case No. 32/96. Judgment No. 8 of 19.06.1995 under Case No. 12/95 states that the content of the right to property *‘is characterised by three main powers: possession, use and disposal. The latter contains the possibility for the owner of the property to carry out legal transactions with it, freely negotiating and determining the price and the buyer.’* The above-mentioned judgments emphasise the classical content of the property right, justified and emphasised by property law doctrine as giving full power to the holder of the right and expressed in the classical Roman triad of possession, use and disposal. Infringements of the right to property may affect each of the owner’s powers as well as his ability to defend his right²³ – in this sense, see Judgment No 20 of 17.10.1995, Judgment No 11 of 21.05.2001.

Gradually, under the influence of international legal acts, in particular the European Convention on Human Rights and Fundamental Freedoms, the Constitutional Court went beyond the traditional property law understanding of property²⁴ and in its constant practice, argued the view that the right to property, enshrined by the constitutional legislator, has a broader content than the concept of property in the property law sense in civil law – Decision No. 22 of 10.12.1996, Decision No. 3 of 4.02.1999,²⁵ Decision No. 3 of 27.04.2000. It includes, in addition to the right of ownership of things, a

²¹ See: **Сарафов, П.** Особености на собствеността като субективно вещно право. // Съвременно право, 2002, № 6, с. 32.

²² В доктрината се критикува разбирането на конституционния съд относно предназначението. Виж **Илиев, П.** Конституционноправни основи на икономическата система и собствеността в различните етапи от развитието на българския конституционализъм, 130 години български конституционализъм – проблеми и тенденции. Първи том. София, УИ „Св. Климент Охридски“, 2009, 97–148.

²³ See: **Сарафов, П.** Развитие на конституционното понятие за собствеността. // Собственост и право, 2001, № 8, с. 6.

²⁴ See: **Сарафов, П.** Развитие на конституционното понятие за собствеността. // Собственост и право, 2001, № 8, с. 5.

²⁵ See: **Сарафов, П.** Понятието „собственост“ според Конституцията. // Съвременно право, 2001, № 6, с. 13; също така **Карагьозова, М.** Основни права на човека. София, УИ „Св. Климент Охридски“, 2002, стр. 252.

number of other rights – the right of use *in rem*, the right of receivables, including from and against the state, rights in securities, shares, stakes in commercial companies, the right to a commercial enterprise (both in its entirety and the individual elements included in its content – the established clientele, acquired permissions to carry out certain business activities), the right to intellectual property, membership rights of a proprietary nature and others.¹⁹ This broad notion of property, both on a national and comparative-legal scale, is due to the fact that, on the one hand, in modern times more and more objects of a proprietary nature acquire legal protection, and, on the other hand, the powers of the holder of the property right are constantly enriched with new powers.²⁶

The interpretation of the CC is in line with what is proclaimed in the European Convention on Human Rights and Fundamental Freedoms, in particular Additional Protocol No. 1 of this Convention and the case law of the European Court of Human Rights. The concept of ‘property’ under the European Convention on Human Rights has a meaning of its own and is broader than the right to property *in rem*. This is evident from the term ‘*biens*’ (goods) used in the French text and ‘*possessions*’ in the English text of Article 1 of Protocol 1 of the Convention. These can be both existing objects and those which the party has a reasonable and legitimate expectation will come into its patrimony.²⁷ The purpose of this broad understanding of property enshrined in these international instruments is to ‘*comprehensively secure the property domain of private actors*’.²⁸ The primary criterion for the existence of a good, legally protected by the Convention, is its economic value or interest.²⁹ The next criterion is the sufficient definition of the good and the interest, i.e., the person claiming their existence must prove them. The right must also be defined in terms of the claims that can be made against it. Those claims must be real and sufficiently specific to be enforceable.³⁰

²⁶ See: Стойчев, Ст. Конституционно право. София, Сиела, 2002, с. 174.

²⁷ See: Ван Дайк, П. Г. Й. Х. Хууф. Европейската конвенция за правата на човека – теория и практика. София, Фондация „Български адвокати за правата на човека“, 2000, с. 582

²⁸ See: Сарафов, П. Понятието „собственост“ според Конституцията. // Съвременно право, 2001, № 6, с. 15.

²⁹ See: Ван Дайк, П. Г. Й. Х. Хууф, Цит. съч., с. 580.

³⁰ Цит. съч.

Article 17(1) of the Constitution stresses that the right to property is guaranteed and protected by law. The protection of private property is criminal, administrative, and civil. Criminal law declares that certain acts – violations of property – are crimes (theft, robbery, fraud, extortion, embezzlement, etc.) Civil law contains a number of provisions that concern the protection of property – these are actions *in rem* (ascertainable, delimitating, negatory, and restitutionary), as well as actions for compensation for damages (contractual and tort liability). Criminal and civil remedies are available through the courts.

The administrative remedy is provided administratively by referral to the relevant administrative authority for the removal of the infringement. **State and municipal property benefit from administrative protection.** Pursuant to Article 80(1) of the State Property Act, state property, which is possessed or held without justification, which is not used for its intended purpose or the need for which has ceased, is seized on the basis of an order of the governor of the district, based on a reasoned request by the relevant minister or head of department. Article 65 of the Municipal Property Act provides that municipal property which is possessed or held without justification, is not used for its intended purpose or the need for which has ceased, will be seized on the basis of an order of the mayor of the municipality. Private property does not enjoy such administrative protection, which is a privilege of state and municipal property only. Public and private property are subject to different legal regimes, which involve differences as regards the origin, purpose, exercise, and protection of property. Hence, we can conclude that the state and municipalities use methods of property management that are inherent to the empire they own, and therefore the two types of property, public and private, cannot be said to be equal.³¹ With regard to private property belonging to natural and legal persons, administrative protection is provided for in a few limited hypotheses – such are Article 213 et seq. In the case of private property, there are limited restrictions, such as those provided for in the Private Property Act, in relation to the possibility of appealing against development

³¹ See: **Стойчев, Ст.** Конституционно право. София, Сиела, 2002, с.178; **Са-
рафов, П.** Публичната и частната собственост като видове право на собственост. // *Правна мисъл*, 2003, № 2, 78–79.

plans and their amendments, as well as in relation to property over which ownership has been restored (agricultural land, forests, and forest land).

On the other hand, Decision No. 19 of 21 December 1993 under Case No. 11/93 and Decision No. 2 of 30 March 2000 under Case No. 2/2000 emphasize that **in the exercise of the right to private state and municipal property**, all legal entities must be on an equal footing, i.e., no privileges should be allowed to the holders of the imperium in the participation of the State in the civil turnover compared to other subjects of private law when exercising the right to **private** state and municipal property, including in the collection of their claims. This requirement is a projection of the need to ensure equal legal conditions for the participants in the exercise of the free economic initiative proclaimed by Article 19 of the Constitution. There is a functional relationship between the principle of protection of private property and the principle of free enterprise because free enterprise implies inviolability of private property. In its Decision No. 7 of 10.04.2001 under Case No. 1/2001, the CC held that in order for free economic initiative to take place, there must be legal guarantees and certainty for legal entities carrying out economic activity in accordance with Article 19(2) of the Constitution. All legal entities must be provided with the same legal conditions for carrying out economic activity. The said judgment points out that the State should not be accorded privileges, but should participate as an equal partner in a legal relationship to which it is a party. It should be precluded from unilaterally modifying the terms of a contract which it has concluded and from creating by law more favourable rules for contracts which it has already concluded since such powers would lead to uncertainty in the civil market.

Article 17(3) of the Constitution declares private property inviolable. This means a prohibition of unjustified and unlawful interference by third parties to possess, use, or dispose of the property right without the consent of the owner or despite the owner's disagreement (Decision No. 6 of 15 July 2013 of CC). As noted by St. Stoychev, in order to benefit from the protection of the right to property, the said property must have been acquired on legal grounds.³² It seems to me that it would be

³² See: Стойчев, Ст. Конституционно право. София, Сиела, 2002, с. 183.

appropriate to add to the requirement of a lawful basis the absence of its being challenged on a ground subsequently abandoned or unfulfilled. Even in the presence of a lapsed or unperfected ground, which in themselves preclude lawful acquisition, defences should be held until established by a challenge. Otherwise, the requirement of legality and legal certainty is violated. The case law of the Court of Human Rights is to this effect. In the case of *Zvolsky and Zvolska v. the Czech Republic*, the Court held that where property rights were acquired by persons of the former communist regime in violation of the requirements of the law, they should not be paid compensation for a lawful expropriation aimed at remedying such violations. However, depending on the specific case and the particular circumstances of the case, a determination of the State's right to interfere with private property may need to be made, in light of the balance between the protection of private property and public interest.³³

The Bulgarian Constitutional Court ruled by Decision No. 4 of 11 March 1998 in case No. 16 of 1997 that properties which were forcibly taken away by the State in the person of the People's Court, which at that time was not part of the country's justice system but was an extraordinary court with defined powers, composed of persons without legal training, which acted alongside the other courts in the country, are subject to restitution.

Article 1, Protocol 1 of the Convention on Human Rights, entitled 'Protection of Property', proclaims the **right of the owner, natural or juridical, to the peaceful enjoyment of his property**. With regard to the peaceful enjoyment of property rights, the jurisprudence of the European Court of Human Rights has argued that a violation of peaceful enjoyment will occur when the owner is denied access to the object of the right, or when restrictions are imposed on the owner by acts of authority or refusal to grant permission for use.³⁴ Hence, it is possible that the property right

³³ See: Харис, Д., Майкъл О'Бойл, Ед Бейтс, Карла Бъкли. Харис, О'Бойл и Уорбрик: Право на европейската конвенция за правата на човека. София, Сиела, 2015, с. 1068.

³⁴ See: Ван Дайк, П. Г. Й. Х. Хууф. Европейската конвенция за правата на човека – теория и практика. София, Фондация „Български адвокати за правата на човека“, 2000, с. 585, и посочените там съдебни решения.

itself may not be affected, but that the ability of the owner to use the object of that right or to dispose of the property may be affected.

The possibility for effective exercise of the right to property by its holder is not only linked to the State's obligation not to interfere but may also have a positive legal content concerning the measures that the owner may reasonably expect from the State. The case of *Öneryildiz v. Turkey* concerned a methane explosion at a municipal landfill site in which there were human casualties and damage to homes. The landfill did not comply with health and safety requirements and the failure to comply with those requirements, i.e., the failure of the municipal administration to take action, constituted a violation of Article 1 of Protocol 1 to the Convention. Positive measures of protection, according to the Court, are preventive and remedial and consist both in the provision of an opportunity for protection by the owner of the property and in the State's intervention to implement that opportunity.

In its Decision No. 12 of 4 June 1998 under Case No. 13/1998, the Constitutional Court declared the Act on the State ownership of the Properties of the Families of Tsar Ferdinand and Tsar Boris III and Their Heirs unconstitutional. The arguments of the Constitutional Court are that the expropriation of the said properties is a compulsory and gratuitous expropriation of private property, which in its legal essence is a confiscation, since it was not carried out in exchange for compensation and for the satisfaction of state or municipal needs – conditions necessary for the compulsory expropriation of private property. There is, according to the CC, a contradiction with the constitutionally proclaimed principle of equality of all citizens before the law.

On the division of property rights into public and private

The right to property is also characterized by its subdivision into public and private property; there is no intermediate position, with the resulting differences in the legal regime of the two types of property.³⁵ The disallowance of a third, intermediate type of property – private property – to benefit from the public property regime is also highlighted in the CC Decision No. 2

³⁵ See: **Сарафов П.** Особенности на собствеността като субективно вещно право. // Съвременно право, 2002, № 6, с. 36.

of 30.03.2000 in Case No. 2/2000 – ‘Allowing such a possibility even ‘for private state claims of particular importance or of great public interest, in accordance with state policy, (according to the opinion of the Minister of Finance) is contrary to the express provision of Article 17(2) of the Constitution.’

According to Decision of the CC No. 19 of 1993 and Decision No. 2 of 1996, the property of the state and municipalities can be public or private. The division of property into public and private, adopted by the Constitutional Court and by the State Property Act (SPA) and the Municipal Property Act (MPA), is based on three criteria – the quality of the holder, the type of the objects of property right and their purpose. There is a dispute in doctrine as to which of these three criteria is the leading one.³⁶ The legislator lists in the SPA and the MPA which property and assets are public state and municipal property, and that which is not public, by argument to the contrary, is considered private state or private municipal property.³⁷ The Council of Ministers determines which properties and assets are public state property – Article 6 SPA. Article 6 MPA determines that the municipal council is competent to change the designation of municipal property – from public to private and vice versa.

The constitutional legal doctrine states³⁸ that the criteria of the CC for the division of property into public and private do not correspond to the criteria set by the constitutional legislator, which takes the sole criterion as the holder of the property right – whether it is the holder of the power of eminent domain or not. According to this criterion, set out in the Constitution and further developed by theory, the subjects of public property are public-law institutions, the holders of authority – the state and municipalities, and the subjects of private property – natural and legal persons.³⁹ Accordingly, the holder of the right of public property will possess the qualities of an owner along with its powers of authority, and the subject of private

³⁶ See: **Марков М.** Относно публичните ограничени вещни права. // Собственост и право, 2005, № 8, с. 6; **Сарафов П.** Публичната и частната собственост като видове право на собственост. // Правна мисъл, 2003, № 2, с. 82.

³⁷ See: **Петров, Вл.** Цит. съч., с. 95.

³⁸ See: **Стойчев, Ст.** Конституционно право. София, Сиела, 2002, с. 177; **Петров Вл.** Цит. съч., 93–94.

³⁹ See: **Стойчев, Ст.** Конституционно право. София, Сиела, 2002, с. 177.

property – only the qualities of an owner.⁴⁰ According to St. Stoychev, the very phrase ‘private state’ and ‘private municipal’ property are internally contradictory, artificially created and devoid of information. They divide public property into property included in the civil turnover and property outside it.⁴¹

The doctrine argues that the division of property into public and private applies only to property rights and does not apply to limited property rights, which are impossible to establish on objects of public ownership.⁴² However, in accordance with the amended regulation of Article 7(5) SPA, such a possibility is provided for – *under conditions determined by law, by a decision of the Council of Ministers, limited property rights may be established on properties – exclusive and public state property, when it is necessary for:*

- 1. construction of a national site;*
- 2. permanent satisfaction of public needs;*
- 3. construction of linear objects of the technical infrastructure not falling under items 1 and 2 – when there is no other technical possibility or when another technical solution is clearly economically inexpedient.*

Article 7(2) MPA provides that properties – public municipal property, may be encumbered with limited property rights only in cases determined by law.

Expropriation of privately owned property and assets for state or municipal needs

Expropriation of property for state and municipal purposes is an exception to the principle of inviolability of private property and an encroachment on property rights by the state or municipalities.

⁴⁰ See: **Петров, Вл.** Правото на собственост в българското законодателство – уредба между три конституции – В: Сборник. „Двадесет години от приемането на Конституцията на Република България. Материали от научната конференция Велико Търново 3 юни 2011 г.“. София, Софи-Р, 2011, с. 94.

⁴¹ See: **Стойчев, Ст.** Конституционно право. София, Сиела, 2002, с. 178.

⁴² See: **Сарафов, П.** Особенности на собствеността като субективно вещно право. // Съвременно право, 2002, № 6, с. 38.

As safeguards in the expropriation of property and assets for state and municipal needs, the Constitution provides requirements that must be met in order for the state or municipality to acquire ownership on this original basis. The expropriation must be made only on the basis of law, these needs must not be able to satisfied in any other way, and equivalent compensation must have been determined and paid in advance.

Before private property is encroached, according to Vl. Petrov, it should be established whether the state or the municipality cannot be satisfied with other properties that are state or municipal property. According to the author, there is no restriction in this respect; moreover, the Constitution specifies the subject for the needs of which the expropriation is made, but not by whom the expropriation should be made.⁴³ This interpretation is also consistent with the equal treatment of all forms of property. In this sense, the provisions of Articles 32–41 SPA and Articles 21–33 MPA, according to Vl. Petrov, do not correspond to the will of the constitutional legislator.

In connection with the expropriation of properties for state and municipal needs, the Constitutional Court, in its Decision No. 6 of 4 July 2006 under Case No. 5/2006, had occasion to rule on the question of the unconstitutionality of the provisions of § 2 of the Act amending and supplementing SPA (SG No. 17 of 2006), which created paragraphs 2 and 3 of Article 32 SPA. The said provisions concern the definition of the term ‘equivalent monetary compensation’ within the meaning of Article 17(5) of the Constitution. Taking into account the need to fill the gap in the law and the manner in which the equivalent monetary compensation is determined (in accordance with the purpose of the properties before the detailed development plan came into force, based on the market prices of properties with similar characteristics located in the vicinity of the expropriated properties), the Constitutional Court holds that there is no unconstitutionality of the said provisions, as the criteria set forth in the provisions of Article 32(2) and (3) MPA are objective and do not infringe

⁴³ See: **Петров, Вл.** Цит. съч., с. 100. Възможността нуждите да се задоволят с държавни или общински имоти и тяхното отчуждаване се признава и от **Марков, М.** Относно публичните ограничени вещни права. // *Собственост и право*, 2005, № 8, с. 6

the inviolability of private property. With regard to the assessment, the CC upholds that the purpose of the property should be taken into account, i.e., the purpose which it had prior to its expropriation in the relevant detailed development plan, and not its future purpose, in view of which the expropriation is made. It is in this way that the equivalent compensation of the property should be determined, because it corresponds to its actual, not its future, value.

In another decision, Decision No. 6 of 15 July 2013 under Case No. 5 of 2013,⁴⁴ the Constitutional Court ruled on the unconstitutionality of the provisions of Article 38(1), (2) and (3) and Article 39(1), second sentence, of the State Property Act, Article 29(3)1 and Article 30 of the Municipal Property Act. These provisions concern the issue of compulsory expropriation of private property for state or municipal needs and the notification of the owner of the property of the relevant individual administrative act of expropriation solely through State Gazette, as well as the appropriation of the property without compliance with the constitutional requirement for prior and equivalent compensation to the owner due to the provision in the law that the appeal of the act does not suspend implementation. The Constitutional Court finds that the aforementioned method of notification violates the right to effective protection of private individuals and legal entities (Article 56 of the Constitution) at the expense of facilitating the state and municipalities in the procedure.

The Constitutional Court, in its judgment, referred to the European Convention on Human Rights as an international source under Article 5(4) of the Constitution and to the judgment of 16.12.1992 in *De Geoffre de la Pradelle v. France* (12964/87) in relation to the provision by the State of a clear, practical and effective opportunity to challenge an administrative act which directly affects the applicant's right to property and which must be communicated to the applicant in person. In the view of the CC, the impugned provisions of the SPA and the MPA violate the constitutional requirement of the legislator that compensation be paid in advance, i.e., prior to revocation of the property right. The prior payment of compensation is a prerequisite for the expropriation of the property and its acquisition

⁴⁴ **Решение № 6 от 15 юли 2013 г. по конституционно дело № 5 от 2013.**

by the State or the municipalities. If the amount of the compensation is disputed by the owner, the court decision must enter into force in order for the compensation to be paid in advance.

Under Article 1(1) of Protocol 1 to the European Convention on Human Rights, *'no one shall be deprived of his property except in the public interest and in accordance with the conditions laid down by law and the general principles and rules of international law'*. The Convention permits infringements of the right to property, but only where there is a legitimate public interest, there are conditions laid down in law and consistency with the general principles of international law. Or as the Court's case law states – a *'fair balance between the requirements of the public interest and the requirement that the fundamental rights of the individual be protected'* is required.⁴⁵ It is the balance between the requirements of the public interest and the protection of the rights of the individual that is the basis of the permissibility of infringements on private property.

In conclusion, it can be summarised that the constitutional foundations of the corporate and financial system are central to the functioning of the state and closely tied to all other constitutionally established societal systems, such as the political, social, educational, etc. All systems operate both together and with a predominance of some of them. The manifestation in a different or identical volume of the different constitutionally established systems reveals a different perspective, which, in its conclusion, aims only at the satisfaction of the needs of man. The seemingly established limitations on the freedom of the individual viewed through the natural medium of manifestation of the individual systems lead to the conclusion that in many cases limitations have their remedial and protective effect. On the other hand, the legislator has provided mechanisms through which the desired effects can be achieved in an indirect way, such as could be achieved if the

⁴⁵ See: Ван Дайк, П. Г. Й. Х. Хууф, Европейската конвенция за правата на човека – теория и практика. София, Фондация „Български адвокати за правата на човека“, 2000, с. 585, и посочените там съдебни решения: Решение от 23.09.1982 г. *Sporrong and Lönnroth*; Решение от 9.12.1994 г. *Holy monasteries*; Решение от 21.11.1995 г. *Velosa Barreto v. Portugal*.

restrictions were removed. By skilful use of the possibilities provided by one constitutional system, an effect can be achieved in another, despite the obvious difference in their substantive scope and content. Through the political system, change can be brought about in any other system, and through any other system (economic, cultural, social); policy change can be brought about in any other sphere, precisely to meet the needs of the individual.

CHAPTER: 18

FUNDAMENTALS OF CONTEMPORARY FINANCIAL LAW

Savina Mihaylova-Goleminova

ABSTRACT	KEY WORDS
This chapter presents the fundamentals of contemporary Financial Law. The financial doctrine examines the new challenges facing the Republic of Bulgaria as a member of the European Union (EU), firmly rooted in constitutional, financial and administrative traditions, including case-law in the field of administrative justice. The present study focuses on the challenges facing Bulgaria as member state in the field of Financial Law. Issues related to the subject and method of legal regulation, financial system, legal sources of financial law and financial administration will be reviewed below.	Financial Law, financial administration, financial legal relations, financial system.

I. INTRODUCTION

The generally recognised financial legal doctrine and research in the field serve as pillars of the present review. The theory of financial legal relations (FLR) developed by Professor Milcho Kostov in his work entitled *Financial Legal Relations*¹ ('FL') serves as basis for the analysis below and the elaboration of a concept for modern public financial legal relations and the participation of the state.²

¹ See: **Костов, М.** Финансови правни отношения. София, БАН, 1979; **Димитров, В.** Финансово право. София, Нова звезда, 2019; **Пенов, С.** Финансово право. Обща част. Учебен курс. София, УИ „Кл. Охридски“, 2021; **Пенов, С.** Финансово право. Специална част. Учебен курс. София, УИ „Кл. Охридски“, 2020, etc.

² From a more practical point of view, the concept of financial legal relations and finances, mentioned above, was of crucial significance for overcoming the erroneous practice of national courts which assumed that the relations between managing authorities

II. BASIC ISSUES

1. Financial legal relations

The components of financial relations are the following:

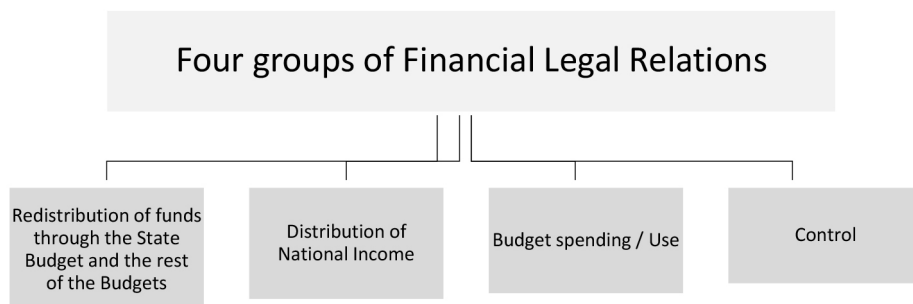
Diagram 1 – Components of FL



In general, legal regulation of financial law, as a form of objective law, covers four major groups of public legal relations:

of operational programmes under European Structural and Investment Funds (ESIF) in Bulgarian and beneficiaries are relations between equals.

Diagram 2 – FL



FL as objective law and a branch of applicable law has the task of ensuring the legal regulation of basically four main groups of public relations, related to the distribution, redistribution and use of national income, as well as control over other activities. In general, all relations are different types of legal public relations (financial, constitutional, administrative) within the EU and national financial system³ (system of public finances,⁴ banking and non-banking system, monetary system)⁵. This is why a multidisciplinary approach combining knowledge and skills from several academic disciplines is needed to address complex issues and difficulties.

Nowadays, all that has been said so far can serve to point out certain characteristics of these relations which were also highlighted by M. Kostov, bearing in mind the challenges due to the complicated correlations and relations with EU Law, the financial system and public finances of the EU:

- They arise, develop and expire as a result of the financial activities of the member state/EU (supranational authorities);

³ Regarding the penal protection of the financial interests of EU and Bulgaria, see Chapter 29, including **Христов, Х.** Право на Европейския съюз – наказателноправни въпроси, София, Сиела, 2012; **Кузманова, Н.** Обхват на наказателноправната защита на финансовата система. Част първа. // Правна мисъл, 2022, № 1, 27 – 43; and **Кузманова, Н.** Обхват на наказателноправната защита на финансовата система. Част втора // Правна мисъл, 2022, № 2, 20–47.

⁴ See Chapters 19, 20, 23, 27.

⁵ See Chapter 25.

- They arise, develop and expire under imperative financial rules and legal acts – European and national;
- They exist only as legal relations based on legal acts as they do not exist objectively in reality;
- They are public relations;
- It is through them that the process of distribution of national revenue and expenditure, as well as the inflow of cash to the EU and national budget and control over these activities takes place;
- They are of pecuniary and organisational nature;
- They are all regulated through authoritative methods, because the ‘active’ party in these relations is always the State, represented by public authorities which exercise the State’s authoritative rights.

2. Financial law and its contemporary importance

In his work ‘History of old Bulgarian Law’⁶ S. Bobchev notes: *‘The first questions to be asked when one begins to study any science are: what does this science teach, what is it taught for and how. In other words, it is first appropriate to give an explanation of the subject, the task and the methods. It falls to the encyclopaedia and to the general theory of law to explain critically the various definitions of law, and to philosophy or sociology to point out how to determine the most precise word and what it means [...] Law is the essential element [...] Aristotle said ‘man is a social animal’, but in order to regulate his relations to others like him certain norms are necessary. The totality of these norms constitutes law [...] The questions of how men form social unions for peaceful and inoffensive living, what the organisation of these unions should be, what their needs are, what their functions are, are the subject and task of public law and of state law.’*

On page 358 he adds, regarding the science of finance: *‘the science of finance distinguishes two major groups of public funds: the first one: revenue from public properties, forests, lands, monopolies and real estates; second: taxes, which are two categories: taxes for services rendered, collected at the*

⁶ See: **Бобчев, С.** История на старобългарското право. Лекции и изследвания. София, П. М. Бжзайтов, 1910, 1–4.

time of the service, and different types of properties or private income, which was direct or indirect.'

Regarding the history of Bulgarian Financial Law, in 1967 Prof. A. Angelov pointed out in his book on Financial Law that: *'in bourgeois law, Tax Law was specified as a separate subject from Financial Law. In Bulgaria, before 9 September 1944, tax law was taught in the universities. In the introduction to his book on the subject, Petko Stoyanov⁷ does not mention the existence of Financial Law (...) Tax Law is only part of the integrated law discipline – Financial Law.'*⁸

Researches from academia in Central and Eastern Europe have also attempted to rationalize the place of financial law in contemporary realities. *'FL is the most dynamically developing area of legal orders in all the states throughout the world.'*⁹

Currently, it is one of the most influential and reputable branches of Public Law in Bulgaria. FL has its own fundamental place in the legal order of Western Balkan and Central and some Eastern European Countries (former socialist countries). These countries have traditions in the legal doctrine in this field, because of their common past and common future. Some contemporary issues of Financial Law and legal and economic doctrine are also highlighted in Chapters 1, 8,¹⁰ 16, 17, 19, 20, 21, 22, 23, 24, 25, 26, 27, 28, 30, because, as Prof. Jacques Malherbe notes in the Preface to the book: *'The subject-matter of the book is complex and multifaceted, proving that there is a need for joint analysis between lawyers and economists. The present book is a good example of such a collaboration.'* It must be noted that, from the perspective of legal doctrine, FL is part of the so-called **'Economic Law'**, because it is influenced by the Economic policy of the EU.¹¹ We can also talk of **Financial Constitutionalism**: *'European*

⁷ **Стоянов, П.** Данъчно право. София, Издателство БАН, 1994.

⁸ See **Ангел, А.** Финансово право на Народна Република България. София, Наука и изкуство, 1967, 56–57.

⁹ **Mrkývka, P.** (ed.) System of Financial Law: General Part: Conference Proceedings. 1st ed. Brno: Masaryk University, Faculty of Law. Publications of the Masaryk University, theoretical series, edition Scientia, 2015, p. 18.

¹⁰ On the topic of Public enterprises, which are related to the public finances of the State.

¹¹ See European Semester Country Report: https://economy-finance.ec.europa.eu/publications/2023-european-semester-country-reports_en [Accessed on 15 January 2024].

*financial constitutionalism has been a fact since the introduction of the euro as a common European currency, with the establishment of the Eurozone, with the establishment of the European National Bank and the European Court of Auditors and with the development of financial budget relations within the Union, as well as between the Union and member states and membership applicants. Following the financial crisis that began in 2008–2009, however, the institutionalization of European financial constitutionalism received a new political impetus.*¹² The previous two Chapters 16 and 17 present additional value towards understanding the constitutional dimension of contemporary FL in Bulgaria as a member state of the EU.

Contemporary researchers in the field of Financial Law are Prof. Strashimir Kuchev, Prof. Georgi Petkanov, Prof. Sasho Penov, Prof. Valeri Dimitrov, Prof. Emil Zlatarev, Prof. Ivan Stoyanov, Prof. Lyuben Karanikolov, Assoc. Prof. Yuriy Kuchev, and others.

Nowadays FL is an independent branch of law in our legal system with its own subject and method of legal regulation (imperative/authoritative). In order to determine FL as an independent branch of public law we use well-known methods, identifying, most importantly, its **object and method** of legal regulation. The **object** of legal regulation: (financial are those relations that are settled through the authoritarian method of legal regulation and relate to public finances (both EU and national) and include public banking and non-banking relations (both EU and national), as well as monetary relations (both EU and national). FL regulates those relations in society that develop in connection with the establishment and functioning of the financial system and the activities of the State through state authorities acting in the financial area.

For example, the object of legal regulation covers several groups of relations as regards to public and local finances. The first group of relations arise on the occasion of the distribution of national income through taxes, charges and duties paid to the budget (and forming its revenue). Through the system of public claims, including taxes, excise duties and customs duties, compulsory social security contributions and other contributions to the budget, etc., the State determines how much of the national income needs to be allocated towards funding of public expenditures. **The second group** of relationships arise on

¹² Белов, М. Финансов конституционализъм. София, Сиби, 2015, 23–27.

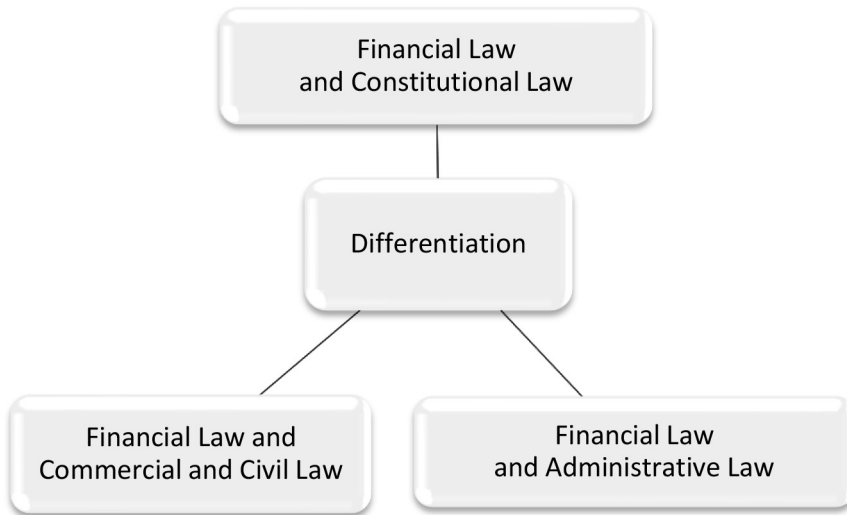
the occasion of the distribution of these funds through the state budget voted by the National Assembly and approved in terms of revenue and expenditure. Accumulation of public revenue occurs in various types of monetary funds and accounts such as the state budget, municipal budgets, social security budget, health insurance budget. **The third group** are relations arising on the occasion of budget spending. This group includes relations related to the utilisation of accumulated funds, centralised and decentralised cash resources, relationships developing within the banking and non-banking system, including the monetary system. **The fourth group** of relations are those arising on the occasion of control over the previous three activities (see Chapter 22).

As a principle, the organisation and functioning of the State cannot be regulated only through public financial rules. As mentioned above, a multidisciplinary approach must be applied. In this respect Constitutional law¹³ has the objective of regulating the public relations which constitute the foundation of the public-economic system and the political organisation of society. Administrative law,¹⁴ on the other hand, regulates public relations arising in the process of governance in the area of taxation (See Chapters 16 and 17).

In addition, all organisational forms of financial activities develop on the basis of Constitutional and Administrative law and are subject to the principles set out therein, because in its content, method and manifestations financial activity is, in its largest part, a variant of executive and enforcement, managerial activity.

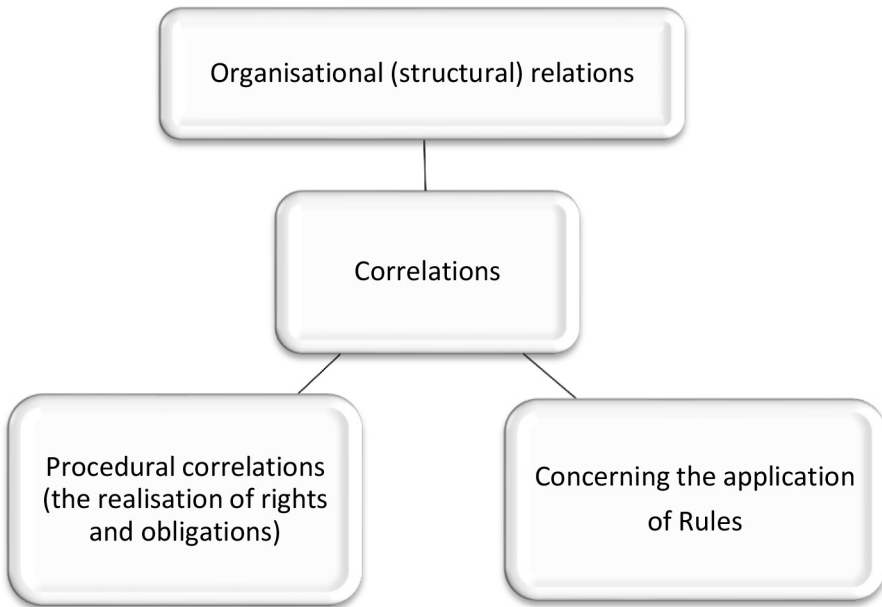
¹³ On the topic of Constitutional Law, see: **Друмева, Е.** Конституционно право. Пето допълнено и преработено издание. София, Сиела, 2018; **Киров, П.** Конституиране на представителното управление в България. София, Сиела, 2015; **Близнашки, Г.** Принципи на парламентарното управление. София, УИ „Св. Климент Охридски“, 1997; **Близнашки, Г.** Парламентарно право. София, УИ „Св. Климент Охридски“, 2017; **Белов, М.** Финансов конституционализъм. София, Сиби, 2015.

¹⁴ With regard to Administrative Law, the entire commonly accepted administrative legal literature is recommended.

Diagram 3 – Differentiation of FL

The Constitution is the source of financial law and establishes the principles for organisation of the financial system. Constitutional law deals with the structure of the state, the form of governance, the establishment of social and economic relations and the political authorities of the state. The distinction between Financial Law and Administrative Law is mainly based on the object of legal regulation. Administrative law deals with the management/executive activities of the State. The financial activity of the state is also a management/executive activity and is often carried out by the same executive authorities. Financial law regulates the management and control related to finance and the financial system. Administrative law deals with the general management/executive state power but does not cover relations arising from the distribution of national income. The method is authoritarian for both branches. FL also has correlations with other areas of Law:

Diagram 4 – Correlations of Financial Law



The distinction between Financial Law and Commercial/Civil Law is that financial relations are the result of civil or commercial relations and occur together or after them.¹⁵ The method of legal regulation is the tool for **differentiation**.

In some cases, subjects may appear as an auxiliary criterion. In financial law relations always arise as a result of the financial activities of the State or public bodies. Financial relations arise in the course of creation, distribution, accumulation, spending and use of national income and control over these activities, but always in the public interest. Financial relations emerge and develop always within the financial system. The State is always one of the subjects in these relations, acting as an ‘active player’, represented by its specific public authorities. FL is in connection with all of the above branches, as well as with branches of law, and the **interactions between them** can be divided into three groups: organisational (structural) interactions; interactions concerning the application of financial rules;

¹⁵ See Chapter 8 on the topic of Public Enterprises.

procedural interactions (the implementation of the rights and obligations of subjects) as mentioned by Prof. Milcho Kostov in his book.

In terms of spatial correlations, FL is mostly related to Administrative and less to Constitutional law, because financial authorities are public authorities and the individual financial act is an administrative instrument.¹⁶

Violations of legal norms in financial law are subject to one of the four types of liabilities: administrative, criminal, disciplinary, civil.¹⁷

3. Financial System

As G. Petkanov highlights: *‘A central place in the financial system [...] is held by the budget, which concentrates the national centralised fund of cash resources [...] The significance of the budget is determined not only by its volume, but also by its leading role in the financial system [...] The activities of the state in the field of the budget are economic in nature, but they are carried out by government authorities, in the manner prescribed by the law, i.e., budget issues relate to both the economic and legal science. The law is the instrument ensuring implementation of the financial policies of the state, and henceforth – of the social and economic development programme for the country’*.¹⁸

Currently, based on positive law and practice, financial theory reconsiders the theoretical constructions of **‘Financial System’**, **‘Public Finance’**, **‘Control’**, **‘Financial Control’**, **‘Supervision’**, **‘Audit’** and **‘Financial Administration’**. Regarding protection of EU and Bulgarian financial interests, see Chapters 22 and 23.

The financial systems of the Republic of Bulgaria (as a Member State) and the EU correlate and interact on the basis of EU and national legislation.

The term **‘Financial System’** comprises not only of **Public finance but also of the Banking and Non-banking subsystems**,¹⁹ including the

¹⁶ See Chapters 8, 22, 23, 24, 28, 30

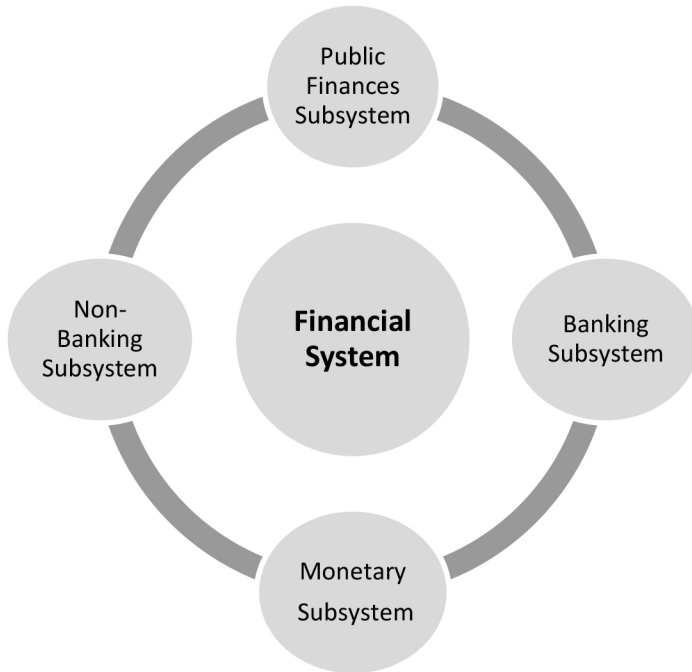
¹⁷ Examples can be seen in Chapters 22, 23, 30.

¹⁸ **Петканов, Г.** Бюджетна компетентност на Народните съвети в НР България. София, УИ „Св. Климент Охридски“, 1988, с. 5. See also **Костов, М.** Финансов план и финансовоправна норма. София, 1972, 42–49.

¹⁹ Regarding the financial system, see Regulation (EU) No 575/2013 of the Europe-

Monetary subsystem of the financial system.

Diagram 5 – Subsystems of the Financial System



The fundamental roles of the **Financial system** are: ‘(i) providing a secure mechanism for payments at a distance; (ii) mobilising capital from savers who have more financial resources than uses for them; (iii) selecting projects from amongst those seeking investment to capital; (iv) monitoring the performance of those executing projects in which investment has been made; and (v) managing risk. There are institutions and financial instruments that monitor and manage risk and there are others that assist investors with taking risk’.²⁰

an Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (*OJ L 176*, 27.6.2013, 1–337).

²⁰ **Armour, J., Dan Awrey, Paul Davies, Luca Enriques, Jeffrey Gordon, Colin Mayer, Jennifer Payne.** *Principles of Financial Regulation*. Oxford University Press, 2016, 22–23.

A robust financial sector is an important milestone on the road to joining the Euro area. Bulgaria has already joined the Banking Union (see Chapter 25). Therefore, it is crucial to ensure that the financial sector is robust and well-regulated and supervised, and systemically-significant institutions in particular.

‘The institutional components of financial systems [...] Traditionally, these have been broken down into two components: first:, financial intermediaries such as banks, saving and lending institutions, pension funds, mutual funds, and insurance companies; and second, financial markets such as equity markets, bond markets, derivative and options markets, futures and commodity markets, and ancillary actors which facilitate the production and dissemination of information that enable markets to operate’.²¹ The Financial system is an economic system.

In general, ‘**Public finance**’ is a ‘*system for the provision and financing of public goods and services, reallocation and transfer of income and accumulation of resources by budgetary organisations by means of revenue, aid and donations, realisation of financial assets and debt assumption*’ (Article 3 of the Public Finance Act). The economic basis for the achievement of common European objectives is the EU budget, which sets the overall revenue and expenditure of the Union for the year.

III. LEGAL SOURCES OF FL

1. European Union Law

The main EU values transferred from the constitutional traditions of the Member States are the pillar of the current EU, established in its primary Community law. EU law is an independent legal system which takes precedence over national legal provisions. EU law is composed of three different types of legislation:

- **Primary legislation:** Treaty on the Functioning of the European Union (TFEU); Treaty on the EU (TEU); Charter of Fundamental Rights of the EU; main principals.

²¹ Ibid., p.23.

- **Secondary legislation based on the EU Treaties (Article 288 TFEU):** to exercise the Union's competences, the institutions shall adopt regulations, directives, decisions, recommendations and opinions. A regulation shall have general application. It shall be binding in its entirety and directly applicable in all Member States. A directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and methods. A decision shall be binding in its entirety. A decision which specifies those to whom it is addressed shall be binding only on them. Recommendations and opinions shall have no binding force.²²
- **Case-law** (judgments of the Court of Justice of the EU (CJEU)).²³
- **International agreements:** EEA Agreement; Free Movement of Persons Agreement with Switzerland; Association Agreements.

The **involved EU institutions are those within the TFEU:** Council and European Parliament (legislative power); European Commission (executive power); CJEU (judicial power), etc. According to Article 2, item 67 of Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (*OJ L 193, 30.7.2018, p. 1–222*) ‘**Union institution**’ means the European Parliament, the European Council, the Council, the Commission, the Court of Justice of the European Union, the Court of Auditors, the European Economic and Social Committee, the Committee of the Regions, the European Ombudsman, the European Data Protection Supervisor or the European External Action Service (the ‘EEAS’); the European Central Bank shall not be considered to be a Union institution.

²² Three categories of legal acts: **legislative acts** (Article 289 TFEU), which regulate the main issues of the matters in which the EU has competence; **delegated non-legislative acts** (Article 290 TFEU); **executive acts** (Article 291 TFEU).

²³ CJEU only interprets EU law.

The EC must act within the limits of the powers conferred on it by the Treaty (differs in the different fields of financial legislation which regulates relations within different subsystems of the financial subsystem). In areas outside the EC's exclusive competence, the EC must act in accordance with the principle of subsidiarity only if the proposed action cannot be sufficiently achieved by the Member State.

EU law has a supranational character and prevails over national law (even constitutional provisions).

The law stemming from the TFEU cannot be overridden by domestic legal provisions.

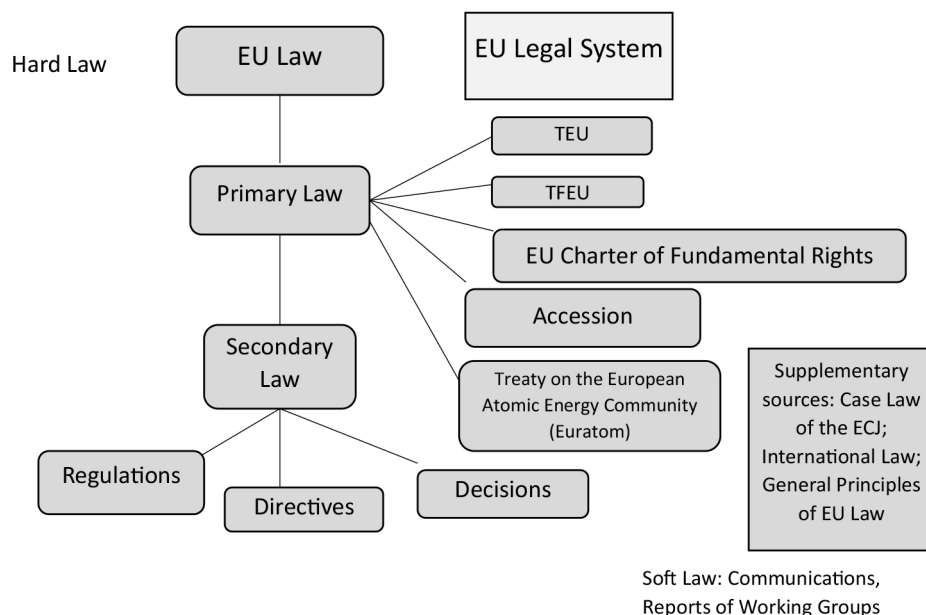
National courts and administration need to ensure supremacy of EU law and perform interpretations in line with EU law. Also, national law in conflict with EU law cannot be applied. National legislatures need to adapt national provisions in conflict with EU law.

The main principles of EU law are **the direct effect** and the supremacy of EU law. A legal norm of EU law has direct effect when it immediately and directly confers on natural and legal persons in the EU subjective rights that must be recognised and protected by national courts.

EU law does not explicitly define the procedural order and form for the protection of the subjective rights of private legal entities, which EU law provides to them. The practice of the ECJ²⁴ confirms that the implementation of EU regulations by the member state is carried out in accordance with **the procedural order established in national law**. Judgment of the Court of 12 June 1990, Federal Republic of Germany v Commission of the European Communities. Several Bulgarian tax cases and ECJ preliminary rulings can serve as examples: Cases C-2/09; C-203/10; C-621/10 and C-129/11; C-284/11; C-553/16; C-142/12; C-552/16; C-118/11; C-132/16 CEC; C-550/11; C-549/11; C-642/11; C-234/11; C-107/13; C-76/15; C-285/11; C-78/12; C-18/13; C-492/13; C-138/12; C-111/14; C-242/18; C-4/20; C-257/20; C-1/21.

²⁴ For example, as regards to public procurement issues, see: C-6/20; C-195/21; C-669/20; C-441/22; C-443/22; C-195/21, etc.

Diagram 6 – EU Law



TFEU: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:12012E/TXT&from=EN>

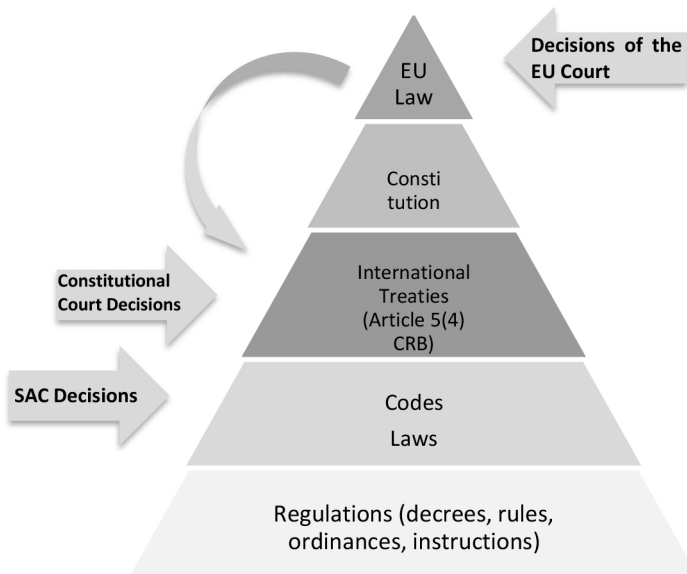
2. National legislation

The Constitution establishes that the **Republic of Bulgaria is a legal state (Article 4)**.²⁵ The public relations that arise, develop and conclude in the contemporary Financial System of the Republic of Bulgaria are the object of study, being, in some aspects, also a part of the EU Financial System. The hierarchy of normative acts in the legal system of the Republic of Bulgaria also needs to be examined.²⁶

²⁵ On the topic of Rule of Law and the legal state, see: **M. Belov**, Rule of Law at the Beginning of the Twenty-first Century. Hague, 2018.

²⁶ See Сборник „Източниците на правото – съвременни национално- и международноправни перспективи“. София, УИ „Св. Кл. Охридски“.

<https://law.uni-sofia.bg/bg/sbornik-iztochnicite-na-pravoto-svremenni-nacionalno-i-mezhdunarodnopravni-perspektivi-elektronna>[Accessed on 15 January 2024].

Diagram 10 – Bulgarian Law²⁷

There are several sources of FL in the formal sense; the following must also be taken into consideration: tradition is not a source of Financial Law; court practice is not a source of Financial Law and only legal regulations may serve as sources of Financial Law.

An important role play the rulings of the Supreme Administrative Court declaring the nullity of by-laws, and the decisions of the Constitutional Court which rule on the constitutionality of certain statutory rules or acts. The interpretative decisions of the Supreme Court of Cassation and the Supreme Administrative Court are mandatory.²⁸

²⁷ See the Statutory Instruments Act.

²⁸ For example: Тълк. решение № 3 от 8.04.1985 г. по н. д. № 98/1984 г., ОЧНК на ВС; Тълк. решение № 2 от 03.06.2009 по тълк. дело 7/2008, OCC от I и II колегия на ВАС; Тълкувателно постановление № 1 от 27.02.2015 г. на Върховния касационен съд по тълк. д. № 1/2014 г., ОЧНК и OCC на Втора колегия на Върховния административен съд; Тълк. решение № 2 от 03.06.2009 по тълк. дело 7/2008, OCC от I и II колегия на ВАС; Тълк. решение № 3 от 12.04.2017 по т. д. № 5/2016 г., OCC от I и II колегия на ВАС; Тълк. решение № 13 от 20.12.2021 г. по тълк. дело № 1/2021 г. OCC от I и II колегия на ВАС; Тълк. решение № 14 от 21.12.2021 по тълк. дело 3/2021, OCC от I и II колегия на ВАС; etc.

As mentioned above with regards to the case law of the European Court, a source of EU law are only those court acts or series of acts which give rise to, amend or terminate the effect of statutory norms.

There are, however, rulings of the ECJ on Bulgarian requests for preliminary rulings which have prompted amendments to Bulgarian tax legislation and have helped overcome contradictory practices of the Supreme Administrative Court, pushing amendments in legislation by the Parliament.²⁹

In the first place, the Bulgarian National Legal Framework includes some basic articles from the **Constitution of the Republic of Bulgaria (CRB)**:

- **Article 84** (1) pass, amend, supplement, and repeal the laws; 2. adopt the state budget and the budget report; 3. establish the taxes and determine the amount of state taxes; 8. elect and remove the Governor of the Bulgarian National Bank and the heads of other institutions established by law; 9. approve state-loan agreements; 13. grant amnesty);
- **Article 60(1)** Citizens shall pay taxes and duties established by law proportionately to their income and property. (2) Any tax concession or surtax shall be established by law.);
- **Article 62(1)** The National Assembly shall be vested with the legislative authority and shall exercise parliamentary control. (2) The National Assembly shall have an independent budget.);
- **Article 91(1)** The National Assembly shall establish a National Audit Office to supervise the implementation of the budget. (2) The organisation, authority and procedures by which the National Audit Office shall act shall be established by law.);
- **Article 117(1)** The judiciary shall protect the rights and legitimate interests of all citizens, legal entities and the State. (2) The judiciary shall be independent. In the performance of their functions, all judges, court assessors, prosecutors and investigating magistrates shall be subservient only to the law. (3) The judiciary shall have an independent budget.);

²⁹ C-2/09; joint cases C-621/10 and C-129/11; C-203/10; C-550/11; C-142/2012; C-549/11; C-9/12.; C-643/11; C-642/11; C-118/11; C-153/11; C-234/11; C-107/13; C-576/15; C-285/11; C-78/12; C-18/13; C-284/11, C-492/13, C-138/12; C-111/14.

- **Article 106.** (The Council of Ministers shall manage the implementation of the state budget; organise the management of the state's assets; conclude, confirm or denounce international treaties when authorised to do so by law.);
- **Article 141**(1) A municipality shall have its own budget. (2) A municipality's permanent sources of revenue shall be established by law. (3) The municipal council shall determine the size of local taxes under conditions, by a procedure and within the frames, established by law. (4) The municipal council shall determine the size of local charges by a procedure, established by law. (5) The State shall ensure the normal work of the municipalities through budget appropriations and other means.

According to Article 5(4) of the Constitution, **international treaties**³⁰ which have been ratified in accordance with the constitutional procedure, have been promulgated and have come into force with respect to the Republic of Bulgaria, are part of the legislation of the State. They have primacy over any conflicting provisions of domestic legislation. This rule applies to international conventions as well.

Codes: Tax and Social Security Procedure Code (TSSPC); Administrative Procedure Code (APC); Civil Procedure Code (CPC); Criminal Procedural Code (CPC); Social security code (SSC).

³⁰ Treaties for the Avoidance of Double Taxation. These serve as basis for the avoidance of levying of direct taxes on the income and property of taxable entities by two or more jurisdictions. Bulgaria has an extensive treaty network. There are 70 active DTTs in Bulgaria, covering 71 countries (DTTs with the Federal Republic of Yugoslavia apply to the Republic of Serbia and Montenegro). TSSPC introduces the procedure for the settlement of disputes between Member States of the European Union in connection with double taxation agreements or other international agreements of a similar nature (Articles 135–142). The procedure of applying the agreements for avoiding the international double taxation of the income and the property (134a–134t). The provisions of the EU Directive concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures are also implemented in the TSSPC. Bulgaria is a signatory to the multilateral OECD Convention on Mutual Administrative Assistance in Tax Matters and its amending protocol. The Convention is effective in respect of Bulgaria as of 1 July 2016.

Laws³¹ take the most prominent place among sources of FL. On the whole, financial acts are designated with a different period of entry into force and not the generally applicable three-day period (see below).

Statutory rules related to the budget normally come into effect on 1 January of the respective year and their validity is equal to that of the Budget Act.

The provisions of Article 16(3) of the Public Finance Act apply to legal acts in the field of FL and their amendments: *‘No changes in taxes or compulsory insurance contributions, in terms of all their elements, shall be stipulated to enter into force before the date of entry into force of the state budget act and/or the laws regulating the budget of the National Health Insurance Fund and the public social insurance budget for the relevant year, or before the date of entry into force of the act amending and supplementing them.’*

According to Article 14(1) of the Statutory Instruments Act (SIA), a statutory instrument can be given retroactive effect only in cases of specific exceptions. In Decision No. 9/1996 of the Constitutional Court, the Constitutional Judges share the opinion that citizens need to have advance knowledge of their obligations towards the State. Article 14 SIA lays down the requirements and exceptions for retroactive effect with the provision that sanctions cannot have a retroactive effect unless the new sanctions imposed are less severe than the previous ones.

The legal foundations of different subsystems of the financial system (both EU and National) and different financial relations cannot be presented exhaustively. They include the following sources:

- Insurance Code
- Social Security Code
- Public Finance Act
- Public Sector Internal Audit Act

³¹ Interpretation by analogy is inadmissible. See адм. д. № 2254/2018 на ВАС – VII отд. и Тълк. решение № 3/2008 по тълк. д. № 2 на ВАС. With reference to Tax Laws, stringent interpretation, expanded interpretation and interpretation by analogy are inadmissible.

- Financial Management and Control in the Public Sector Act
- Public Financial Inspection Act
- National Audit Office Act
- Municipal Debt Act
- State Debt Act
- State Aid Act
- Public Enterprises Act
- Public Procurement Act
- Administrative Violations and Sanctions Act
- Corporate Income Tax Act
- Personal Income Tax Act
- Local Taxes and Fees Act
- Value Added Tax Act
- Excise Duties and Tax Warehouses Act
- Insurance Premium Tax Act
- Interest on taxes, Fees and other Similar Government Claims Act
- Customs Act
- Currency Act
- Bulgarian National Bank Act
- Credit Institutions Act
- Bank Deposit Guarantee Act
- Recovery and Resolution of Credit Institutions and Investment Intermediaries Act
- Limitation of Cash Payments Act
- Measures Against Money Laundering Act
- Payment Services and Payment Systems Act
- Bank Bankruptcy Act

- Financial Supervision Commission Act
- Markets in Financial Instruments Acts
- *Collective Investment Schemes and Other Undertakings for Collective Investments Act*
- Public Offering of Securities Act
- Measures Against Market Abuse with Financial Instruments Act
- Special Investment Purpose Companies and Securitization Companies Act
- Supplementary Supervision of Financial Conglomerates Act
- Health Insurance Act
- Export Insurance Act
- Others.

3. Strategic documents

Strategic documents play an un important role in the financial system and its subsystems, but they do not have a binding effect. The most important Strategic document at EU level is the EU Green Deal (see also Chapter 26).³² The most important Bulgarian strategic document is ‘Bulgaria 2030’ but there are different strategic documents in different fields of economy³³ (for examples, see Chapters 21, 26, 27, 28). The corelations between the Strategic Documents, the Budget, the Multiannual Financial Framework and Funds can be seen below:

³²GreenDeal:https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal_en [Accessed on 15 January 2024].

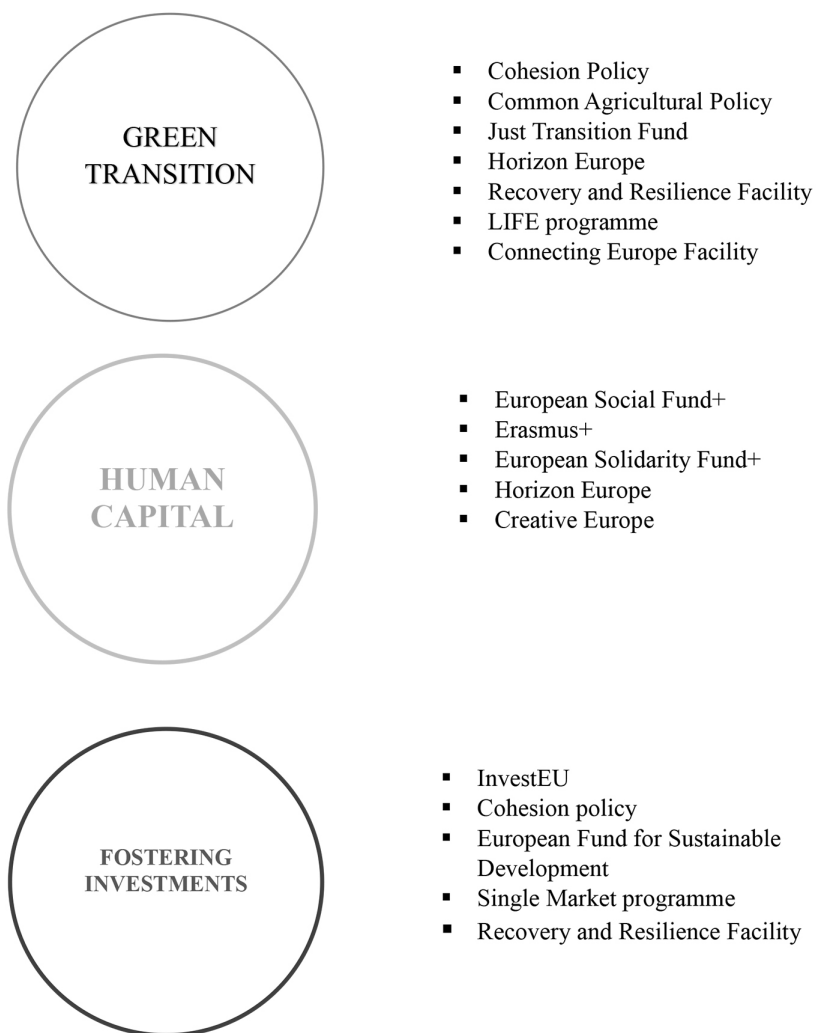
³³ For example, in the field of Transport: <https://www.mtc.government.bg/bg/category/42/nacionalen-plan-za-razvitie-na-kombiniraniya-transport-na-republika-blgariya-do-2030-g> [Accessed on 15 January 2024]

Diagram 7 – EU Budget – Multiannual Financial Framework 2021–2027³⁴

Commitment appropriations	2021	2022	2023	2024	2025	2026	2027	Total 2021-2027
1. Single market, innovation and digital	19,712	19,666	19,133	18,633	18,518	18,646	18,473	132,781
2. Cohesion, resilience and values	49,741	51,101	52,194	53,954	55,182	56,787	58,809	377,768
2a. Economic, social and territorial cohesion	45,411	45,951	46,493	47,130	47,770	48,414	49,066	330,235
2b. Resilience and values	4,330	5,150	5,701	6,824	7,412	8,373	9,743	47,533
3. Natural resources and environment	55,242	52,214	51,489	50,617	49,719	48,932	48,161	356,374
of which: market-related expenditure and direct payments	38,564	38,115	37,604	36,983	36,373	35,772	35,183	258,594
4. Migration and border management	2,324	2,811	3,164	3,282	3,672	3,682	3,736	22,671
5. Security and defence	1,700	1,725	1,737	1,754	1,928	2,078	2,263	13,185
6. Neighbourhood and the world	15,309	15,522	14,789	14,056	13,323	12,592	12,828	98,419
7. European public administration	10,021	10,215	10,342	10,454	10,554	10,673	10,843	73,102
of which: administrative expenditure of the institutions	7,742	7,878	7,945	7,997	8,025	8,077	8,188	55,852
TOTAL COMMITMENT APPROPRIATIONS	154,049	153,254	152,848	152,750	152,896	153,390	155,113	1,074,300
TOTAL PAYMENT APPROPRIATIONS	156,557	154,822	149,936	149,936	149,936	149,936	149,936	1,061,058

³⁴ See the Multiannual financial framework: <https://www.europarl.europa.eu/factsheets/en/sheet/29/multiannual-financial-framework> [Accessed on 15 January 2024]

Diagram 8 – Cross-cutting priority areas and funding of policies³⁵



³⁵ **Source Lexxion**, Christine Hamza (M&E factory Ltd Vienna).

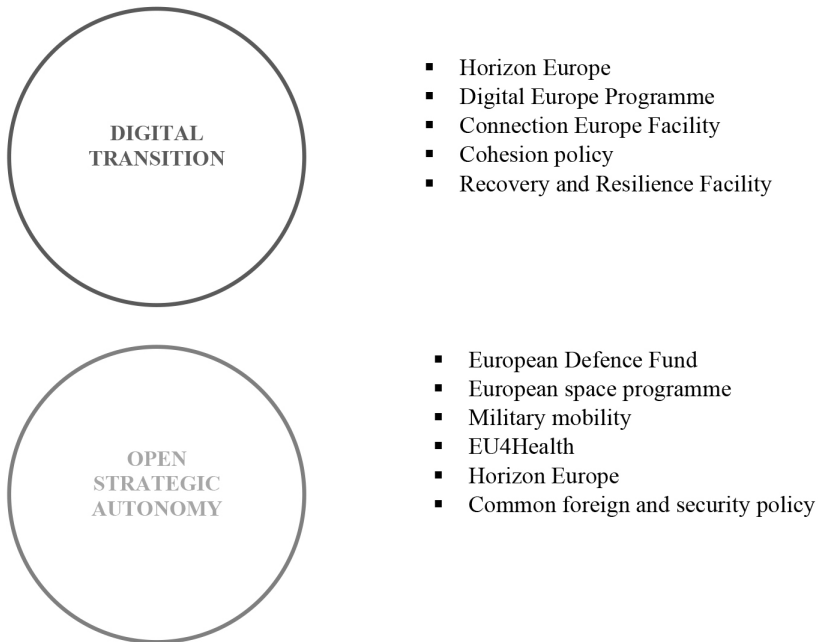
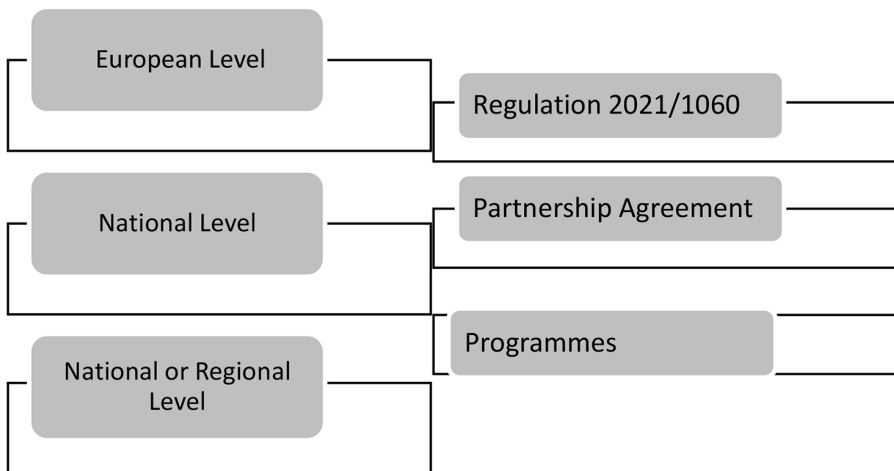


Diagram 9 – Policy Framework³⁶ of Coordination and Complementation of funds in Shared Management



³⁶ Visit the European Structural and Investment Funds Portal: <https://www.eufunds.bg/en> [Accessed on 15 January 2024].

IV. FINANCIAL ADMINISTRATION

1. Basic issues

The public relations arising, developing and expiring in the financial system in the Republic of Bulgaria and EU are considered in two aspects: as a set of FL for management and control and as a set of state bodies that carry out financial activities.

Financial authorities participate in financial legal relations from the moment they acquire the capacity of state body. In this case the financial legal personality comes after the administrative legal personality. A state body does not have to be a legal entity in order to participate in financial legal relations. For example, the NRA is a legal entity, while revenue authorities and public bailiffs are state bodies. Such bodies have different ranks – executive director, regional director, different ranks of directors and experts. One of the parties in the financial legal relations is the State, acting through the respective body. The principal in the legal relations is the State itself, although the specific state body within the specific legal relations depends on the type of representation. In addition, state financial inspection is carried out by the bodies of the specialised administration of the Public Financial Inspection Agency (PFIaG). PFIaG is an administration under the Minister of Finance and is a legal entity supported by the budget. The structure, composition and organisation of the agency's work are determined by organisational regulations adopted by the Council of Ministers (Article 6 of the Public Financial Inspection Act (PFIA)). **Bodies of the agency are the director and the financial inspectors (Article 7 PFIA).** In all cases subjects are indicated in the relevant financial rules and cannot be indiscriminately changed.

The doctrine is based on the understanding that financial authorities participate in financial legal relations in the capacity of state authorities. Chapter 5 CRB, entitled 'Council of Ministers', specifies the following bodies of the executive power: Cabinet of Ministers, Prime Minister, Ministers. The Administration Act (AdA) is also applicable. Chapter Four, Article 19(1) AdA notes that the bodies of the executive power are central and territorial. Paragraph (2) of the same article lists the

central bodies of executive power. Article 19(3) AdA non-exhaustively lists the territorial bodies of executive power: regional governors and mayors of municipalities. There are other bodies that, although not regulated in the CRB, belong to the executive power system.

There are also independent state bodies (Bulgarian National Bank (BNB), the Audit Office (AO) and the Financial Supervision Commission (FSC)),³⁷ having extremely important functions related to ‘supervision’ (BNB and FSC) and ‘audit’ (AC)³⁸ in the financial system of the Republic of Bulgaria, as they also have relations with EU institutions.

Their legal regulation is contained in the CRB or special laws, while their powers also derive from EU law. There is no dispute in positive law and financial law doctrine: these are independent bodies that stand outside legislative and executive powers.³⁹ For example, the election of the members of their governing bodies (the governor and the three deputy governors of the BNB,⁴⁰ respectively the chairman of the FSC)⁴¹ is a guarantee for their independence.

³⁷ Article 2(2) and (3) FSCA: The Commission is a specialised state body for regulation and supervision of the activities of persons under Article 1(2), hereinafter referred to as ‘supervised persons’. The commission, in exercising its powers, is independent of the executive branch of government and reports on its activities under this Act to the National Assembly.

³⁸ See Решение № 5 на Конституционния съд по к. д. № 1 от 2011 г.

³⁹ Article 8 CRB: The power of the State shall be divided between legislative, executive and judicial branches.

⁴⁰ Article 12 BNBA: (1) The Governor of the Bulgarian National Bank shall be elected by the National Assembly. (2) The National Assembly shall elect the deputy governors – heads of the main departments under Article 19, on a proposal by the Governor. (3) The other three members of the Governing Council are appointed by the President of the Republic. (4) The term of office of the members of the Governing Council shall be 6 years. Election/appointment of a new member of the Governing Council shall be made not earlier than three months and not later than two months before the end of the term of office of the current member. If the election/appointment is not made until the end of the term of office, the member of the Governing Council whose term of office has expired shall continue to perform his duties until the new election/appointment.

⁴¹ Article 5(1) FSCA: The Chairperson of the Commission shall be elected by the National Assembly. (2) The National Assembly shall elect the remaining members of the Commission on the proposal of its Chairperson.

The National Assembly elects the Audit Office (see Chapter 22), which controls the implementation of the budget. The organisation, powers and activity of the Audit Office are regulated by law, i.e., the National Audit Office Act (NAOA) (Article 91 CRB). The BNB is established by the BNB Act. The FSC is also established by a special FSC Act.

Under the concept of ‘**financial administration**’, a term well known and established in financial law doctrine, we understand all bodies that carry out some financial activity and have some financial powers. ‘**Financial administration in the narrow sense**’ covers specialised state bodies that are competent to carry out financial activities. Together, they make up the ‘**actual financial administration**’. Some of the bodies of the actual financial administration, on the basis of Article 85(1)9 CRB, have powers that are established by instruments of EU law. The relevant state bodies are numerous and vary in degree and structure. The authorities are diverse because finance covers a large field of activities and it is possible for any state authority to have powers in the field of finance. To the extent that financial authorities are public authorities, they have corresponding functions, authority and certain competence in the field of finance. The majority of financial activity is carried out by state government bodies,⁴² but the legislative body – **the National Assembly** also has financial powers: it adopts the state budget and the report on its implementation; establishes by law the taxes and determines the amount of state charges; grants financial amnesty, and has other powers listed in Article 84 CRB. **The President** also has financial powers, such as cancelling uncollectible state debt (Article 98(12) CRB). The body that organises the implementation of the budget is **the Council of Ministers**,⁴³ according to the CRB and Public Finance Act (PFA). So, the concept of ‘**financial administration**’ includes both bodies of general competence (while at the same time having powers in the field of finance) and bodies with special competence, i.e.,

⁴² Within the meaning of §1, item 1 of the Supplementary Provisions of the Administrative Procedure Code, an: ‘*Administrative authority*’ shall be any authority *appertaining to the system of the executive branch of government, as well as any holder of administrative powers empowered in pursuance of a law*.

⁴³ Article 106 CRB: The Council of Ministers shall manage the implementation of the state budget; organize the management of the state’s assets; conclude, confirm or denounce international treaties when authorized to do so by law.

bodies whose powers are entirely in the field of finance. Such body is **the Minister of Finance** with the entire administration under him.⁴⁴ The structure of the Ministry of Finance includes the subordinate authorities having a budget under the Minister of Finance, which are independent legal entities. Some these authorities have regional structures across the country: the **National Revenue Agency; the Customs Agency; the State Financial Inspection Agency; the Audit of EU Funds Executive Agency; the Public Procurement Agency.** The ‘financial administration in the narrow sense’ also includes the independent bodies: the **Audit Office; BNB; FSC.** We must not forget **the employees of municipal administrations under Article 4 of the Local Taxes and Fees Act, the mayor and the municipal council of the municipality.** In financial law, there is no financial authority that is omnicompetent. Powers are always related to the specific authority of the hierarchy. Exercising their powers, the bodies of the financial administration act primarily under conditions of bound competence and on the basis of the law.

Financial control and Audit in the public sector (see Chapter 22) in the context of EU public finances forms the basis of the **activities of our specialised financial administration**, which manages and controls public finances – both European and national: in the first place, this is the revenue administration: the **National Revenue Agency, the Customs Agency, local municipal revenue administrations** (which manage and control the collection of national budgetary revenue and EU’s own revenue, as well as revenue designated for local budgets; **in the second place**, the institutions which manage and control the expenditure part of the national budget, respectively the EU budget (with an institutional framework of bodies being set up for the purpose, the establishment of which is set out in EU law (**Managing Authorities (MA), Accounting Authorities (AccA), Audit Authorities (AA), Paying Agencies (PA)**), all authorising officers within the meaning of the Public Finance Act, **aid administrators** within the meaning of the State Aid Act; **in the third place**, the institutions which exercise control and audit the preceding activities – the **Public Procurement Agency, the Ministry of Finance** (State aid, budget, etc.), the EU Funds Audit Agency, the **Protection of the Financial Interests of**

⁴⁴ See Ministry of Finance: <https://www.minfin.bg/> [Accessed on 15 January 2024].

the European Union Directorate (AFCOS) with the Ministry of Interior, the **State Financial Inspection Agency**, the **Public Procurement Agency**, etc. Below is an illustrative diagram of the components of the specialised financial administration:

Diagram 11 – Components of financial administration in the narrow sense



Revenue bodies and public executors must act in accordance with the main principles outlined in TSSPC, as follows: lawfulness, objectivity, self-dependence and independence, *ex officio* actions, good faith and right of protection. The principles of good administration are: legality; procedural propriety; participation; openness; rationality; relevance; propriety of purpose; reasonableness; legitimate expectations; legal certainty; proportionality.⁴⁵

2. Financial administration and Charter of Fundamental Rights of the EU

The term ‘financial administration’ is aptly integrated into the term ‘right to good financial administration’. The right to good administration derives from the Charter of Fundamental Rights of the EU and is one of the main administrative and procedural principles derived from the practice of the EU Court of Justice. In the context of this study, we will talk about the ‘right to good financial administration in a broad sense’. The right to good administration is proclaimed in Article 41 of the Charter in connection with Article 51 of the same Charter. Moreover, this fundamental right is applicable to the ‘financial administration in the broadest sense’ of the Republic of Bulgaria when it applies EU law in: the area of own revenues of the EU budget (VAT and customs), where the authorities of Member State act under conditions of shared competence with the institutions of the union; in the field of competition (state aid and public procurement); in the management of EU funds, regardless of how they are managed, according to the Financial Regulation;⁴⁶ with regard to the common currency (Euro);⁴⁷ banking and financial supervision; etc. The existence of good administration is a prerequisite for EU membership of a candidate country according to the Copenhagen criteria, so that it will have the capacity to deal with the implementation of EU law. A further interpretation of this principle is

⁴⁵ See the Administration Act; for further information on the main principles see: **Craig, P.** Administrative Law. Fifth edition. Sweet & Maxwell. 2016.

⁴⁶ See Chapter 27.

⁴⁷ The Union has exclusive competence (Article 3, § 1, b. ‘c’ TFEU) in the field of monetary policy of the member states whose currency is the Euro, which will face new challenges to their financial legal doctrine and practice concerning the powers of the Central Bank (see Chapter 25). We are just one step away from entering the Eurozone.

that the lack of good financial administration,⁴⁸ may be a prerequisite for liability for damages, including damages arising from violation of EU law. The state is responsible for damages caused by illegal acts or actions of its bodies and officials (Article 7 CRB) and the fundamental principle of EU law on the state's liability for damages in Article 4(3) TEU.

All bodies included in the broad concept of financial administration, being also budget organisations as per § 1, item 5 of the Supplementary provisions of PFA, must comply with the principle of 'good financial management'.

⁴⁸ See also **Craig, P.** *Administrative Law*. Sweet & Maxwell. 2016, 293–294.

CHAPTER 19:

BASIC CONCEPTS OF BUDGET LAW AND BUDGET PROCESS IN BULGARIA

Desislava Kalcheva

ABSTRACT	KEY WORDS
This chapter presents the legislation and basic concepts related to the budgetary process in Bulgaria. The main stages associated with the approval of the state budget in Bulgaria are analysed. The budget process is a phased process where the different stages are: drawing up of the draft budget, adoption, implementation, and approval of the report on implementation of the State Budget. The main elements related to each of the stages of the budget process are presented. The timeframe of the process is summarised. The chapter also provides a characterization of all parties involved in the process. The essence of the budgeting programme is also presented. The role and significance of the Fiscal Council of Bulgaria are highlighted, along with the commitments that the Council has in relation to the budgetary process.	state budget, budget legislation, budget process, Bulgaria, Fiscal Council

I. INTRODUCTION

Financial law faces many challenges due to its complex interrelationship and correlation with European law, the financial system and EU public finances. Financial law is a regulator of public financial activities, and budget law is a sub-branch of financial law.¹ Financial law, including budgetary law is developing dynamically not only in Member States but also in EU law as it addresses the challenges facing the EU.

¹ Regarding Financial Law, see Chapter 18.

Budget law, as part of objective law, constitutes an aggregation of legal rules which regulate a certain spectrum of public relations – those related to the planning and implementation of the state budget. These financial legal relations fall into the second category, i.e., relations related to the redistribution of national income.

Thus, budget law is a part of financial law and exhibits its distinguishing features, characteristics and specifics. Budget relations are organisational, non-objective legal relations because they do not have money as their object. These legal relations are cyclic – they recur on an annual basis between the same subjects. They arise and develop only between state bodies. No natural or legal persons participate in these relations. From a subjective point of view, budget law is applied in the same manner as the term ‘subjective right’. Budget law belongs to state authorities (with independent budgets) which is why we speak of budget rights or budget competence. The budget process is a phased process where the different stages are: drawing up of the draft budget, adoption, implementation, approval of the report on the implementation of the State Budget. Each phase is a prerequisite for the following phase.

According to the **Public Finance Act (PFA)** Article 3,² Public finance is a system for the provision and financing of public goods and services, reallocation and transfer of income and accumulation of resources by budgetary organisations by means of revenue, aid and donations, realisation of financial assets and debt assumption.

Public finances are a topic studied by economic, legal and other social sciences in an interdisciplinary way. Public finances are defined differently in view of their different characteristics and manifestations. From a legal perspective, public finances are a system of social relations that arise in the implementation of the financial activity of states, of supranational entities, or other social realities in the course of allocation and use of national income, respectively the income of any social or political establishment, and the control on that activity (see also Chapters 18, 20, 22, 23). The largest group of financial relations

² Public Finance Act (Zakon za Publichnite Finansi) available (in Bulgarian) at: <https://lex.bg/laws/ldoc/2135837967>, [Accessed on 14 January 2024].

arise to provide the funds necessary for the functioning of the state, which are defined by legal theory as *public finances*.

The rules of the budget process (stages, budgetary competence of EU institutions) are regulated by Articles 313–319 TFEU.³

The budget planning process is important and fundamental in determining state policy and the state of public finances. Since 2014, the main law that defines the budget process at both local and central levels is the Public Finance Act. The Public Finance Act transposes the key provisions of Directive 2011/85/EU of the Council of 8 November 2011 on requirements for budgetary frameworks of the Member States⁴ and Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of the Protocol on the Excessive Deficit Procedure.⁵

With the adoption of the Public Finance Act (PFA), the State Budget Structure Act and the Municipal Budgets Act are repealed.⁶ The budget process is also regulated in the Constitution of the Republic of Bulgaria,⁷ the State Budget Act, and, of course, the annual Budget Act. The budget

³ The financial year runs from 1 January 1 to 31 December – **Article 313**; The budget is established in accordance with a specific legislative procedure – **Article 314(1)**; The budget initiative is conferred on the European Commission – **Article 314(2)**; The budgetary legislative power is shared between the European Parliament (the EP has no independent legislative power and can exercise it only jointly with the Council) and the Council (the EP and the Council have equal powers regarding the adoption of the EU budget and the control on its implementation) – **Article 314(3)**;

⁴ *OJ L 306, 23.11.2011, 41–47.*

⁵ *OJ L 145, 10.6.2009, 1–9.*

⁶ **Александрова, С., Гергана Михайлова, Десислава Калчева, Стефан Петров.** Системи за финансова стабилност и фискална дисциплина на общините в България. София, ИК УНСС, 2021.

⁷ **Article 84:** The National Assembly shall exercise the following powers: 2. adopt the state budget and the report on the implementation thereof; **Article 106.** The Council of Ministers shall direct the implementation of the state budget; organise the stewardship of state property; and shall conclude, endorse, and denounce international treaties where so provided for by the law. **Article 117.** (1) The judiciary shall protect the rights and legitimate interests of the citizens, the legal persons, and the State. (2) The judiciary shall be independent. In the performance of the functions thereof, all judges, jurors, prosecutors and investigating magistrates shall be subservient only to the law. (3) The judiciary shall have an independent budget. Constitution of the Republic of Bulgaria, available (in Bulgarian) at: <https://www.parliament.bg/bg/const> [Accessed on 14 January 2024].

is, essentially, a financial plan, and, in accordance with legal theory, can be adopted by means of a statutory instrument or decision. In Bulgaria, the budget is adopted by means of an Act, i.e., the Act is its legal form, while in its essence the budget is a financial plan. This legal form allows for the inclusion of legal rules which apply over the fixed term of the budget year.

Comparative legal theory claims that the Annual State Budget Act is not a statutory act in the material sense, because it contains only a small number of legal norms. In the Republic of Bulgaria, the Constitutional Court upholds the understanding that the annual budget act is only a formal act because it does not contain legal norms that regulate public relations. Annual budget acts are laws in the formal sense only because they are voted by the National Assembly under the name ‘Act’. In their basic, essential content, they do not contain legal norms. In their expenditure part, they contain provisions authorising state authorities to carry out the necessary expenditure of state funds up to a certain amount. The texts of the annual budget act are statutory instruments that manage funds from the general state monetary fund. They are management (administrative) acts which, without this changing their basic legal characteristics, are issued in the form inherent to acts of the National Assembly and according to the procedure provided for the legislative body. This is sufficient proof that the ‘act’ is simply a form for adopting the financial plan, but in terms of content it has no normative character. Theoretically, it is classified as a general non-normative act.⁸

The Council of Ministers issues decrees to supplement the annual budget act. The type of budget system depends on the state system. Bulgaria adopts a central budget, a budget of the National Assembly and a budget for the judiciary; within the central budget, certain departments and authorities, for example the Audit Office, also have independent budgets.

The content of the term ‘budget process’ is derived from the analysis of the procedural activities of state authorities, the rights of which are set out by valid legislation and the Public Finance Act. On the basis of this

⁸ Михайлова-Големинова С. Предизвикателства пред държавите членки и кандидатките за членство в европейския съюз в областта на данъчното облагане и финансовото право. София, Сиела, 2019, 238–238.

assumption, the budget process comprises an aggregation of procedural activities carried out in a specific sequence and can be regarded as a form of implementation of the budget rights of state authorities.

The budget process is a phased process where the different stages are: drawing up of the draft budget, adoption, implementation, and approval of the report on the implementation of the State Budget. For this reason, the budget process is characterized by dynamic factual elements. The principles of the budget process are set out in Article 20 of the Public Finance Act.

The budget procedure includes the stages, time limits, allocation of responsibilities and requirements for the drawing up of the medium-term budget forecast and of the draft state budget.⁹ It is the duty of the Minister of Finance to submit a proposal to the Council of Ministers for the launch of the annual budget procedure for the next budget year no later than January 31 of the current budget year. The medium-term budget forecast is the basis of the annual budget procedure. It covers a period of three years.¹⁰

The purpose of this chapter is to outline the legal framework of the budget process, to provide a definition of the budget process, to examine the main procedural steps, and to present the key participants in the budget process.

II. ESSENCE AND STRUCTURE OF THE BUDGET PROCESS

The budget process can be considered in its economic, political, organisational and legal aspects. From a legal point of view, the budgetary process is characterized by repetition of the same successive stages. It is a dynamic process starting with the preparation of the medium-term budget forecast and of the annual draft budget, through the adoption of the annual budget implementation report. The budget estimate comprises a series of actions united by an end goal, i.e., its composition is dynamic. Each action in

⁹ Article 67(2) of the Public Finance Act available (in Bulgarian) at: <https://lex.bg/bg/laws/ldoc/2135837967> [Accessed on 26 January 2024].

¹⁰ Брусарски, Р., Андрей Захариев, Георги Манлиев. Финансова теория. София, Фабер, 2015.

the budget process is in itself a source of procedural legal consequences aimed at its overall development and is of independent intra-procedural relevance.¹¹

The rules for the budget process are defined in the **Public Finance Act (PFA)** in force as of 1 January 2014, amended in State Gazette issue 15 of 15 February 2013, amend. SG. issue 95 of 8 December 2015, amend. and suppl. SG. issue 43 of 7 June 2016, amend. and suppl. SG. issue 91 of 14 November 2017, amend. and suppl. SG. issue 98 of 17 November 2020; **in the provisions and guidelines of the Ministry of Finance**, while the deadlines and steps are determined in the **Council of Ministers' Decree** for the relevant budget year. Within the framework of budget planning, the forecasts prepared are on a three-year medium-term basis. They are based on assessments and calculations for the parameters of the Consolidated Fiscal Programme (CFP); assessments and calculations for the maximum amount of commitments for expenses that can be incurred during the year, and for the maximum amounts of new obligations for expenses that can be accumulated during the year by primary budget authorisers (PBA); an assessment of key indicators of the Public Administration sector based on forecasts of the activities of legal entities falling within the scope of this sector, in accordance with the requirements of the European System of National and Regional Accounts.

Fiscal policy is developed in compliance with the fiscal rules and constraints set out in PFA. **The budget procedure aligns with the deadlines for implementing the mechanisms and measures outlined in the main stages of the European Semester which coordinates economic policies in the respective year.**

Proposals for new investment projects, the financing of which is envisaged through agreements for external and domestic state loans in the budget year and/or for which state guarantees are proposed in the budget year, must meet the requirements of the Ordinance on the Requirements to be met by Investment Projects Financed by Government Loans and Projects Applying for Financing by Sovereign Guarantee, as well as the requirements of Decree No. 337 of the Council of Ministers of 2015 (Official Gazette, issue 94 of 2015).

¹¹ **Пенов, С.** Финансово право. Специална част. София, УИ „Св. Климент Охридски“, 2020, 103–104.

It should be noted that the formats of the budgets are programme-based. These programme formats are developed in accordance with the classification of policy areas/functional areas and budget programmes established by the Council of Ministers, within the competence and responsibility of the respective primary budget authoriser.

According to the Planning, Programming, and Budgeting System (PPBS) introduced in 1956, it is important to first develop programmes and plans that incorporate specific objectives and outcomes, and then to allocate the financial resources required to achieve them. The system demonstrates the logical sequence of the budget process, starting with the elaboration of programmes and policies, detailing them in action plans, and finally, developing the budgets, i.e., forecasting the required financial resources per funding source.

In Bulgaria, the first attempts to introduce such a budgeting system were made with the introduction of the so-called programme-target approach in 1972. However, in the context of a centralised planned economy, this attempt remained merely a slogan – its essence remained unexplored and the effects of its actual implementation in management practices were never utilised.

Following the democratic changes, the topic of *‘results-oriented budgeting process,’ ‘goal-oriented budgeting process,’ and ‘programme budgeting’* (in line with the ideas embedded in PPBS) was again put on the agenda. Reforms in the financial and budgetary sector were carried out to ensure stable financial management of national resources and those from the European Union (EU).

Since 1997, Bulgaria has implemented an integrated approach to budget development, where planning and budgeting are based on the scope of the **medium-term financial framework (MTFF)** in full alignment between the MTFF and the commitments made under pre-accession programmes. National co-financing for pre-accession instruments was guaranteed by the Budget Act and the procedures of the National Fund with the Ministry of Finance, which is responsible for the financial management of EU funds and the corresponding national co-financing.

In 2002, the **Ministry of Finance undertook a budget reform based on the introduction of programme-oriented and results-based budgeting. The first pilot programme budget for 2003 was implemented at the Ministry of Environment and Water.** Starting from 2004, programme budgets were introduced in the Ministry of Labour and Social Policy and the Ministry of Transport and Communications. In 2005, the Ministry of Education and Science and two other ministries were included, and from 2006 onwards, all sectoral ministries developed their own programme budgets. The budget for 2007 marked the first programme budget of the Republic of Bulgaria. Since 2014, the concept of programme budgeting is implemented in municipalities through pilot programmes.

The aim of programme budgeting is to delegate more responsibilities and authorities to sectoral ministries. Each sectoral budget is voted on separately, and each corresponding minister becomes responsible for the allocation of funds. **This action scheme helps overcome centralisation, provides a more precise justification of goals, facilitates more efficient resource utilisation, and provides a clear vision of who is responsible for the non-fulfilment of one or another programme.** Simultaneously, the introduction of the programme approach in budgeting is a condition for more effective absorption of funds from the European Union's Structural Funds. During the stage of national budget planning, all national resources and those from the EU are planned jointly. In this manner, comprehensive achievement of strategic objectives is ensured, and co-financing of resources to achieve these objectives is guaranteed.

An advantage of the programme budget is that it transparently demonstrates the political intentions of the Government in its structure. These intentions, taking the form of specific elements in the budget structure, known as programmes, can be much more easily planned and executed through the budget. Programmes consist of a set of compatible activities and projects developed to complement each other for the achievement of the goals set. Each programme should have only one primary budget authoriser responsible for its implementation, which serves to personalise authority and accountability in the programme's overall organisation, execution, and reporting (including non-fulfilment). Each programme serves one operational objective. In this way, it is possible to measure how effectively

resources are allocated within the consolidated budget and sectoral budgets, as well as to measure efficiency in terms of contribution of each programme to the implementation of the Government's political intentions.

When identifying the structure of the programme budget we need to answer the following three questions:

- What is the objective, i.e., what is taxpayers' money being spent on? – The answer identifies the Government's strategic objectives.
- What will the Government do to achieve this goal? – The answer identifies the programmes (groups of activities and/or projects) through which operational and, in turn, strategic objectives will be fulfilled.
- How much will achieving the set goals cost? – The answer relates to the expenditure of resources and is determined by the objectives, the proper operation of the programmes, and the personal responsibility of the primary budget authoriser.

*The budget process is a complex set of financial actions of various state bodies and departments, related to the entire technological cycle of the budget. This is the overall activity of planning, drafting, reviewing, approving, implementing, finalising, and reporting on the state budget. **The budget process is legally regulated in terms of structure, deadlines for implementation of individual stages, and the requirements for them.*** It is based on the Constitution of the Republic of Bulgaria, the Public Finance Act of 2014, and the State Budget Act of the Republic of Bulgaria, which is adopted every year. The budget process is an important process that must ensure the necessary funding sources for the normal functioning of the state.

The main stages or phases of the budget process are as follows:

1. Drafting of the budget.
2. Discussion of the budget draft.
3. Adoption of the budget.
4. Execution of the budget.
5. Reporting on budget execution.

The process requires coordination with all laws voted and applied in the country, which are related to the state budget, at each of the budget phases. *For example, the main portion of planned revenues is composed by tax revenue. The size and methods of collection are regulated in separate tax laws passed by the National Assembly. It is not recommended for changes in tax laws to be introduced after voting of the annual state budget.*

During the different stages of the budget process, all state bodies and institutions participate, but the initiative **and the most important role lie with the Ministry of Finance.**

III. DRAFTING OF THE BUDGET

The first stage of the budget process is the procedure for drafting of the budget for the next year. According to the Public Finance Act, the Council of Ministers, through the Minister of Finance, organises the preparation of the medium-term budget forecast and the draft state budget. The medium-term budget forecast is prepared for a period of three years.¹²

According to Article 67(1) PFA, annually, by January 31, the Council of Ministers, on proposal by the Minister of Finance, adopts the budget procedure for the medium-term budget forecast and the draft state budget for the following year. The Council of Ministers adopts a decision on the specific budget procedure for the relevant year. This decision is a general administrative act and applies to the budget authorisers of all budgets. It defines the rules and criteria that will be followed in the preparation of the medium-term budget forecast and the draft state budget act, as well as the stages of the budget procedure.¹³ *The budget procedure includes the stages, deadlines, allocation of responsibilities, and requirements for preparing the medium-term*

¹² Draft of the Updated medium-term budget forecast for the 2024–2026 period available (in Bulgarian) at: <https://www.minfin.bg/bg/legislation/7/493>. [Accessed on 14 January 2024].

¹³ **Пенов, С.** Финансово право. Специална част. София, УИ „Св. Климент Охридски“, 2020, 105.

*budget forecast and the draft state budget. The budget procedure covers all budget authorisers across the budgets of budgetary organisations.*¹⁴

Elaboration of the budget projects of state bodies starts from the lowest to the highest levels. After receiving guidelines and instructions, all financial units of the respective institutions commence work on creating the basis for the budget draft. Tables are developed reflecting their expected financial position in terms of revenues and expenditures. The data is sent to the respective ministry, which checks whether the guidelines of the Ministry of Finance have been followed. The tables and expenditure norms are observed, along with the correlation between the main indicators of the institution's past activities and the amount of planned expenses, planned savings, etc. The financial departments of the ministries have the authority to make changes to their submitted calculations, adjusting some revenues and expenses if such are provided.

According to Article 68 PFA, **within the budget procedure, the Minister of Finance prepares a spring and autumn macroeconomic forecast by 25th March and 25th September, respectively. The macroeconomic forecasts, including their underlying assumptions on which these forecasts are based, are published on the website of the Ministry of Finance within 10 days of their preparation.**

Within the budget procedure, the Council of Ministers, upon proposal by the Minister of Finance, adopts standards for state-delegated activities with physical and value indicators. The standards serve to determine the total amount of funds required for financing state-delegated activities and their allocation among primary budget authorisers. The standards for state-delegated activities are jointly developed by the respective minister, the National Association of Municipalities in the Republic of Bulgaria, and the Minister of Finance.

In September, the budget drafts developed by the National Assembly, the Presidency, individual ministries, and regional and municipal administrations are submitted to the Ministry of Finance. Along with the budget drafts, reports containing the justifications for the planned revenues

¹⁴ Information on the budget procedure 2024, available (in Bulgarian) at: <https://www.minfin.bg/bg/1586>. [Accessed on 14 January 2024].

and expenditures are attached. Within the same deadline and under the same requirements, the National Audit Office and the Supreme Judicial Council submit budget drafts to be included as an integral part of the draft state budget.

Budget forecasts and budget drafts are developed by:

- Budget authorisers related to budgetary organisations, including municipalities;
- State authorities for the budgets of budgetary organisations that apply a programme budget format – also per policy area/functional area and budget programme;
- Programme budget authorisers for the National Assembly’s budget – also per functional area and budget programme;
- The Supreme Judicial Council for the budget of the judiciary – also per judicial authority;
- The respective Programming and Reporting Body/Managing Authority for the European Union funds account of the National Fund – per indicator from the Unified Budget Classification and per programme;
- The Executive Director of State Fund Agriculture for the European Union funds account of State Fund Agriculture – per indicators from the Single Budget Classification and per programmes;
- The respective Programming and Reporting Body for other European Union funds accounts and funds from other international programmes and agreements to which the European Union funds regime applies – per indicator from the Single Budget Classification and per programme;
- The respective Programming and Reporting Body for state enterprises included in the Consolidated Fiscal Programme – per indicator from the Single Budget Classification;
- The respective Programming and Reporting Body for state higher education institutions and for the Bulgarian Academy of Sciences for their budgets – consolidated, and on a budget-by-budget basis per indicator from the Single Budget Classification.

If necessary, the Ministry of Finance develops a draft of amendments to the updated medium-term budget forecast based on the parameters of the laws adopted by the National Assembly: State Budget Act of the Republic of Bulgaria for the respective year; State Social Security Budget Act; National Health Insurance Fund Budget Act, and tax laws.

If any of the aforementioned state authorities do not independently prepare a budget draft, this is prepared by the Ministry of Finance. Apart from budgetary organisations, by September 15, the Ministry of Finance develops its own comprehensive version of the state budget draft. This allows for a comparison of all proposed drafts, seeking the best possible combination among them.

The budget drafts presented to the Ministry of Finance are analysed, and any existing deficiencies are rectified through coordination. Compliance with the law is ensured for the expenditures, sources, and guidelines for the projected revenues and expenditures, as well as their objectivity and justification. Options for cost savings are explored through more efficient use of funds or identification of new reserves to increase revenue.

In the case of deficiencies or irregularities, the Ministry of Finance can make corrections to the presented documents. According to a pre-defined schedule, internal coordination is conducted within the government with the respective budgetary bodies to finalize their budget drafts and rectify any inaccuracies.

The Ministry of Finance reviews the budget drafts of the Audit Office and the Supreme Judicial Council; **it cannot, however, make corrections to their budgets, but only inform them in writing of its opinion on the proposed drafts.**

Following consultations with the state bodies, the final version of the state budget draft is prepared. It includes the proposal of the Council of Ministers for the budget drafts of the state bodies that have not submitted their version within the specified period.

In accordance with Article 79(1) PFA, the Minister of Finance prepares and submits to the Council of Ministers:

- The draft of the State Budget Act;
- The draft of the updated medium-term budget forecast, reflecting the recommendations of the Council of the European Union and the differences between the macroeconomic scenarios from the spring and autumn forecasts of the Ministry of Finance;
- The draft opinion of the Council of Ministers on the budget of the judiciary;
- The protocol of consultations with the National Association of Municipalities in the Republic of Bulgaria;
- Other documents specified in the budget procedure.

The draft State Budget Act represents the government's proposals for specific revenues and expenditures in actual form, as well as the main goals and priorities that the budget will follow in the coming year.¹⁵

Together with the State Budget Act, the Minister of Finance submits to the Council of Ministers the programme formats of the budgets of primary authorising officers under the state budget, indicating those that do not comply with the parameters of the draft State Budget Act and the updated medium-term budget forecast.

Annually, by October 31, the Council of Ministers, upon proposal by the Minister of Finance, approves the State Debt Management Strategy under the State Debt Act for the period of the respective medium-term budget forecast.

The Council of Ministers approves the draft of the State Budget Act together with the updated medium-term budget forecast. The parameters of the approved draft must correspond to the parameters of the updated medium-term budget forecast.

¹⁵ Герунов, А. Публични финанси: Теория и политика. София, УИ „Св. Климент Охридски“, 2016, с. 370.

1. Fiscal Council and its role in budget preparation

According to the International Monetary Fund's definition, Fiscal Councils are often non-partisan, technical bodies entrusted as a public finance watchdog to strengthen credibility of fiscal policies with a variety of mandates. Fiscal councils are independent bodies set up by governments to evaluate fiscal policy. According to the research of Lars Calmfors and Simon Wren-Lewis 'the fiscal councils provide some form of ex-post and ex-ante evaluation of fiscal policy and longer-run fiscal sustainability. Unlike independent central banks, no fiscal council has any formal power to decide the national deficit. Instead, they provide advice of various kinds, by producing forecasts or evaluating government policies. There are a number of possible reasons why these bodies have no formal power over policy...'¹⁶

The EU fiscal governance framework *inter alia* broadened the role and tasks of national fiscal watchdogs in an attempt to foster budgetary discipline and to increase national ownership of EU fiscal rules. Fiscal councils are generally defined as independent public institutions that are aimed at strengthening commitments to sustainable public finances. According to the so-called two-pack,¹⁷ eurozone countries should have in place an independent body, such as a fiscal council, which is in charge of monitoring compliance with numerical fiscal rules and, where appropriate, assesses the need to activate the correction mechanism foreseen under the Fiscal Compact.^{18, 19}

¹⁶ **Calmfors L., Simon Wren-Lewis.** What are fiscal councils, and what do they do? CEPR, 2011. Available at: <https://cepr.org/voxeu/columns/what-are-fiscal-councils-and-what-do-they-do> [Accessed on 21 January 2024].

¹⁷ See the Official Journal of the European Union, OJ L 140, 27.05.2013, and the box entitled 'The 'two-pack' regulations to strengthen economic governance in the euro area'; Monthly Bulletin, ECB, Frankfurt am Main, 2013.

¹⁸ The requirements for fiscal councils are primarily spelled out in the two-pack, which relates only to eurozone countries. However, references to fiscal councils are also made in the Fiscal Compact, affecting all contracting parties, and in the European Commission's common principles, which were issued in June 2012.

¹⁹ For more information, see ECB Monthly Bulletin June 2014, available at: https://www.ecb.europa.eu/pub/pdf/other/mb201406_focus08.en.pdf [Accessed on 14 January 2024].

It is important to know that IMF maintains the Fiscal Council Dataset. This dataset describes key features of 51 institutions in 49 countries that are identified as fiscal councils across the IMF membership as of 2021.²⁰

The Fiscal Council of Bulgaria²¹ plays a role in the preparation of the draft budget and in the implementation of the state budget. In accordance with the Fiscal Council and Automatic Correction Mechanisms Act, the Fiscal Council:²²

- Monitors compliance with the numerical fiscal rules provided in the Public Finance Act, which relate to the Public Administration sector and the consolidated fiscal programme.
- Prepares a reasoned opinion and recommendations on the spring and autumn macroeconomic forecasts of the Minister of Finance within 10 days of their publication on the website of the Ministry of Finance.
- **Prepares a reasoned opinion and recommendations on the draft of the State Budget Act, the drafts of the State Social Security Act and the National Health Insurance Fund Act, the draft acts for their amendment and supplementation, the projects of the medium-term budget forecast,** as well as other strategic documents of the Council of Ministers related to compliance with numerical fiscal rules within the procedure of coordination and submission of drafts for consideration at a meeting of the Council of Ministers.²³
- Prepares a reasoned opinion on the reports **on the implementation of the state budget**, the budgets of the state social security and other social security funds administered by the National Social

²⁰ IMF Dataset, available at: <https://www.imf.org/en/Data/Fiscal/fiscal-council-dataset> [Accessed on 26 January 2024].

²¹ Information on the Fiscal Council of Bulgaria is available at: <https://www.fiscal-council.bg/bg>, [Accessed on 14 January 2024].

²² **Article 6, Fiscal Council and Automatic Correction Measures Act** available (in Bulgarian) at: <https://lex.bg/bg/laws/ldoc/2136477159>, [Accessed on 14 January 2024].

²³ Opinion and recommendations on the Draft State Budget 2024, the drafts of the state social security budget, and the budget of the National Health Insurance Fund, as well as the projects of the medium-term budget forecast are available (in Bulgarian) at: <https://www.fiscal-council.bg/bg/publikacii> [Accessed on 14 January 2024].

Security Institute, and the budget of the National Health Insurance Fund within the procedure of coordination and submission of drafts for consideration at a meeting of the Council of Ministers.

- Prepares and provides the Chairperson of the National Assembly with a reasoned opinion and recommendations on the approved draft acts, documents and reports no later than 14 days after their submission to the National Assembly by the Council of Ministers.
- In the event of a significant deviation of macroeconomic forecasts from the reported data over a period of at least four consecutive years, recommends to the Minister of Finance the adoption of measures to correct the deviation.

Unlike the fiscal councils in more developed EU countries, the Fiscal Council in Bulgaria has significantly more limited tasks. The Fiscal Council of the Netherlands is an example of an excellently functioning watchdog. In the late 2000s, the CPB²⁴ was given the role of fiscal council, performing the traditional tasks of a fiscal watchdog, such as forecasting, assessing policy initiatives, evaluating fiscal transparency, *ex ante* and *ex post* evaluation of fiscal policy, monitoring observance of fiscal rules, and evaluating fiscal sustainability. The Bureau's main tasks are: medium-term baseline projection, analysis of election platforms, and regular quarterly forecasting, of which the first two are unique to the Netherlands. The medium-term baseline projection, based on an assumption of unchanged economic policies, is published by the CPB every four years, before every general parliamentary election. It is discussed in a meeting of the Budgeting Framework Commission, a body chaired by the Ministry of Finance and composed of top civil servants, among them the CPB Director, and is the starting point for assessing any policy initiative that has been proposed.

Unlike the Fiscal Council of the Netherlands, the Fiscal Council in Bulgaria does not prepare independent budget forecasts, does not analyse pre-election platforms and does not prepare quarterly financial forecasts. The main tasks of the Council are based on the *ex-post* evaluation of the financial forecasts, including the proposal for the state budget, which the Ministry of Finance publishes on its website. The reasons why the Fiscal

²⁴ CPB, Netherlands Bureau for Economic Policy Analysis, the Dutch Fiscal Council.

Council in Bulgaria cannot develop further are: difficult communication with the Ministry of Finance, the mandate of the experts (5 years), difficulties in continuity, etc. It is recommended that the analyses prepared by the Fiscal Council are more independent, more comprehensive and based on generally accepted econometric models.

2. Discussion and adoption of the state budget

By October 31, the Council of Ministers submits to the National Assembly the approved drafts for the State Budget Act, State Social Security Budget Act, and the National Health Insurance Fund Budget Act, along with the updated medium-term budget forecast, which presents the relevant motives, and the programme formats of the budgets of primary authorising agents corresponding to the parameters of the draft State Budget Act and the updated medium-term budget forecast.

The drafts of the state budget, the budget of the State Social Security, and the budget of the National Health Insurance Fund are reviewed under the procedure determined by the Rules of Organisation and Procedure of the National Assembly (NA).

The draft budget is submitted for consideration to the National Assembly with a full budget classification and all the necessary analytical information serving as rationale for the proposed draft.²⁵ Within three days of receiving the draft act for the state budget, the Chairman of the National Assembly distributes it to all standing parliamentary committees, designating the Budget and Finance Committee as the lead in the discussion. The draft budget is adopted in two voting sessions, which are held in different sessions of the National Assembly.

The state budget is adopted in component budgets, including main types of revenues, expenditures, and transfers, the budget balance of the republican budget and its financing, the total amounts of revenues and expenditures of the budgets of state bodies, and their relations with

²⁵ For more information on the work of the National Assembly, see: Rules on the work of the National Assembly, available (in Bulgarian) at: <https://www.parliament.bg/bg/podns> [Accessed on 14 January 2024].

the central budget, the relations of the state budget with the budgets of municipalities, and the relations with off-budget funds.

The discussion of the draft budget begins no earlier than 24 hours after its submission to the National Assembly with its consideration by the standing parliamentary committees for the first vote, with each committee pronouncing on the part of the draft that falls under its competence. Upon request for additional information—references and/or explanations regarding the planned revenues or expenditures of a given ministry, department, or other budgetary institution, the relevant institution is obliged to provide it. All opinions of the standing parliamentary committees are summarized by the Budget and Finance Committee in a report. It is advisable for the members of the budget committee to familiarize themselves with the opinions and arguments of the members of other standing committees before the draft budget is submitted for consideration in the plenary hall.

It should be noted that the debates on the new budget held in the National Assembly are of a political nature. Assembly members are elected by different political parties and defend specific priorities. In this way, representatives of each political party or coalition seek to secure more funds for tasks they deem crucial.

During the first reading in the plenary hall, the draft budget is discussed in principle and in its entirety, and the members of the Assembly pronounce on the main provisions of the draft act. The Minister of Finance, on behalf of the Council of Ministers, presents an exposition, outlining the key points in the financial document under consideration. The procedure continues with a report presented by the Chairman of the Budget and Finance Committee, followed by discussion of the draft budget. After the discussions, the first-reading vote takes place.

Within a 7-day period from its adoption, members of parliament can make written proposals for amendments and additions to the draft adopted at first vote, along with the respective justifications. As an exception, the National Assembly may decide to shorten this period, but not less than three days, or extend it by up to three weeks.

Within the specified period, the Budget and Finance Committee submits a report for the second reading to the National Assembly,

containing the written proposals made by the members of parliament and the committee's opinion on them, as well as the proposals of the budget committee. Sometimes, additional clarifications and agreements from the Budget and Finance Committee and the Council of Ministers are necessary to ensure the feasibility of proposals and to conduct a comprehensive analysis of the implications that a given amendment will have on other portions of the budget. This approach aims to maintain budget balance.

The National Assembly discusses and votes on the second reading chapter by chapter, section by section, or text by text. The duration of the debates in the plenary hall is not normatively specified as a deadline, as opinions and proposals can be expressed by any member of parliament. The adoption of the draft budget at the second reading is carried out in accordance with the Unified Budget Classification. Budget revenues are separated into groups, sections, activities, and paragraphs and are voted on separately.

Upon adoption of the draft budget, it becomes the country's budget for the respective year. It comes into effect once it is published in State Gazette.

In the event that the National Assembly rejects the draft budget presented by the Government, the Government must resign, a new government must be formed, and it must submit a new draft budget. Alternatively, the National Assembly, which has not adopted the presented draft budget at the second reading, dissolves itself, new parliamentary elections are held, and the new National Assembly is invited to vote on the same version of the draft budget. Bulgaria applies the first option.

The state budget act and the final version of the budget adopted by the legislature after discussions and adjustments, contains the policies and activities that the government will carry out during the fiscal year.²⁶

In the event that the budget period has started, and there is no adopted budget due to a political or economic crisis, use of the so-called monthly budgets is imposed. Article 87 of the Public Finance Act is applied, which

²⁶ Герунов, А. Публични финанси: Теория и политика. София, УИ „Св. Климент Охридски“, 2016, с. 370.

regulates that 'If the National Assembly fails to adopt the state budget before the beginning of the budget year, the budget revenue shall be collected in compliance with the applicable laws and expenditure and transfers shall not exceed the expenditure or transfer amount for the same period of the preceding year, up to the amount of the revenues, aid and donations received, while taking into account any regulations adopted by the National Assembly and the Council of Ministers which stipulate additional or reduced budget resources and while observing the fiscal rules laid down herein and the fiscal objectives approved by the Council of Ministers in the medium-term budgetary forecast.'

This means that each month a sum can be spent within 1/12 of the expenses from the previous budget. The legally established period for the use of the monthly budgets is three months. Following expiration of this three-month period, if the budget is still not adopted, the National Assembly determines an additional period for the collection of revenues and the performance of expenditures.

Execution of the budget is entrusted to the Council of Ministers, i.e., the Council begins to issue instructions for budget execution. Control over execution of the state budget within the fiscal year is carried out by the Audit Office.

3. Budget execution

Where the activities related to the preparation, voting, and adoption of the state budget are completed on time, execution of the budget begins from the first day of the new budget year – January 1.

Within one month of promulgation of the State Budget Act in State Gazette, the Ministry of Finance is obliged to publish a Decree on the Budget Execution, specifying the financial indicators for the budgets of state bodies and budget organisations. Based on this Decree, and within one month of its publication, the latter must finally specify their budgets according to the full budget classification and for the respective quarters and submit them to the Ministry of Finance. The Ministry reviews them and pronounces on their legality. In the event of violations, the Ministry sets deadlines for their rectification.

Primary budget authorisers organise and manage the execution of their budgets. They determine the budgets of secondary budget authorisers and approve them unless otherwise specified in PFA or another act. Secondary budget authorisers determine and approve the budgets of their lower-level budget authorisers.

The Minister of Finance issues instructions for the execution of the state budget and the accounts for funds from the European Union. The instructions are published on the website of the Ministry.

Execution of the budget means the regular collection of planned revenues and the timely payment of stipulated expenses in order to ensure the smooth progress of economic and social processes in the country. Budget execution can be divided into two parts – execution of the revenue part and execution of the expenditure part.

Execution of the state budget in its revenue part

The organisation and deadlines for the collection of various revenues in the budget are regulated by respective laws, making it crucial to avoid statutory changes to such laws after the budget execution phase begins.

When the revenues are accumulated in the budget, it can be said that they accrue to the ‘treasury’ of the state, which is why budget execution in its revenue part is referred to as the *cash execution of the budget*.

Cash execution of the budget is based on the principle of the unity of the treasury. All revenues accrue to a common account or treasury, and state expenditures are financed solely from there. *Two systems of cash execution of the budget are known – the treasury system and the banking system.*

The treasury system is historically older. It involves the establishment of special cash registers within tax authorities, departments, and administrations for the collection of budget revenues. The special feature of this system is its combination with the fund principle in budget management. Depending on the types of collected revenues, funds with specific purposes are formed. Each fund has its own source of income and is used to finance a specific activity. The disadvantage of this system is that it is not always possible to find a source of income for every expenditure,

and the funds collected in a particular fund are not always sufficient to cover necessary expenses. Additionally, the fund system contradicts the principle of unity of the budget and centralisation of state funds.

The *banking system* emerges as a more sophisticated way of accumulating budget revenues. With the development of banking institutions, the cash execution of the budget gradually establishes itself as one of their main functions, and the central bank gradually becomes the main cashier of the state. Under the banking system, banks are authorised by the state to carry out actions related to the collection of revenues, their storage, servicing of budget and off-budget accounts, and disbursement of amounts for state expenditures to authorised persons. A unified treasury is formed, ensuring centralisation of budget revenues and the principle of budget unity comes into force. All these activities are carried out under the control of the central bank (in our case – the Bulgarian National Bank), which is also the main depository of the state. It organises and carries out the cash execution of the state budget through commercial or other banks. The Minister of Finance and the Governor of the central bank jointly issue an Ordinance on the cash execution of state and municipal budgets and the social security budget. All actions related to the cash execution of the state budget, as well as the storage of cash and other valuables in connection with it, are carried out free of charge.

Budget execution in its expenditure part

After the budget is approved and the funds are allocated quarterly, its execution in the expenditure part begins. This execution is associated with significant responsibilities and is of particular importance. For this reason, it is subject to stricter control compared to execution of the revenue part.

Regarding the execution of the expenditure part of the budget, the Council of Ministers may:

- approve internally compensatory changes to the approved annual State Budget Act expenditures in policy areas and budget programmes per primary budget authorisers under the state budget upon their proposal, coordinated with the Minister of Finance;
- approve changes to the approved personnel expenses in the budgets of the primary budget authorisers under the state budget upon their

proposal, coordinated with the Minister of Finance. The Council of Ministers may approve additional expenses/transfers for the budgets of primary budget authorisers, as well as for budgetary organisations at the expense of the central budget, provided that the budget balance is not violated;

- approve changes to the budgets that are part of the state budget in the financing part of the budget balance upon proposal by the respective primary budget authoriser, coordinated with the Minister of Finance.

Regarding the execution of the expenditure part of the budget, the Minister of Finance:

- can make changes to the budgets of primary budget authorisers under the state budget for aid and donations and for revenue from insurance compensations;
- can make changes for expenses unforeseen in the budgets of the primary budget authorisers under the state budget, for unspent funds from previous years from aid and donations and from insurance compensations, at the expense of a compensated reduction in expenses under the state budget;
- can adopt, internally, compensatory changes to the approved expenditures in the budget programmes of primary budget authorisers under the state budget upon their proposal, without changing the approved expenditures in policy areas. In these cases, the overall personnel expenses cannot be changed except in the case of changes to delegated budgets;
- can introduce compensated changes between budgets upon mutual proposal of primary budget authorisers without changing the purpose and destination of the funds, including by changing their budgetary relations with the central budget;
- can make changes to the expenditures in the budgets of primary budget authorisers at the expense of transfers received from the respective budget accounts for funds from the European Union;

- can make other changes between the budgets of the primary budget authorisers and the accounts for funds from the European Union, provided that the balance of the state budget is not compromised;
- can make changes to the budgetary relations with the central budget of primary budget authorisers, whose budgets are included in the state budget, for payments and receipts in the financing part of the budget balance;
- can make changes for expenses unforeseen in the budgets of the National Assembly and the judiciary, for unspent funds from previous years from aid and donations and from insurance compensations, at the expense of a compensated reduction in expenses under the state budget;
- can, upon proposal by the respective primary budget authoriser, make changes to the indicators for delegated budgets resulting from the over-fulfilment of their revenues, unless otherwise provided by the state budget act for the respective year.

The Minister of Finance makes changes in the budgetary relations of the respective municipalities with the central budget resulting from changes in the administrative-territorial structure of the country.

The Bulgarian National Audit Office exercises control over the proper execution of the budget throughout the year.

Information on the periodic execution of expenditures and revenues of the state and municipalities can be found on the respective institutions' websites.

4. Budget accounting

The Ministry of Finance monitors the current execution of the consolidated fiscal programme.

The Minister of Finance submits to the Council of Ministers information on the cash execution of the state budget and the key indicators of the consolidated fiscal programme for each quarter of the current budget year.

The Council of Ministers submits to the National Assembly, for information purposes, a report on the cash execution of the consolidated fiscal programme for the first half of the current budget year no later than September 15.

The periodic closing allows for ongoing monitoring of budget execution. If deviations from the approved indicators are identified, timely action can be taken to make corrections. In the event of non-fulfilment of certain revenues or expenditures, an analysis is conducted to identify the reasons and to outline measures for their rectification. One particular aspect of the periodic closing of the budget is that, despite its name, the budget's operation does not cease after its completion. This is a type of control, the results of which serve to draw attention to specific indicators whose execution is not proceeding as planned.

In accordance with the provisions of Article 138 of the Public Finance Act, the Minister of Finance:

- by June 30, prepares and submits to the Audit Office an annual report on the execution of the state budget based on the approved indicators, as well as a report on the consolidated fiscal programme based on the annual reports of the primary budget beneficiaries and the central budget.
- by September 30 of the following budget year, submits to the Council of Ministers a report on the execution of the state budget, based on the audited annual reports of primary budget authorisers and the central budget prepared by the Audit Office, accompanied by a report.

The Council of Ministers adopts the annual report on the execution of the state budget and submits it to the National Assembly for approval. During the period from the examination of the report by the Budget Commission to its discussion in the plenary hall, if errors and inaccuracies with significant effects on the indicators of state budget execution reports are found in the course of the audit process by the Audit Office, the Audit Office notifies the Minister of Finance and the Budget and Finance Committee, indicating the necessary corrections to be made in the report. The Minister of Finance, in turn, provides a written opinion to the Budget

and Finance Committee and the Audit Office, and, in accordance with it, for the purposes of accountability and public finance statistics, may make changes to the accounting data for cash execution under the consolidated fiscal programme.

During the discussion of the state budget execution report in the National Assembly, the Minister of Finance presents the annual report on the main indicators of the state budget execution, the achievement of fiscal targets, information on the execution of the consolidated fiscal programme, as well as the annual report on the state of public debt. Ministers present the annual reports on the execution of the policies for which they are responsible.

By December 31 of the following year, the National Assembly adopts a resolution on the report on the execution of the state budget.

In conclusion, after the budgetary period has elapsed, the *annual closing of the budget is conducted*. It is final, and after that, the budget ceases to operate. Its essence lies in the final determination of the size and structure of all realised revenues and expenditures within the budget period. It is carried out on all elements of the budget classification. Two methods are used for the closing of the budget – budgetary closure and budgetary exercise.

Bulgaria has elected to use the *budgetary closure* method. With this method, the annual closure is carried out on December 31, i.e., on the last day of the budget year. After this date, all payments and receipts under the old budget cease. All budget authorisers are obliged to collect the planned revenues and make the corresponding expenditures by the end of the budget period, as the accounts under the old budget are closed. From January 1, new accounts are opened, but they are designated for the next budget. With this closing, it is also possible to determine a budget surplus or deficit.

As a global practice, the *budgetary exercise* is also used for annual closure.²⁷ With this method, there is a liquidation period of one to three

²⁷ Коцев, Ц., Тодорка Владимирова, Владимир Владимиров и др. Публични финанси. Варна, ИК „Стено“, 2008, с. 286.

months for the collection of revenues and the execution of expenditures not realised during the year. During this period, two budgets are exercised simultaneously – the old and the new. In practice, this method extends the budget period beyond the normal. During the liquidation period, alongside the implementation of the new budget, all remaining voted funds from the old budget are collected, and any overdue expenditures are carried out. To some extent, the existence of such an additional period is sometimes reasonable, as it is not always possible to carry out all financial operations by December 31. On the other hand, this method creates conditions for violations of financial discipline by transferring revenues and expenditures from one budget to the other. This deforms the results of budget closure and undermines its purpose. This is why the method of budgetary closure finds broader application.

The report on the execution of the budget is prepared after its closure. It is compiled based on aggregated data from all budget units. The annual performance report summarises the fiscal position at the end of the year, providing interim data on revenue, expenditure, deficits and accumulated debt. In addition, the annual report also provides a report on the implementation of set goals and policies.²⁸ This report is submitted for review by the Council of Ministers and then approved by the National Assembly. The report on the execution of the budget from the previous year is voted on and published together with the new budget for the following budget year. The acceptance of the budget execution report is an expression of approval of the government's financial policy and its release from financial responsibility. With the acceptance of the report, the budget process is concluded.

²⁸ Герунов, А. Публични финанси: Теория и политика. София, УИ „Св. Климент Охридски“, 2016, с. 370.

CHAPTER 20:

FOUNDATIONS OF BUDGET LAW AND BUDGET PROCESS IN THE EUROPEAN UNION

Desislava Kalcheva

ABSTRACT	KEY WORDS
The legislation of the European Union (EU) is a complex system that encompasses a wide range of legal acts and regulations. The EU legislative process involves several institutions, and the laws adopted at EU level are binding on all member states. The purpose of this chapter is to present an analysis of the legislative framework of the budgetary process at European Union level. Issues related to key principles of the EU, the Multiannual financial framework and the Annual budget of the EU as well as the 2021–2027 long-term EU budget and the next generation instruments for EU recovery are also analysed.	budget law, budget process, European Union, NextGeneration EU, Multiannual Financial Framework 2021–2027

I. INTRODUCTION

The budget process at European Union level is characterized by a complex nature. The budget law and budget process in the European Union (EU) are crucial aspects of its governance, ensuring the allocation and management of financial resources to support EU policies and programmes. Various European institutions are involved in the process. The process is regulated by a series of treaties, agreements, regulations, directives, and others.

The economic foundation for achieving the common European goals is the EU budget, which outlines the overall revenues and expenditures of the Union for the year, based on the adopted policy development strategy. The Union's development strategy and its goals for the respective

programming period are adopted first, followed by the Multiannual Financial Framework, which ensures the achievement of these goals by the EU and its member states. Member states also adopt strategies in accordance with EU strategies (Partnership Agreement, Operational Programmes, and other strategic sectoral documents, etc.). The annual budgets of the EU are then adopted in accordance with Articles 310–325 of the TFEU (Treaty on the Functioning of the European Union) and the financial regulation, annual budgets of the EU.¹

The general principles governing the Union's budget are as follows: (1) the principle of unity; (2) the principle of accuracy; (3) the principle of universality; (4) the principle of annuality; (5) the principle of equilibrium; (6) the principle of specification; (7) the principle of the unit of account; (8) the principle of transparency; (9) the principle of sound financial management.²

The main definitions and elements concerning the EU Budget and budget process are:³

- **Legal Basis:** the primary legal basis for the EU budget is outlined in the Treaty on the Functioning of the European Union (TFEU). Title II of the TFEU, Articles 310 to 325 provide the legal framework for the EU's financial regulations and budgetary procedures.
- **Multiannual Financial Framework (MFF):** The EU's MFF sets out the annual ceilings of expenditure that can be spent on various policy areas. The current framework runs for the period 2021–2027. EU MFFs are adopted for multiannual periods (usually 7 years, as in the present case).
- **Annual EU Budget:** The EU's annual budget is prepared, adopted, and implemented through a specific budgetary procedure. The budget covers the revenue and expenditure of the EU for a given financial year. *The budgetary procedure involves the European*

¹ Михайлова-Големинова С. Предизвикателства пред държавите членки и кандидатките за членство в европейския съюз в областта на данъчното облагане и финансовото право. София, Сиела, 2019.

² For more information: European Commission, Directorate-General for Budget, European Union public finance, Publications Office, 2014, <https://data.europa.eu/doi/10.2761/17724> [Accessed on 29 January 2024].

³ European Commission: https://commission.europa.eu/index_en [Accessed on 15 January 2024].

Commission, the European Parliament, and the Council of the European Union.

- **Budgetary Procedure:** The budgetary procedure typically follows a series of steps:⁴

1. *Submission of the draft budget by the Commission* – Parliament and the Council lay down guidelines on the priorities for the budget. The Commission draws up the draft budget and forwards it to the Council and Parliament (no later than 1 September under Article 314(2) TFEU, but according to the pragmatic timetable, by the end of April or beginning of May). The Commission may modify the draft budget at a later stage to take account of new developments, but no later than the point at which the Conciliation Committee (see below) is convened. The Parliament has the power to amend and approve or reject the budget.

2. *Adoption of the Council's position on the draft budget* – the Council adopts its position on the draft budget and forwards it to Parliament (under Article 314(3) TFEU it must be submitted by 1 October at the latest, but according to the pragmatic timetable it is sent by the end of July). The Council must inform Parliament in full of the reasons why it adopted its position.

3. *Parliament's reading* – Parliament has 42 days in which to respond. During this period, it may either approve the Council's position or decline to take a decision, in which case the budget is deemed finally adopted, or else Parliament can propose amendments if they are adopted by a majority of its members, in which case the amended draft is referred back to both the Council and the Commission. The President of Parliament, in agreement with the President of the Council, must then immediately convene a meeting of the Conciliation Committee.

4. *Meeting of the Conciliation Committee and adoption of the budget* – from the day on which it is convened, the Conciliation Committee (composed of equal numbers of representatives of the Council and of Parliament) has 21 days to agree on a joint text. To do so, it must take its decision by a qualified majority of the members of the Council or their

⁴ For more information: European Parliament: <https://www.europarl.europa.eu/factsheets/en/sheet/10/the-budgetary-procedure> [Accessed on 15 October 2023].

representatives and by a majority of the representatives of Parliament. The Commission takes part in the Conciliation Committee's proceedings and takes all the necessary initiatives to seek to reconcile the positions of Parliament and the Council.

- **Financing of the EU Budget:** The EU budget is financed through a combination of sources, including member state contributions (based on their Gross National Income), customs duties, and other revenue streams.
- **Budgetary Functions:** The EU budget serves various functions, including supporting common policies (agriculture, cohesion, research, etc.), external actions, administration, and addressing unforeseen circumstances.
- **NextGenerationEU:** NextGenerationEU is a specific instrument designed to address the challenges posed by the COVID-19 pandemic and kick-start the European economy. It is part of the broader MFF for 2021–2027.
- **Management of EU Funds:** the institutional framework and types of regimes for the management of EU funds are established to ensure effective and transparent use of financial resources.
- **Rule of Law:** The EU budget and financial management are subject to the rule of law, ensuring accountability, transparency, and adherence to legal principles.

Overall, the budget law and process in the EU are integral to the functioning of the Union, supporting its policies, programmes, and strategic objectives.

The purpose of this chapter is to present the essence of the European Union budget, its key principles, the budgetary process and procedure, including the Multiannual Financial Framework, and basic regulatory framework.

It is the budget that plays central role within the public finances and financial system of EU and of Bulgaria as a Member State (see also Chapters 13, 16, 17, 18, 19, 22).⁵

⁵ See **Пенов, С.** Финансово право. Обща част. Учебен курс. София, УИ „Св. Кл. Охридски“, 2021; **Пенов, С.** Ренов, S. Финансово право. Специална част. Учебен курс. София, УИ „Св. Кл. Охридски“, 2020.

II. BUDGET OF THE EUROPEAN UNION

1. Key principles and regulatory framework. Multiannual financial framework.

The budget of the European Union is determined in the foundational treaties of the European Union: The Treaty of Lisbon (or the Treaty on the Functioning of the European Union)⁶ and the Treaty of Maastricht (or the Treaty on European Union).⁷ Articles 310–325 of the Treaty on the Functioning of the European Union⁸ define:

- the general principles governing budgetary procedures and the principle of sound financial management (Article 310);
- the principle of financing the budget from own resources (Article 311);
- the multiannual financial framework – annual expenditure ceilings for at least 5 years (Article 312);
- the schedule for the financial year (Articles 313–316);
- the procedures for budget implementation and control, and confers the necessary powers (Articles 317–319).

The Treaty on European Union⁹ provides the legal basis for the accession of any European country to the EU and the values on which the EU is founded. The EU budget¹⁰ supports a range of policies implemented within the European Union and contributes to the EU's strong role as a global leader in combating climate change and as the world's largest donor of humanitarian aid and development assistance.

⁶ More information: <https://www.europarl.europa.eu/factsheets/bg/sheet/5/the-treaty-of-lisbon> [Accessed on 15 October 2023].

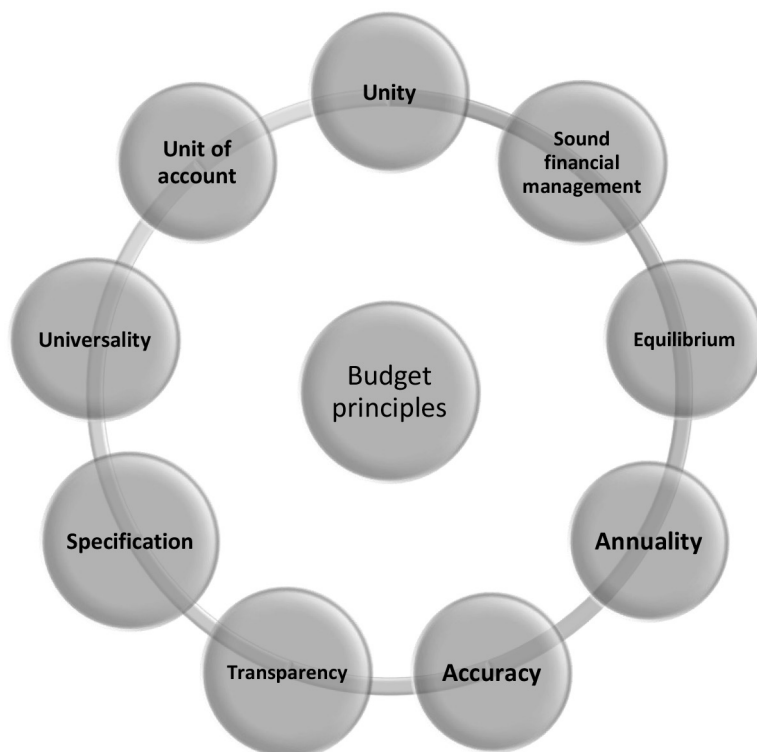
⁷ More information: <https://www.europarl.europa.eu/about-parliament/bg/in-the-past/the-parliament-and-the-treaties/maastricht-treaty> [Accessed on 15 October 2023].

⁸ More information: <https://eur-lex.europa.eu/legal-content/BG/TXT/?uri=celex%3A12012E%2FTXT> [Accessed on 15 October 2023].

⁹ EUR-Lex, **Treaty on European Union**: <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=legisum%3A4301855> [Accessed on 15 January 2024].

¹⁰ More information about the EU Budget, European Commission: https://ec.europa.eu/info/strategy/eu-budget_bg [Accessed on 15 January 2024].

Figure 1. The EU budget adheres to nine common principles:



Source: European Commission

The EU budget adheres to nine common principles:

- **Unity** – all EU revenues and expenditures are contained in a single document; The principle of unity of the Union budget stems from Article 310(1) TFEU which lays down that: ‘All items of revenue and expenditure of the Union shall be included in estimates to be drawn up for each financial year and shall be shown in the budget.’ The principle of unity makes the budget the vehicle of all expenditure and all revenue. All Union revenue and expenditure should be incorporated in a single budget document. The principle is confirmed in Article 2(c) of the Financial Regulation (FR) which defines the budget as ‘the instrument which, for each financial year, forecasts and authorises all revenue and expenditure considered necessary for the Union’;

- **Accuracy** of the budget – the principle of accuracy basically means that the Union will not spend more than is necessary. This principle is defined in different ways (in Article 8 FR): — ‘no revenue shall be collected and no expenditure effected unless booked to a line in the budget; — no expenditure may be committed or authorised in excess of the authorised appropriations; — an appropriation may not be entered in the budget if it not for an item of expenditure considered necessary’;
- **Annuality** – funds are spent within the year; The principle of annuality requires budget operations to relate to a specific financial year. This makes it easier to monitor the activities of the Union executive. It is defined by the TFEU from two angles: as regards estimates: ‘All items of revenue and expenditure of the Union shall be included in estimates to be drawn up for each financial year’ (first paragraph of Article 310 of the TFEU); and as regards implementation: ‘The expenditure shown in the budget shall be authorised for the annual budgetary period in accordance with [the Financial Regulation]’ (second paragraph of Article 310 TFEU); ‘The appropriations entered in the budget shall be authorised for a financial year which shall run from 1 January to 31 December’ (Article 9 FR);
- **Equilibrium** – revenues and expenditures are balanced, there is no possibility of deficit; The principle of equilibrium means that budget revenue must equal budget expenditure. This rule is enshrined in the first paragraph of Article 310 TFEU which states that ‘the revenue and expenditure shown in the budget shall be in balance’. It was incorporated in the successive own-resources decisions and in the FR (Article 17). The Union, unlike its Member States, is not allowed to borrow to cover its expenditure and cannot raise loans within the framework of the budget. The only exceptions to this rule are the building acquisition projects which may be financed through loans in accordance with Article 203(8) FR. This possibility to raise loans is without prejudice to the principle of equilibrium. The balance for a given financial year consists of the difference between all the revenue collected in respect of that financial year and the amount of payments made against appropriations for that financial year, plus the amount of the appropriations for the same financial year carried over and taking account of possible exchange rate differences.

- **Unit of account** (the Euro) – As in other international organisations, the question of which monetary unit to use arose for the Community budget. The principle of adopting a unit of account distinct from national currencies was established in the earliest days of the ECSC in Decision No 3/52 of 23 December 1952 and, in the case of the EEC and Euratom, by the Treaties themselves (Article 279 of the EC Treaty and Article 181 of the Euratom Treaty). With the exceptions of 1958, 1959 and 1960, when preparations were being made for applying Article 279 of the EC Treaty and Article 181 of the Euratom Treaty, and the EEC and Euratom budgets were drawn up in Belgian francs, the Community budget has always been expressed in units of account. Finally, with economic and monetary union and the launch of the euro on 1 January 1999, the Community budget adopted the new single currency as its unit of account;
- **Universality** – budgetary revenue should not be allocated to a specific expenditure item; The principle of universality is a corollary of the principle of unity. It does not stem directly from the Treaties, but from Article 20 FR, which states that: ‘Total revenue shall cover total payment appropriations ... All revenue and expenditure shall be entered in full [in the budget and in the accounts] without any adjustment against each other.’ In line with this principle, budget revenue may not be assigned to specific items of expenditure (non-assignment rule) and revenue and expenditure may not be set off against each other (gross budget rule). Consequently, revenue is pooled and used without distinction to finance all expenditure. This principle supplements the unity principle by ensuring that budgetary authorisation for a given item of expenditure does not depend on the amount of a given item of revenue, which would restrict the scope of such authorisation and split the budget into watertight segments;
- **Specification** – each budgetary credit is intended for a specific type of expenditure; The principle of specification determines both the horizontal and the vertical structure of the budget.

1) *The horizontal structure of the budget.* The budget is divided into: a general statement of revenue; sections, subdivided into statements of revenue and of expenditure, for each institution: the European

Parliament (Section I), the European Council and Council (Section II), the Commission (Section III, including Annexes on OLAF, the Publications Office), the Court of Justice (Section IV), the Court of Auditors (Section V), the European Economic and Social Committee (Section VI), the Committee of the Regions (Section VII), the European Ombudsman (Section VIII), the European Data Protection Supervisor (Section IX) and the European External Action Service (Section X); in addition, Section III (Commission), which accounts for 95 % of expenditure, is organised under titles corresponding to the Commission's policy areas. Each title is, in turn, subdivided into chapters, of which the first (01) includes all administrative appropriations for the policy area in question and the other ones correspond to the related operational activities. A general summary of administrative appropriations allocated to policy areas is also included. Finally, the budget includes a number of annexes with additional information on specific issues; the Commission Section of the budget (Section III) also covers the expenditure for pensions and European schools, which is common to all institutions.

2) *The vertical structure of the budget*: the budget nomenclature. Under the Activity Based Budgeting nomenclature, revenue and expenditure are classified according to their type or the use to which they are put under titles, chapters, articles and items (Article 41 FR). Under Article 8 FR 'no revenue shall be collected and no expenditure effected unless booked to a line in the budget'. The article is therefore the slot to accommodate revenue and expenditure, while the real organisation by specific area, which the European Parliament and the Council are responsible for determining, is at the level of chapters. As a rule, only the European Parliament and the Council may make decisions on transfers between chapters.

- **Sound financial management** – savings and efficiency of expenditures. The principle of sound financial management is based on Article 317 of the TFEU, which provides that 'the Commission shall implement the budget ... on its own responsibility and within the limits of the appropriations, having regard to the principles of sound financial management'. Article 30 FR links this principle to the principles of economy, efficiency and effectiveness. The principle of economy requires that the resources used by the institution to

engage in its activities are available in due time, in appropriate quantity and quality and at the best price. The principle of efficiency is concerned with the best relationship between resources employed and results achieved. The principle of effectiveness is concerned with attaining the specific objectives set and achieving the intended results. In practice, sound financial management is based on setting verifiable objectives which can be monitored by measurable indicators, in order to switch from means-based management to results-oriented management. Allocation of resources to activities (using activity-based budgeting or ABB) makes it possible to integrate the cost of the activities and their objectives. It also means that the total costs of the various operations can be verified and the Commission's work programme can be better tailored to ensure an appropriate relationship between policy priorities and the allocation of resources.;

- **Transparency** – Articles 34 and 35 FR enshrine the principle of transparency. Transparency applies to the entire budget cycle, but is particularly visible in the requirements concerning publication. Under Article 34, the budget must be established and implemented and the accounts presented in compliance with the principle of transparency. The President of the European Parliament shall have the budget and any amending budget, as definitively adopted, published in the Official Journal of the European Union. The budgets shall be published within three months of the date on which they are declared definitively adopted. The consolidated annual accounts and the report on budgetary and financial management drawn up by each institution shall be published in the Official Journal of the European Union. Information on borrowing-and-lending operations contracted by the Union for third parties must be given in an Annex to the budget (Article 35(1) FR).¹¹

¹¹ See: European Commission, Directorate-General for Budget, European Union public finance, Publications Office, 2014, Chapter 11: <https://data.europa.eu/doi/10.2761/17724>.

1.1. Multiannual Financial Framework of the European Union

Article 312 of the Treaty on the Functioning of the European Union (TFEU) regulates the Multiannual Financial Framework. It serves as a planning tool for the medium term within the European Union and differs from the Union's annual budget. The prescribed legal form for its adoption is a regulation, through which its mandatory implementation is achieved.¹²

The long-term budget of the EU, officially known as the Multiannual Financial Framework (MFF),¹³ sets annual limits for EU commitments in various policy areas and for total annual payments (the expenditure part of the budget) and must cover at least five years. In practice, its duration is typically set for seven years in most cases. The MFF aims to ensure consistency in the development of EU spending within its own resources and establishes provisions with which the annual EU budget must comply, ensuring financial discipline. Specifically, the MFF Regulation sets expenditure ceilings for broad categories of expenditure, called functions.

The MFF also sets maximum amounts that can be spent in addition to the MFF ceilings for responding to emergencies or unforeseen needs (special instruments).¹⁴

Various adjustments to the MFF can be made during its implementation:

- Annual technical adjustments in the current prices of the MFF ceilings;
- Programme-specific adjustments;
- Reallocations or reprogramming of budgetary commitments;

¹² **Пенов, С.** Финансово право. Обща част. Учебен курс. София, УИ „Св. Кл. Охридски“, 2021; **Пенов, С.** Ренов, S. Финансово право. Специална част. Учебен курс. София, УИ „Св. Кл. Охридски“, 2020.

¹³ For more information on the MFF, see: European Parliament: https://www.europarl.europa.eu/factsheets/bg/sheet/29/multiannual-financial-framework#_ftn3 [Accessed on 15 October 2023].

¹⁴ More information on the special instruments https://commission.europa.eu/strategy-and-policy/eu-budget/long-term-eu-budget/2021-2027/spending/flexibility-and-special-instruments_en [Accessed on 15 October 2023].

- Revisions due to unforeseen circumstances or other events (e.g., a revision of EU treaties with budgetary implications, accession of new EU members).

In a historical perspective, the increasing discrepancy between available resources and actual budgetary needs in the 1980s led to a climate of conflict in the relations between the institutions. The concept of the Multiannual Financial Perspective (MFF) was developed as an attempt to reduce conflicts, strengthen budget discipline, and improve implementation through better planning. The first interinstitutional agreement (IIA) for this purpose was signed in 1988 (the Interinstitutional Agreement on Budgetary Discipline and Improvement of the Budgetary Procedure, signed by the Parliament, the Council, and the Commission on 29 June 1988). It included the financial perspective for the period 1988–1992, also known as the ‘Delors I’ package, aimed at providing the funds necessary for the budget implementation of the Single European Act.

On 29 October 1993, the second IIA was agreed upon, along with the financial perspective for the period 1993–1999 (the ‘Delors II’ package), allowing for the doubling of structural funds and an increase in the own resources ceiling. The third IIA for the financial perspective for the period 2000–2006, also known as Programme 2000, was signed on 6 May 1999, and one of its main goals was to provide the necessary resources for financing the expansion. The fourth IIA, covering the period 2007–2013, was concluded on 17 May 2006.

The Treaty of Lisbon transformed the MFF from an interinstitutional agreement into a Council regulation, subject to the approval of the European Parliament, meaning that the MFF is no longer the subject of an interinstitutional agreement but a binding legislative act. The Treaty on the Functioning of the European Union (TFEU) codifies the multiannual budget and the EU budget as a whole and recognizes the importance of the MFF as a key element of the EU’s budgetary architecture. The most important characteristic of the European budget is that it is an instrument for achieving political objectives set at the level of the European Union.

As with any other budget, it is an expression of the social contract for the redistribution of national income, for the purposes of which public

resources are allocated, and for the sources of these resources. The difference from national budgets is that at the European level this contract is intermediated and is not between members of society expressing their will through elections but finds expression in a consensus between the governments of the member states. Article 312 of the Treaty on the Functioning of the European Union (TFEU) specifies that, in addition to determining the amounts of 'the annual ceilings on commitments appropriations by category of expenditure and of the annual ceiling on payment appropriations,' the MFF must also 'lay down any other provisions required for the annual budgetary procedure to run smoothly.'

The MFF Regulation is accompanied by an IIA, which covers areas of budgetary discipline, cooperation on budgetary matters, and sound financial management. The fifth MFF, covering the period 2014–2020, was adopted on 2 December 2013. This MFF is the first to be adopted in accordance with the new provisions of the Lisbon Treaty, under which the Council, using a special legislative procedure, unanimously adopts the MFF Regulation after obtaining Parliament's approval. It is also the first MFF to have a decrease in overall amounts in real terms.

On 20 June 2017, a revised MFF for the period 2014–2020 was adopted with an agreement for additional support for migration-related measures, jobs, and growth. It also reinforced the Flexibility Instrument and the Emergency Aid Reserve, allowing for further funds to be shifted between budget headings and years, in order to be able to react to unforeseen events and new priorities.

On 2 May 2018, the European Commission presented legislative proposals for a new sixth MFF for the period 2021–2027. Following the outbreak of the COVID-19 pandemic, on 27 May 2020, the EC presented a recovery plan (NextGeneration EU), which includes revised proposals for the MFF and own resources, as well as the creation of a Recovery Instrument worth €750 billion. After Parliament's approval, on 17 December 2020, the Council adopted the Regulation laying down the long-term budget of the EU for the period 2021–2027.

The MFF for 2021–2027 sets a maximum level of expenditure of 1,074.3 billion euros (at 2018 prices), covering seven main expenditure areas:

- Single market, innovation, and digital technology: 132.8 billion euros

- Cohesion, resilience, and values: 377.8 billion euros
- Natural resources and environment: 356.4 billion euros
- Migration and border management: 22.7 billion euros
- Security and defence: 13.2 billion euros
- Neighbourhood regions and the world: 98.4 billion euros
- European public administration: 73.1 billion euros

1.2. European legal framework for MFF 2021–2027

The European legal framework for the MFF for the 2021–2027 period encompasses the following significant treaties, regulations, and agreements:

- Article 312 of the Treaty on the Functioning of the European Union;
- Council Regulation (EU, Euratom) 2020/2093¹⁵ of 17 December 2020 laying down the multiannual financial framework for the years 2021–2027;
- Regulation (EU, Euratom) 2020/2092¹⁶ of the European Parliament and of the Council of 16 December 2020 on a general regime of conditionality for the protection of the Union budget;
- Council Regulation (EU) 2020/2094¹⁷ of 14 December 2020 establishing the European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis;
- Interinstitutional Agreement of 16 December 2020 between the European Parliament, the Council of the European Union¹⁸ and

¹⁵ Council Regulation (EU, Euratom) 2020/2093 available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.LI.2020.433.01.0011.01.ENG> [Accessed on 15 October 2023].

¹⁶ Regulation (EU, Euratom) 2020/2092 available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32020R2092> [Accessed on 15 October 2023].

¹⁷ Council Regulation (EU) 2020/2094 available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.LI.2020.433.01.0023.01.ENG&toc=O-J%3AL%3A2020%3A433I%3ATOC>.

¹⁸ Interinstitutional Agreement of 16 December 2020 between the European Parliament, the Council of the European Union available at: <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32020Q1222%2801%29> [Accessed on 15 October 2023].

the European Commission on budgetary discipline, cooperation in budgetary matters, and sound financial management, as well as on new own resources, including a roadmap for the introduction of new own resources.

Given the dynamic economic situation and the need for MFF updates, it should be noted that there is active updating of the regulatory acts defining the MFF.

1.3. Phases of the MFF framework decision-making process

The European Council and the Council of the EU play a central role in the process of determining the EU's long-term budget,¹⁹ which typically covers a period of five to seven years. Negotiations on the MFF begin several years before the start of the period covered by the new budget. Formally, the process begins with the presentation of the so-called Multiannual Financial Framework (MFF) package by the European Commission. Among the most important documents in the package are:

- ❖ the Multiannual Financial Framework Regulation, which lays down how much the EU can spend;
- ❖ the Own Resources Decision, which defines the sources of the EU's revenue.

The European Commission also proposes sectoral programmes for the new programming period. *Negotiations on the MFF proceed along two parallel lines:*

Political – following the European Commission's proposal, negotiations take place based on a so-called negotiating box prepared by the Presidency (the respective rotating Presidency of the Council of the EU). As work progresses, negotiations move from experts to EU ambassadors, ministers, and ultimately heads of state and government. When the European Council reaches agreements on key political issues, they become the basis for legislative work.

¹⁹ The long-term EU budget, European Commission. available at: https://commission.europa.eu/strategy-and-policy/eu-budget/long-term-eu-budget_en [Accessed on 15 October 2023].

Legislative – the 27 member states discuss the technical elements of the EC's legislative proposals in the relevant bodies of the Council. The aim is to bring the positions of the member states as close together as possible. With agreement in the Council, the substantive part of the legislative process for the adoption of the regulation on the MFF and the rules on own resources begins.

Decision-making process for the MFF

The General Affairs Council²⁰ is responsible for the work on the MFF package and prepares the so-called negotiating box. The draft negotiating box brings together the elements that are most likely to require political direction and priority-setting from EU leaders. The aim is to facilitate the preparation of draft European Council conclusions on the MFF, which are presented by the President of the European Council. The EU leaders, who meet within the European Council, provide political guidance on the key features of the long-term budget. Based on these guidelines, the Council reaches its position.

MFF regulation is adopted under a special legislative procedure,²¹ according to which:

- unanimity is required to secure a deal in the Council;
- the consent of the European Parliament is required to conclude the decision-making process;
- in practice, the Parliament may approve or reject the Council's position, but may not make amendments to it.

The own resources decision requires:

- a unanimous agreement for adoption in the Council;
- an opinion from the European Parliament;
- ratification by each Member State in accordance with its constitutional requirements before entering into force.

²⁰ European Council – Council of the European Union available at: <https://www.consilium.europa.eu/bg/council-eu/configurations/gac/> [Accessed on 15 October 2023].

²¹ European Council – Council of the European Union: Special legislative procedures available at: <https://www.consilium.europa.eu/en/council-eu/decision-making/special-legislative-procedures/> [Accessed on 15 October 2023].

The EU Multiannual Financial Framework (MFF) is usually negotiated as a package, along with proposals for own resources (the revenue part of the budget) and for new and ongoing programmes and funds. Formally, these elements are adopted through different legislative procedures with varying roles for the European Parliament, the European Council, and the European Commission. Although Parliament's approval is required before the Council can adopt the MFF Regulation (Article 312 of the TFEU), it is only consulted by the Council before the decision on own resources is taken (Article 311 of the TFEU). Sectoral regulations, on the other hand, are agreed upon through the ordinary legislative procedure, with Parliament acting on an equal footing with the Council (Articles 289 and 294 of the TFEU). Additionally, despite the Treaties, the proposal to link the new MFF with the NextGenerationEU instrument in support of the EU's economic recovery following the Covid-19 pandemic introduced another legal basis and decision-making procedure into this complex picture. The European Commission's proposal for a regulation establishing the recovery instrument is based on Article 122 of the TFEU and requires a decision solely from the Council. The European Parliament is informed of the decision taken.

Decisions for sectoral programmes

The Council's sectoral configurations²² lead the work on the EU's funding programmes within the Council.

Example: The Agriculture and Fisheries Council works on legislative proposals in the field of the Common Agricultural Policy (CAP), while the Competitiveness Council deals with programmes for the Single Market, scientific research, and space.

With a few exceptions, decisions on these programmes are taken jointly with the European Parliament through the ordinary legislative procedure.²³

²² More information on the Council's sectoral configurations: European Council – Council of the European Union: <https://www.consilium.europa.eu/bg/council-eu/configurations/> [Accessed on 15 October 2023].

²³ The codecision procedure was first introduced in 1992 and its use extended in 1999. With the adoption of the Lisbon Treaty, codecision was renamed the ordinary leg-

The financial and horizontal aspects of the programmes depend on the outcome of the negotiations on the MFF.

2. Annual EU budget – budgetary procedure and main parameters of fund allocation

The annual budget of the EU²⁴ defines all the revenues and expenditures of the European Union for a calendar year. It ensures the funding of EU policies and programmes in line with the priorities of the policies and the legal obligations of the EU. Annual budgets must fit within the expenditure limits (‘ceilings’) defined in the Multiannual Financial Framework (MFF) and must achieve a balance of expenditure and revenue.

In practice, the size of the commitments undertaken and the payments are usually included in the budget under the respective ceilings of the MFF. The difference, or ‘margin’, between the ceiling and the planned amounts provides leeway in case of unforeseen needs.

2.1. Budgetary procedure

The budgetary procedure is one of the special legislative procedures²⁵ used in the European Union. It is used to determine the annual budget of the European Union. The financial year covers the period from 1 January to 31 December, and the EU’s annual budget (the general budget of the EU) is adopted by the Council of the EU and the European Parliament in accordance with the budgetary procedure provided for in Articles 313–316 of the Treaty on the Functioning of the European Union (TFEU).²⁶

islative procedure and it became the main decision-making procedure used for adopting EU legislation. It applies to around 85 policy areas.

²⁴ More information on the annual budget of the EU: European Commission: https://commission.europa.eu/strategy-and-policy/eu-budget/how-it-works/annual-lifecycle/preparation_en [Accessed on 15 October 2023].

²⁵ The Council is, in practice, the sole legislator. The European Parliament is required to give its consent to a legislative proposal or be consulted on it. More information available at: <https://www.consilium.europa.eu/en/council-eu/decision-making/special-legislative-procedures/> [Accessed on 15 October 2023].

²⁶ Treaty on the Functioning of the European Union: <https://eur-lex.europa.eu/legal-content/bg/TXT/PDF/?uri=CELEX:12012E/TXT&from=en#page=137> [Accessed on 15 October 2023].

Three institutions of the EU participate in the procedure for adopting the annual budgets of the EU: the European Parliament, the Council of the European Union, and the European Commission.

The budgetary procedure²⁷ takes place in the year preceding the year in which the respective budget will be executed.

The Council's position on the draft budget presented by the European Commission is discussed and adopted by the member states within the preparatory bodies of the Council at the following levels:

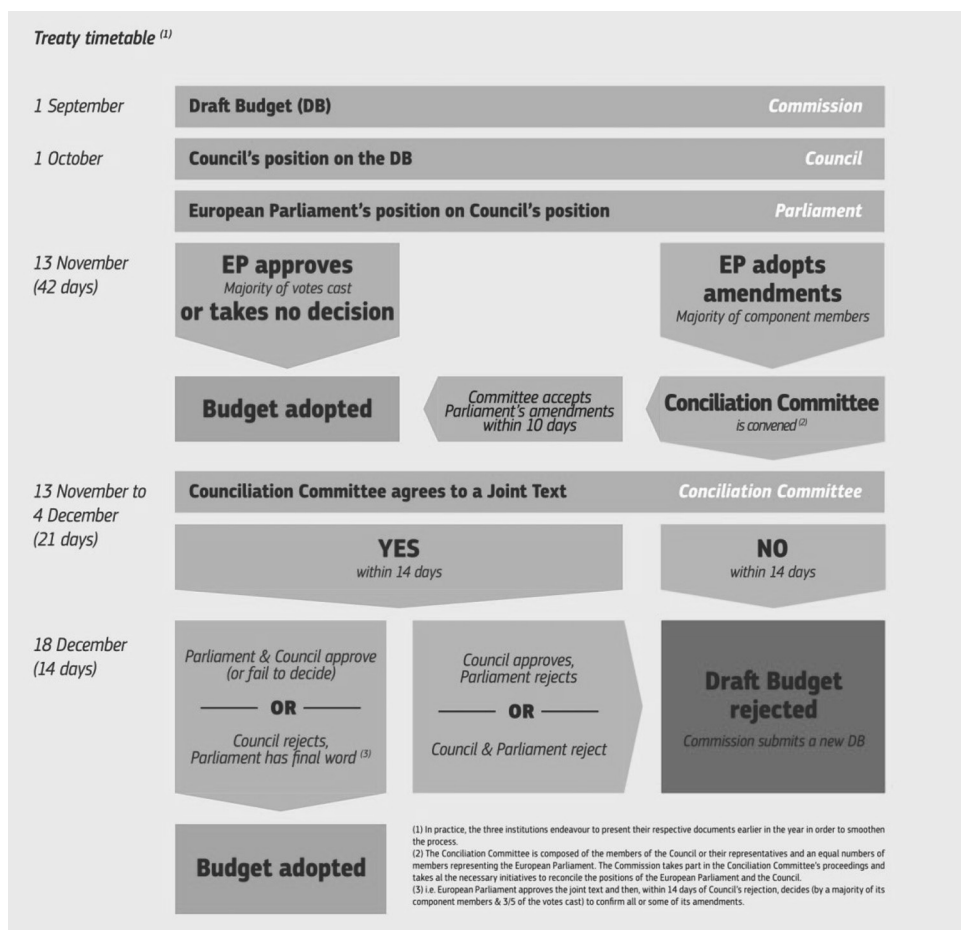
- At the expert level, in the meetings of the Budget Committee of the Council;
- At the political level, in the meetings of the Committee of Permanent Representatives of the Governments of the Member States to the EU (COREPER) and subsequently in the meetings of the Council of Finance Ministers (ECOFIN-Budget Council).²⁸

The Council's position is presented to the European Parliament, which prepares its position on it within a certain timeframe—either by agreeing with the Council's position or by making amendments to it. In case of disagreement by the Council regarding the amendments presented by the European Parliament, a conciliation procedure begins, during which the European Parliament and the Council seek to reach an agreement on the contentious points within a period of 21 days following the adoption of the European Parliament's position. The ECOFIN-Budget Council mandates the Council Presidency to conduct negotiations. After reaching an agreement on the budget proposal, it must be formally approved by both the Council and the European Parliament within 14 days.

²⁷ More information on the Budget Procedure, Ministry of Finance: <https://www.minfin.bg/bg/879> [Accessed on 15 October 2023].

²⁸ More information on the Economic and Financial Affairs Council configuration (Ecofin): <https://www.consilium.europa.eu/bg/council-eu/configurations/ecofin/> [Accessed on 15 October 2023].

Figure 2. Budget Procedure



Source: European Commission, Ministry of Finance

The budgetary procedure for determining the annual budget is the only area in which the European Parliament has a stronger voice in decision-making than the Council of the European Union.

In accordance with the provisions of Ordinance No. 85 of the Council of Ministers²⁹ dated 17.04.2007 on Coordination on European Union matters, experts from the Ministry of Finance are responsible for preparing

²⁹ More information at: <https://lex.bg/laws/ldoc/2135550959> [Accessed on 15 October 2023].

guidelines, comments, and positions in the course of the discussions and for adopting documents related to the draft budget of the EU during the meetings of the Budget Committee, COREPER, and ECOFIN. Bulgaria's positions are coordinated within Working Group 28 Financial and Budgetary Issues of the Council for European Affairs.

The Economic and Financial Policy Directorate at the Ministry of Finance prepares a bulletin entitled Key Economic and Political Decisions in the EU, which reflects the outcomes of the meetings of the EU Council on Economic and Financial Affairs (ECOFIN) and Bulgaria's positions on the discussed topics. The bulletin³⁰ is published in Bulgarian after each meeting of the Council.

2.2. EU budget for 2023

The EU budget for 2023³¹ aims to stimulate recovery from the coronavirus pandemic, to lead Europe towards a sustainable future, to protect and create jobs, and to strengthen the Union's strategic autonomy.

The budget for 2023 is realistic and in line with actual needs by ensuring prudent budgeting and, without prejudice to the provisions of the Interinstitutional Agreement (IIA), leaving sufficient margins under the MFF ceilings to deal with unforeseen circumstances. At the same time, it provides sufficient resources to ensure the implementation of EU programmes and enables timely payment of the commitments undertaken under the current and previous MFFs (2023 is the last year for execution of commitments under shared management, undertaken under the MFF for the 2014–2020 period).

This is the third annual budget within the framework of the long-term EU budget for the period 2021–2027 – the Multiannual Financial Framework (MFF). The budget for 2023 is complemented by actions in support of the recovery from COVID-19 under the NextGenerationEU – the EU's plan for pandemic recovery.

³⁰ More information at: <https://www.minfin.bg/bg/210> [Accessed on 15 October 2023].

³¹ More information at: <https://www.consilium.europa.eu/bg/policies/eu-annual-budget/2023-budget/> [Accessed on 15 October 2023].

Timeline:

- March 15, 2022 – The Council defined its priorities for the EU budget for 2023.³²
- June 7, 2022 – The EC announced its calculations for 2023 and working documents accompanying the draft budget for 2023, including programme reports, information on the expenditure and revenue of EU institutions, and others.
- July 13, 2022 – The Council reached an agreement on its position regarding the draft budget for 2023.
- October 5, 2022 – The EC announced Amending Letter No. 1 to the 2023 budget, (Consequences of the war in Ukraine; Union Civil Protection Mechanism; agricultural expenditure; other adjustments, technical updates).
- November 11, 2022 – The Council and the European Parliament interrupted negotiations on the EU budget for 2023 without reaching an agreement.
- November 15, 2022 – The Council and the European Parliament, within the framework of the conciliation procedure, reached an agreement on the EU budget for 2023.

The full text of the EU's annual budget for 2023 is published at the beginning of the year in EUR-Lex.³³

The 2023 Budget of the EU was officially adopted at the end of November 2022 after the Council of the EU and the European Parliament reached a final agreement on the budget on 14 November 2022 during the Conciliation period.

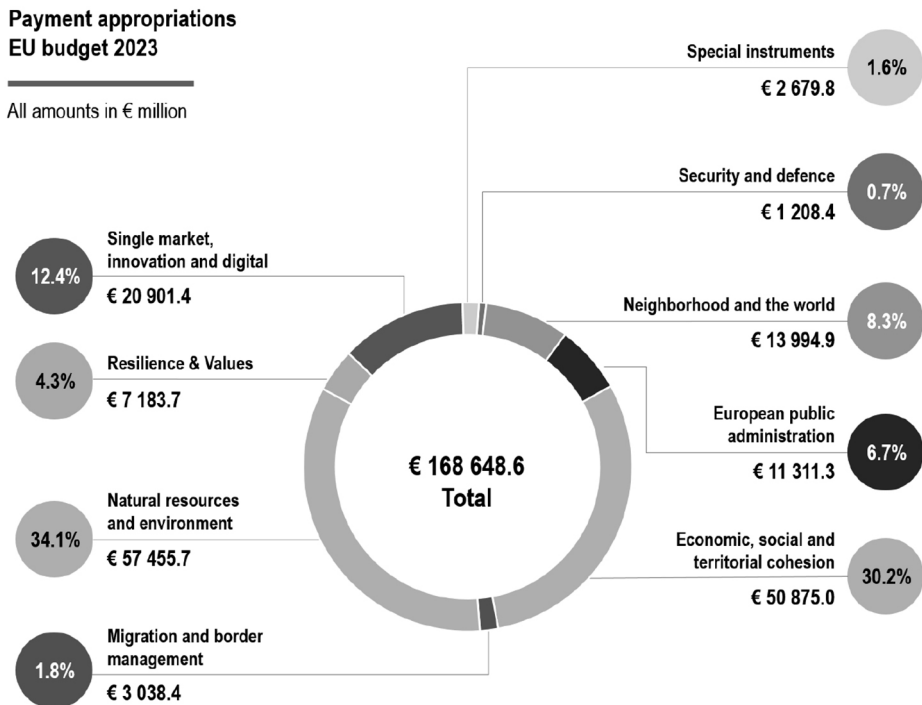
The main parameters of the 2023 Budget are: an overall level of commitment appropriations of EUR 186.617 billion and an overall level of payment appropriations of EUR 168.649 billion (including the special instruments).

³² More Information for the priorities for the 2023 EU budget <https://www.consilium.europa.eu/bg/press/press-releases/2022/03/15/council-sets-its-priorities-for-the-2023-eu-budget/> [Accessed on 15 October 2023].

³³ EUR-Lex: <https://eur-lex.europa.eu/budget/www/index-en.htm> [Accessed on 15 October 2023].

The graphics below show the allocation of the funds under the different headings of the 2023 budget (MoF, 2023).

Figure 3. Allocation of funds by current sections of the EU budget for 2023.



Source: European Commission, Ministry of Finance

3. Financing of the European Union budget. Budgetary functions

According to Article 311 of the Treaty on the Functioning of the European Union, the Union ensures the funds necessary to achieve its objectives and the successful implementation of its policies. Without prejudice to other revenue, the budget is fully financed from own resources.

The Council, acting in accordance with a special legislative procedure, unanimously and after consulting the European Parliament, adopts

a decision determining the provisions applicable to the Union's own resources system. In this context, it is possible to establish new categories of own resources or to abolish an existing category. This decision only enters into force after being approved by the member states in accordance with their constitutional requirements.

The Council, acting by regulations in accordance with a special legislative procedure, determines the measures implementing the Union's own resources system, to the extent provided for in the decision adopted on the basis of the third paragraph. The Council acts following approval by the European Parliament.

No deficit is allowed in the general budget of the EU.

3.1. Main sources of EU revenue

To fulfil their functions, international organisations require revenues, which they collect through various means. Typically, states make monetary contributions based on agreed-upon rules. Another form involves establishing a system of own resources, granting a certain degree of autonomy to the international entity. In the case of sovereign states, increasing budgetary expenses are covered either by creating new taxes, respectively increasing the size of existing budgetary revenues, or through loans.³⁴

The sources of revenue for the EU include: (1) Contributions from member states; (2) Import duties on goods from countries outside the Union; (3) New contributions based on non-recycled plastic packaging waste; (4) Fines imposed on companies that do not comply with EU rules. EU countries agree on the size of the Union's budget and the way it is financed several years in advance.

³⁴ **Пенов, С.** Финансово право. Обща част. Учебен курс. София, УИ „Св. Кл. Охридски“, 2021; **Пенов, С.** Ренов, S. Финансово право. Специална част. Учебен курс. София, УИ „Св. Кл. Охридски“, 2020, с. 136.

The EU budget is mainly financed from EU's own resources³⁵ supplemented by other sources of revenue³⁶ and is based on the principle that expenditures must match revenues.

The EU budget is financed from the following sources:

- a share of each country's Gross National Income (GNI)³⁷ – the Gross National Income (GNI)-based contributions from Member States is the largest revenue source for the EU budget. It ensures that all agreed expenditure has sufficient revenue coverage, thus guaranteeing that the EU budget is always balanced;
- customs duties on imports of goods from countries outside the Union – following the abolition of sugar levies in 2017, customs duties on imports from outside the EU are the only traditional own resource of the EU budget. Member states are responsible for the collection of customs duties at their external borders;³⁸
- a small share of value-added tax collected by each country – VAT was the first tax to be broadly harmonised at EU level, so back in 1970 it was logical to introduce a VAT-based EU budget own resource as a source of revenue alongside customs duties on imports and agricultural levies;³⁹
- a contribution based on the amount of non-recycled plastic packaging waste in each country – the plastics own resource, in place since 1 January 2021, consists of a national contribution

³⁵ More information on the essence of the own resources: https://commission.europa.eu/strategy-and-policy/eu-budget/long-term-eu-budget/2021–2027/revenue/own-resources_bg [Accessed on 15 October 2023].

³⁶ More information on other sources of revenue https://commission.europa.eu/strategy-and-policy/eu-budget/long-term-eu-budget/2021–2027/revenue/next-generation-eu-own-resources_en?prefLang=bg [Accessed on 15 October 2023].

³⁷ More information: https://commission.europa.eu/strategy-and-policy/eu-budget/long-term-eu-budget/2021–2027/revenue/own-resources/national-contributions_bg [Accessed on 15 October 2023].

³⁸ More information on the customs duties https://commission.europa.eu/strategy-and-policy/eu-budget/long-term-eu-budget/2021–2027/revenue/own-resources/customs-duties_bg [Accessed on 15 October 2023].

³⁹ More information on the value-added tax https://commission.europa.eu/strategy-and-policy/eu-budget/long-term-eu-budget/2021–2027/revenue/own-resources/value-added-tax_bg [Accessed on 15 October 2023].

based on the amount of non-recycled plastic packaging waste. This own resource is closely linked to EU policy priorities. This is expected to encourage Member States to reduce packaging waste and stimulate Europe's transition towards a circular economy by implementing the European Plastics Strategy. At the same time, it leaves Member States the possibility to define the most suitable policies to reduce plastic packaging waste pollution in line with the principle of subsidiarity. A uniform call rate of €0.80 per kilogram will be applied to the weight of plastic packaging waste that is not recycled, with a mechanism to avoid excessive contributions from less wealthy Member States;⁴⁰

- other revenue, including contributions from non-EU countries for certain programmes, fines, and interest payments, as well as the eventual surplus from the previous year.

The share of different revenue sources in the EU varies over the years, with the own resource from Gross National Income remaining the main source of financing for the EU budget. **The Council of the EU determines the maximum amount of own resources and their nature, together with the expenditure ceilings in the Multiannual Financial Framework. Once agreed, the resources are automatically channelled to the EU budget without the need for national authorities to make further decisions.**

Some member states receive reimbursement of expenses, or discounts, which serve to reduce the gap between what they pay and what they receive from the EU budget.

To finance NextGenerationEU, the European Commission will raise funds on the financial markets, which will be repaid over a long period – until 2058.

⁴⁰ More information on the calculating of the amount of non-recycled waste from plastic packaging in each country https://commission.europa.eu/strategy-and-policy/eu-budget/long-term-eu-budget/2021–2027/revenue/own-resources/plastics-own-resource_bg [Accessed on 15 October 2023].

OWN RESOURCES SYSTEM

The EU's own resources system has undergone significant development over the years – from financing solely through contributions from member states, through financing entirely from own resources (initially only with traditional own resources (TORs) including customs duties and levies on sugar, and later with TORs and a resource based on VAT), to the current system, combining revenue from TORs (only customs duties without levies on sugar) with a national contribution from member states, containing a resource based on VAT and an additional resource based on GNI, as well as lump sum reductions applicable to Austria, Denmark, the Netherlands, Germany, and Sweden. With the United Kingdom's exit from the EU, the mechanism for correcting the budgetary imbalance of the United Kingdom is removed, and as of January 1, 2021, a new own resource based on non-recycled plastic packaging waste is introduced.

On December 14, 2020, a new Decision (EU, Euratom) 2020/2053 of the Council on the system of own resources of the European Union and repealing Decision 2014/335/EU⁴¹, Euratom was approved. This decision also sets out the provisions authorising the EC to borrow from the capital markets up to EUR 750 billion (at 2018 prices) until 2026 to finance the NextGenerationEU Recovery Instrument and regulates the issues of repayment of the principal of the loan, which is to begin before the end of the MFF 2021–2027 to be fully repaid no later than December 31, 2058. In order to ensure the EU's ability to repay the loan to the capital markets accurately and in a timely manner, the ceilings on own resources are temporarily increased by 0.6 percentage points to cover all EU obligations arising from borrowing.

Decision (EU, Euratom) 2020/2053 entered into force (together with regulations regulating specific aspects of the implementation of the own resources system) on June 1, 2021, following approval by all member states in accordance with their national constitutional requirements, with retroactive effect from January 1, 2021.

⁴¹ Decision (EU, Euratom) 2020/2053 : <https://eur-lex.europa.eu/legal-content/BG/TXT/HTML/?uri=CELEX:32020D2053&from=bg> [Accessed on 15 October 2023].

Categories of own resources according to Decision (EU, Euratom) 2020/2053:⁴²

Traditional own resources – include the customs duties referred to in Article 2(1)(a) of Council Decision 2020/2053, which member states collect on behalf of the EU. Due duties are based on the Common Customs Tariff and are considered as net revenue of the EU, which derives directly from Union legislation. According to Article 9(1) of the Own Resources Decision, member states are responsible for their establishment, accounting, recovery, and provision to the EC, retaining 25% of the amounts as compensation for the administrative costs incurred in their collection, as provided for in Article 9(2).

VAT-based resource – is determined using an improved methodology, whereby a weighted average VAT rate (WAR) for VAT frozen at its 2016 value is applied to the corrected VAT base of each member state only for territorial scope in the few cases foreseen in the Treaty and for infringements to the (Council Directive 77/388/EEC). The VAT base of each country is then capped at 50% of the Gross National Income (GNI) base of the respective country to limit the regressive aspects of the VAT-based resource. Finally, a uniform call rate of 0.3% is applied to the resulting VAT base for all member states.

Base GNI resource – This is the so-called ‘balancing’ resource, which is intended to provide the revenue required to cover expenditure in excess of the amount financed by the other resources. The GNI-based resource is determined by applying a percentage (uniform call rate) to the GNI of the member states, which varies from one financial year to another (depending on the total expenditures of the EU general budget and other types of revenue and own resources for that year). In practice, there is no cap on the size of this rate, except for the ceiling which for the current MFF limits the total amount of all own resources to 1.4% of the EU GNI (the sum of the GNIs of all member states) to cover the annual budget appropriations for payments.

Plastic packaging waste-based resource – this consists of a national contribution based on the amount of non-recycled plastic packaging waste

⁴² **Decision (EU, Euratom) 2020/2053:** <https://eur-lex.europa.eu/legal-content/BG/TXT/?uri=CELEX:32020D2053> [Accessed on 15 October 2023].

and is expected to encourage waste reduction and stimulate the transition to a circular economy. It is calculated by applying a uniform rate of €0.80 per kilogram to the projected quantity of non-recycled plastic packaging waste (in kilograms) from each member state for a given year. To avoid excessive negative impact on some member states, a mechanism is introduced to reduce their annual contributions from this own resource (Bulgaria will benefit from this mechanism, with its annual contribution based on non-recycled plastic packaging waste being almost halved compared to the amount actually due according to the methodology described above).

Corrections – *During the 2021–2027 period, five member states benefit from gross reductions in their annual GNI-based contributions (in 2020 prices): Denmark – €377 million, Germany – €3,671 million, Netherlands – €1,921 million, Austria – €565 million, and Sweden – €1,069 million. The gross reductions are financed by all member states depending on their GNI.*

New own resources for the budget

Since 2018, the EU has been working on proposals to modernize the revenue system for the EU budget. Following the COVID-19 crisis, the Council, the European Parliament, and the Commission agreed on a roadmap for the introduction of new own resources to ensure the disbursement of funds under the EU recovery plan.

The own resource based on plastics was introduced as a new revenue in the budget, effective from January 1, 2021.

In December 2021, the Commission proposed an amendment to the own resources decision to introduce a package of three new revenue sources, known as the ‘first basket’ of new own resources: the carbon border adjustment mechanism; the revised EU emissions trading scheme (ETS); own resource based on reallocated profits of very large multinational companies. Discussions on the three aforementioned new own resources are still ongoing. It is expected that the EC will propose additional new own resources by the end of 2023, which will represent the ‘second basket’ of new own resources.

3.2. Formation of the EU budget. Main expenditure categories

The budget of the EU is primarily intended for investments. For this reason, the EU adopts long-term expenditure plans included in the long-term budget, where priorities and constraints for Union expenditures are defined. Budget functions represent the expenditure categories of the EU budget. They reflect the policy areas in which it has competencies and takes action.

The EU's 2021–2027 long-term budget, together with NextGenerationEU, represents a combined firepower of €2.018 trillion in current prices to help repair the economic and social damage caused by the coronavirus pandemic and steer the transition towards a modern and more sustainable Europe. The package consists of the long-term budget for 2021–2027 (the Multiannual Financial Framework) of €1.211 trillion in current prices, combined with the temporary recovery instrument, NextGenerationEU, of €806.9 billion in current prices.

Table 1. Allocations per heading (all amounts in € billion)⁴³

1. Single Market, Innovation and Digital	149.5	11.5	161.0
2. Cohesion, Resilience and Values	426.7	776.5	1 203.2
3. Natural Resources and Environment	401.0	18.9	419.9
4. Migration and Border Management	25.7	-	25.7
5. Security and Defence	14.9	-	14.9
6. Neighbourhood and the World	110.6	-	110.6
7. European Public Administration	82.5	-	82.5
TOTAL	1 210.9	806.9	2 017.8
TOTAL expressed in 2018 prices	1 074.3	750.0	1 824.3

Source: European Commission

⁴³ More information on the spending categories: https://commission.europa.eu/strategy-and-policy/eu-budget/long-term-eu-budget/2021–2027/spending/headings_en [Accessed on 15 October 2023].

In the EU budget, maximum annual amounts (‘ceilings’)⁴⁴ exist both for:

- **Expenditures** – the long-term budget ceilings establish the maximum amounts that the EU can either commit or spend during the 7-year Multiannual Financial Framework (currently from 2021 to 2027);
- **Revenues** – the own resources ceilings establish the maximum amount of own resources the EU can request from Member States to finance its expenditures in the same period.

Expenditure ceilings

The long-term budget lays down the ceilings for EU expenditure as a whole and for the main categories of expenditure (headings) over the 7-year period. There are two types of expenditure ceilings:

- An annual ceiling for each heading, expressed in commitment appropriations, which are legally binding promises to spend money. Commitment appropriations will not necessarily be spent in the same year, but may be disbursed over several financial years.
- An overall annual ceiling: for commitment appropriations, corresponding to the sum of each heading’s ceilings; for payment appropriations, which indicates the maximum actual amounts authorised for disbursement in a given year.

The expenditure ceilings are lower than the revenue (‘own resources’) ceilings. For each year of the long-term budget, the total payment appropriations have to be such as to avoid that Member States are requested to contribute more than the own resources ceiling.

⁴⁴ More information on the ceilings: https://commission.europa.eu/strategy-and-policy/eu-budget/long-term-eu-budget/2021–2027/spending/headings_en [Accessed on 15 October 2023].

Special instruments and margins

The only exception that allows surpassing the long-term budget ceilings occurs when it is necessary to use special instruments⁴⁵, mobilised to respond to unforeseen circumstances. However, even in this case, the commitment appropriations for special instruments cannot exceed the own resources ceiling.

Additional room for manoeuvre in case of unforeseen needs and emergencies is provided by the difference (‘margin’): between the actual budgeted payment appropriations and the overall annual ceiling for payment appropriations and between the actual budgeted commitment appropriations and the annual ceiling for each heading.

4. The long-term budget of the EU for the 2021–2027 period and the NextGenerationEU recovery instrument

According to Article 312 of the Treaty on the Functioning of the European Union, the MFF is established for a period of at least five years, with the current framework covering the seven-year period from 2021 to 2027.

Chronology of the negotiations:

On May 2, 2018, the European Commission proposed the MFF for the 2021–2027⁴⁶ period amounting to 1,134.6 billion euros (at 2018 prices), which corresponds to 1.11% of the gross national income (GNI) of the EU-27. The Commission also proposed changes to the EU’s system of own resources and linking the EU budget to the rule of law. This was followed by a series of additional legislative proposals for new and continuing spending programmes and funds within the next MFF. As a result of the crisis caused by the COVID-19 pandemic and the need to address it, on May 27, 2020, the EC presented its proposal for the European Recovery

⁴⁵ More information on the Flexibility and special instruments: https://commission.europa.eu/strategy-and-policy/eu-budget/long-term-eu-budget/2021–2027/spending/flexibility-and-special-instruments_en [Accessed on 15 October 2023].

⁴⁶ More information on the proposal of the MFF for the 2021–2027 https://commission.europa.eu/publications/legal-texts-and-factsheets-eu-budget-future_en [Accessed on 15 October 2023].

Plan,⁴⁷ which is based on 2 pillars – the new NextGenerationEU Recovery Instrument and the MFF for 2021–2027.

On December 17, 2020,⁴⁸ the MFF 2021–2027 and the Recovery Instrument were officially approved.

Subsequent actions:

On December 22, 2021, the EC proposed a targeted amendment to the MFF Regulation as part of the own resources package. The amendment is intended to allow for the expenses envisaged for the Climate Social Fund and a special annual automatic correction of the ceilings of the multiannual financial framework based on new own resources that could be used to repay the NextGenerationEU loan.

In accordance with Article 4 of the MFF Regulation for the 2021–2027 period, before the budget procedure for year n+1, on July 7, 2022, the EC made a technical correction to the MFF, COM(2022) 266, with the respective annexes, and communicated this correction to the European Parliament and the Council.

On December 15, 2022, a technical correction to the rules of the long-term budget for the 2021–2027 period came into force: Council Regulation (EU, Euratom) 2022/2496⁴⁹ of December 15, 2022, amending the MFF Regulation to guarantee borrowing for a support package for Ukraine of up to 18 billion euros.

EU legislation implementing the principles enshrined in the Treaties: information regarding legal acts for the own resources system, the regulation on the long-term budget, and the Financial Regulation.

⁴⁷ More information on the proposal for the European Recovery Plan: https://ec.europa.eu/info/strategy/recovery-plan-europe_bg [Accessed on 15 October 2023].

⁴⁸ More information on MFF 2021–2027: <https://www.consilium.europa.eu/bg/press/press-releases/2020/12/17/multiannual-financial-framework-for-2021–2027-adopted/> [Accessed on 15 October 2023].

⁴⁹ **Council Regulation (EU, Euratom) 2022/2496 of 15 December 2022 amending Regulation (EU, Euratom) 2020/2093 laying down the multiannual financial framework for the years 2021 to 2027:** <https://eur-lex.europa.eu/eli/reg/2022/2496> [Accessed on 15 October 2023].

The EC is expected to publish a mid-term review of the functioning of the Multiannual Financial Framework (MFF) for 2021–2027 in 2024, which may include a revision of the financial framework, with the EC’s proposal encompassing both a non-legislative act and a legislative act if related to the revision. The mid-term review will provide an opportunity to reassess whether the current EU budget continues to provide resources and meet the common challenges.

The MFF Regulation⁵⁰ sets a maximum expenditure level of 1,074 billion euros (at 2018 prices) for the 2021–2027 period, covering seven key areas.

Multiannual Financial Framework 2021–2027

€ million (2018 prices)

Headings	2021	2022	2023	2024	2025	2026	2027	2021-2027
1. Single Market, Innovation and Digital	19 712	19 666	19 133	18 633	18 518	18 646	18 473	132 781
2. Cohesion, Resilience and Values	49 741	51 101	52 194	53 954	55 182	56 787	58 809	377 768
2a. Economic, social and territorial cohesion	45 411	45 951	46 493	47 130	47 770	48 414	49 066	330 235
2b. Resilience and values	4 330	5 150	5 701	6 824	7 412	8 373	9 743	47 533
3. Natural Resources and Environment	55 242	52 214	51 489	50 617	49 719	48 932	48 161	356 374
Of which Market related expenditure and direct payments	38 564	38 115	37 604	36 983	36 373	35 772	35 183	258 594
4. Migration and Border Management	2 324	2 611	3 164	3 282	3 672	3 682	3 736	22 671
5. Security and Defence	1 700	1 725	1 737	1 754	1 928	2 078	2 263	13 185
6. Neighborhood and the World	15 309	15 522	14 789	14 056	13 323	12 592	12 828	98 419
7. European Public Administration	10 021	10 215	10 342	10 454	10 554	10 673	10 843	73 102
Of which: Administrative expenditure of the institutions	7 742	7 878	7 945	7 997	8 025	8 077	8 188	55 852
Total commitment appropriations	154 049	153 254	152 848	152 750	152 896	153 390	155 113	1 074 300
Total payment appropriations	156 557	154 822	149 936	149 936	149 936	149 936	149 936	1 061 058

Source: European Commission

⁵⁰ **Council Regulation (EU, Euratom) 2020/2093 of 17 December 2020 laying down the multiannual financial framework for the years 2021 to 2027** <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv%3AOJ.LI.2020.433.01.0011.01.EN-G&toc=OJ%3AL%3A2020%3A433I%3ATOC> [Accessed on 15 October 2023].

NextGenerationEU is a temporary instrument totalling 750 billion euros, aimed at supporting the recovery from the immediate economic and social damages caused by the coronavirus pandemic, to be financed through borrowing from the financial markets.

A key component of the NextGenerationEU Recovery and Resilience Facility⁵¹ is a budget of 672.5 billion euros for loans and grants to support reforms and investments in EU member states. The goal is to mitigate the economic and social impact of the COVID-19 pandemic and enhance the sustainability, resilience, and preparedness of European economies and societies for the challenges and opportunities of the green and digital transition.

The remaining part of the NextGenerationEU funds is allocated to member states through several EU programmes: Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU), Horizon Europe, InvestEU, the European Agricultural Fund for Rural Development, and the Just Transition Fund (JTF).

To finance NextGenerationEU, the European Commission borrows from the capital markets on behalf of the EU.⁵²

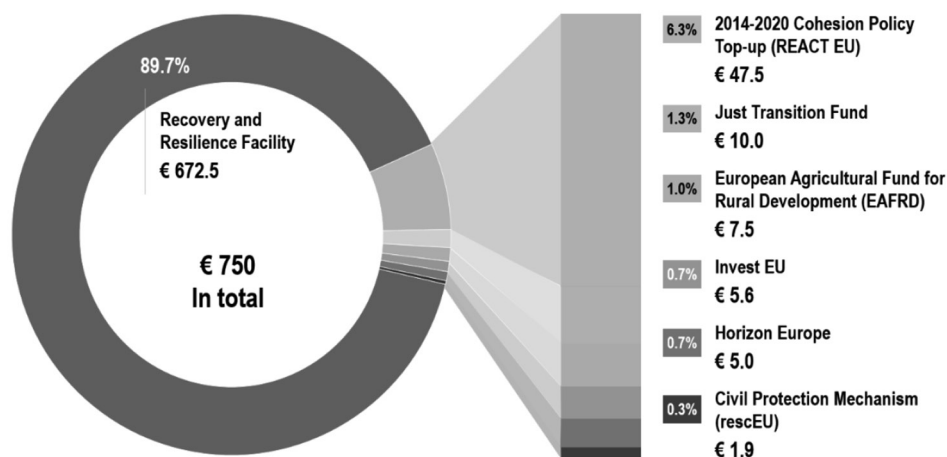
⁵¹ More information on Recovery plan for Europe: https://commission.europa.eu/strategy-and-policy/recovery-plan-europe_bg [Accessed on 15 October 2023].

⁵² NextGenerationEU: https://commission.europa.eu/strategy-and-policy/eu-budget/eu-borrower-investor-relations/nextgenerationeu_en [Accessed on 15 October 2023].

Figure 4. NextGenerationEU

NextGenerationEU

All amounts in € billion, 2018 prices



Source: European Commission

The Recovery and Resilience Facility (RRF) is an EU instrument that provides a broad framework for delivering financial support in the area of public investments and reforms, both as grants and loans. Support under the Facility is provided for investments and reforms, as defined in Regulation (EU) 2021/241, in force as of February 19, 2021, included in the Recovery and Resilience Plans prepared by the member states.⁵³

Under the RRF, reforms and investments in member states are financed from the beginning of the pandemic in February 2020 until December 31, 2026. The scope of the RRF applies to policy areas of European significance, structured into six pillars: (1) Green transition; (2) Digital transformation; (3) Smart, sustainable, and inclusive growth, including economic cohesion, jobs, productivity, competitiveness,

⁵³ More information on the Recovery and Resilience Plans prepared by the member states https://ec.europa.eu/economy_finance/recovery-and-resilience-scoreboard/country_overview.html?lang=en [Accessed on 15 October 2023].

research, development, and innovation, and a well-functioning internal market with strong SMEs; (4) Social and territorial cohesion; (5) Health, and economic, social, and institutional resilience, with the aim of, inter alia, increasing crisis preparedness and crisis response capacity; (6) Policies for the next generation, children, and the youth, such as education and skills. Funds allocated to member states are based on national Recovery and Resilience Plans, which include reform projects and public investments. The plans must:

- Align with EU priorities: boost growth, job creation, and economic and social resilience;
- Reflect country-specific challenges in line with European Semester country-specific recommendations;
- Support the green transition: at least 37% of resources contribute to climate action and environmental sustainability;
- Foster digital transformation: at least 20% of resources contribute to the EU's digital transition.

The beneficiary of EU funds under the RRF is the Republic of Bulgaria, in its capacity as an EU member state. The EU funds financing investments and reforms under the Facility enter the general budgets of member states. No resource in the form of national co-financing is required. The Recovery and Resilience Facility is performance based. Payments from the EC to Bulgaria are not related to the expenses incurred but rather to the achievement of stages and objectives.

Under the Facility, Bulgaria⁵⁴ receives non-repayable financial support. EC payments are made in instalments within the framework of the maximum allocation of resources for Bulgaria or the total value of the expenditure under the Recovery and Resilience Plan⁵⁵ (whichever is smaller).

Activities eligible for funding under the RRF are those initiated no earlier than February 1, 2020. The final deadline for payments from

⁵⁴ **Information System** for Management and Monitoring of EU funds in Bulgaria 2020 <https://2020.eufunds.bg/bg/8010686/0/PriorityLines> [Accessed on 15 October 2023]

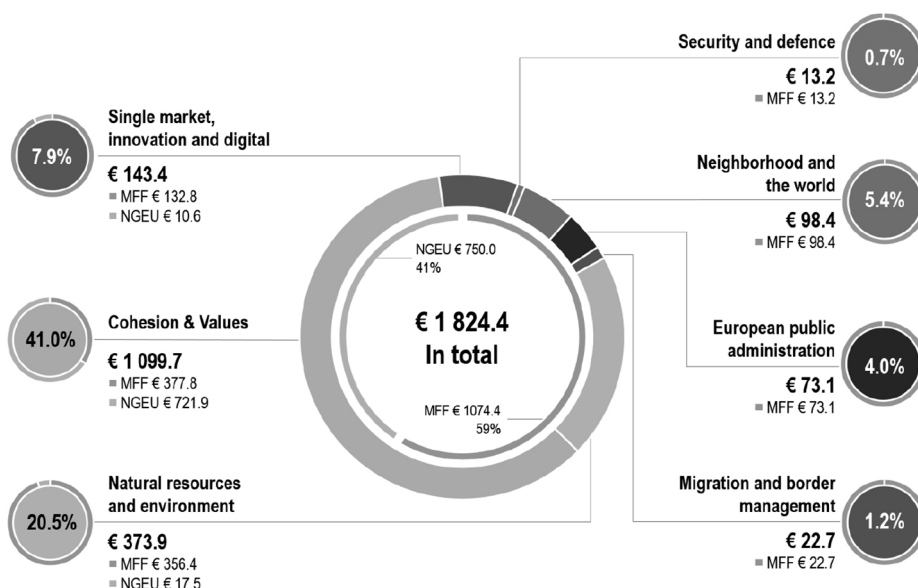
⁵⁵ Nextgeneration.bg <https://www.nextgeneration.bg/14> [Accessed on 15 October 2023].

the EC to Bulgaria is December 31, 2026. To ensure sufficient time for assessment and approval, all stages and objectives must be achieved by August 31, 2026.⁵⁶

Recovery plan for Europe

MFF 2021–2027 and Recovery Instrument NextGenerationEU (NGEU)

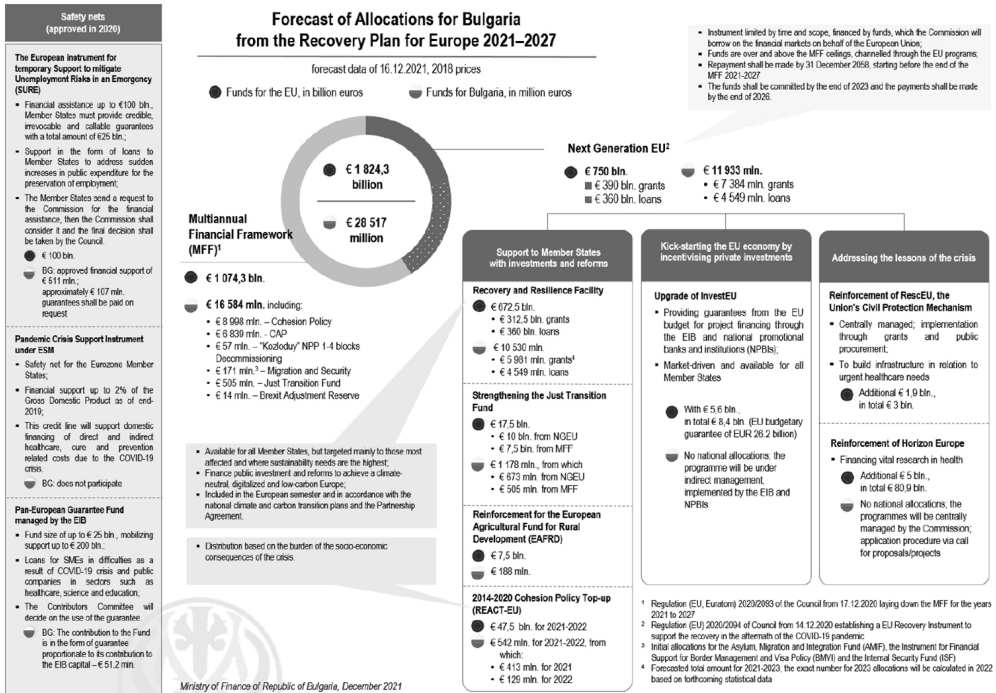
All amounts in € billion, 2018 prices



Source: European Commission, Ministry of Finance

The funds expected to be received by Bulgaria from the Multiannual Financial Framework 2021–2027 and from the NextGenerationEU Recovery Instrument.

⁵⁶ **Information System** for Management and Monitoring of EU funds in Bulgaria 2020 <https://2020.eufunds.bg/bg/0/0/MilestonePayments> [Accessed on 15 October 2023].



Source: Ministry of Finance, European Commission

4. Management of EU funds – institutional framework and types of regimes. Rule of law.

The European Commission, the Council of the European Union, and the European Parliament determine the size and allocation of the budget. The EC is responsible for budget management. Every year, the European Parliament assesses the implementation of the budget for the previous year and decides whether to ‘discharge’ the Commission (i.e., to approve how the Commission has implemented the budget) based on a recommendation from the Council of the EU. The Commission manages the budget under the watchful eye of the European Court of Auditors.⁵⁷ The goal of both institutions is to ensure sound financial management.

⁵⁷ European Court of Auditors: <https://www.eca.europa.eu/en> [Accessed on 15 October 2023].

The EC is responsible for implementing the budget in cooperation with the Member States, under the political control of the European Parliament.⁵⁸

During the 2021–2027 period:

- National authorities will manage about three-quarters of the budget expenditure jointly with the European Commission (shared management).
- The European Commission and its agencies and delegations will manage about 18% of the EU budget (direct management).
- Other international organisations, national agencies, or states outside the EU will manage 8% of the EU budget (indirect management).
- For NextGenerationEU, 90% of the funds will be channelled through the Recovery and Resilience Facility (RRF), applied under direct management.

The ultimate responsibility for budget implementation lies with the European Commission, which must ensure that every spent euro is recorded and accounted for. When irregular payments have been made, the EC collaborates with the relevant parties from the EU to recover the funds.⁵⁹

⁵⁸ For more information European Parliament: <https://www.europarl.europa.eu/factsheets/bg/sheet/30/%D0%B8%D0%B7%D0%BF%D1%8A%D0%BB%D0%BD%D0%B5%D0%BD%D0%B8%D0%B5-%D0%BD%D0%B0-%D0%B1%D1%8E%D0%B4%D0%B6%D0%B5%D1%82%D0%B0> [Accessed on 15 October 2023].

⁵⁹ See also **Пенов, С.** Финансово право. Специална част. Учебен курс. София, УИ „Св. Климент Охридски“, 2020; **Михайлова-Големинова, С., Сашо Пенов, Юрий Кучев, Атанас Симеонов, Калин Славов, Ирена Георгиева.** Проучване на практиката по финансовото управление и контрол на средствата от ЕС. – В: Предизвикателства пред финансово управление и контрол на средствата от Европейския съюз. Доклади от международна научно-приложна конференция, проведена през ноември 2016 г. в гр. София. София, УИ „Св. Кл. Охридски“, 2016, 21–64; **Михайлова-Големинова, С.** Финансови правни отношения в системата на публичните средства от европейските структурни и инвестиционни фондове. София, Сиела, 2017, с. 276; **Костов, С.** Съдебен контрол над усвояването на средствата от структурните и инвестиционните фондове на ЕС. – В: Сборник с доклади от конференция „Прилагане на правото на Европейския съюз в периода 2007 – 2017 г.“ София, издание БАЕЛ, 2018 (под печат); **Янкулова, С.** Практика на Върховния админи-

The rule of law is one of the fundamental values of the European Union. Respecting the principles of the rule of law is crucial for the sound financial management of the EU budget and the effective use of Union funding.⁶⁰

As of January 1, 2021, the EU budget has an additional level of protection in cases where breaches of the rule of law affect or risk affecting the financial interests of the EU. This is due to the Regulation on a general regime of conditionality for the protection of the Union budget (2020/2092) adopted on December 16, 2020, and published in the Official Journal of the European Union⁶¹ on December 22, 2020, effective from January 2021.

This new regime of conditionality allows the EU to take measures, such as suspending payments or financial corrections, to protect the budget. At the same time, final recipients and beneficiaries of Union funds are to continue receiving their payments directly from the respective Member States.

PURPOSE AND SCOPE OF REGULATION (2020/2092) ON A GENERAL REGIME OF CONDITIONALITY FOR THE PROTECTION OF THE UNION BUDGET

Measures under the Regulation on a general regime of conditionality can only be proposed if the EC determines that breaches of the rule of

стративен съд относно решаването на спорове по усвояване на средства от фондове на Европейския съюз. // Адвокатски преглед, 2018, № 1(под печат); **Александрова, И.** Някои въпроси, свързани с приложението на норми, регулиращи подпомагането по схеми и мерки по общата селскостопанска политика, разрешени в съдебната практика. – В: Предизвикателства пред финансовото управление и контрол на средствата от ЕС. Сборник с доклади. София, УИ „Св. Климент Охридски“, 2016; **Михайлова-Големинова, С.** Контрол за законност на управлението на средствата от европейските структурни и инвестиционни фондове-10 години по-късно. // Общество и право. 2018, № 2, 3–21.

⁶⁰ **Mihaylova, Goleminova, S.** Rule of Law Infringements in the Field of European Structural and Investment Funds Management. – In: **Belov, M.** (ed.) Rule of Law at the Beginning of the Twenty-First Century. The Hague: Eleven publ., 2018, 329–339. ISBN: 978-94-6236-858-3.

⁶¹ For more information EUR-lex: <https://eur-lex.europa.eu/legal-content/BG/TX-T/?uri=OJ:L:2020:4331:FULL#LI2020433EN.01000101.doc> [Accessed on 15 October 2023].

law directly affect or are at risk of seriously affecting the sound financial management of the Union budget or the Union's financial interests in a sufficiently direct manner.

The instrument⁶² complements other instruments and procedures for protecting the EU budget, such as checks and audits, financial corrections, or investigations by the European Anti-Fraud Office (OLAF).⁶³ The Commission will use the regulation only if other instruments for protecting the Union budget cannot be used more effectively.

The general regime of conditionality is different from the European rule of law mechanism⁶⁴ (with a central role played by the Annual Rule of Law Report), which aims to promote the rule of law.

FUNCTIONING OF THE REGULATION ON A GENERAL REGIME OF CONDITIONALITY FOR THE PROTECTION OF THE UNION BUDGET

According to the regulation, the EC will propose to the Council of the EU appropriate and proportionate measures if breaches of the rule of law in a Member State jeopardize the financial interests of the EU. The Council will then take a final decision on the proposal for measures.

In any case, final recipients and beneficiaries of Union funding retain their right to receive their payments. For this purpose, the respective Member States should continue to make these payments. In other words, if you are a final recipient or beneficiary of EU funding, you should continue to receive financial support from the Member State regardless of the measures imposed under the regulation.

GUIDELINES RELATED TO THE FUNCTIONING OF THE REGULATION ON A GENERAL REGIME OF CONDITIONALITY FOR THE PROTECTION OF THE EU BUDGET

⁶² For more information: Protecting the EU budget — rule of law
<https://eur-lex.europa.eu/BG/legal-content/summary/protecting-the-eu-budget-rule-of-law.html> [Accessed on 15 October 2023]

⁶³ European Anti-Fraud Office: https://anti-fraud.ec.europa.eu/index_bg [Accessed on 15 October 2023].

⁶⁴ More information: European Commission: https://commission.europa.eu/strategy-and-policy/policies/justice-and-fundamental-rights/upholding-rule-law/rule-law/rule-law-mechanism_bg [Accessed on 15 October 2023].

In order to clarify a number of elements related to the functioning of the Regulation on a general regime of conditionality, the Commission prepared a set of guidelines presented on March 2, 2022. These guidelines explain in detail how the Commission will implement the Regulation on a general regime of conditionality, including how the rights of final recipients and beneficiaries of EU funding will be safeguarded. The guidelines were developed through a comprehensive process, including consultations with the European Parliament and the EU member states. They also took into account the decisions of the Court of Justice of the European Union in cases C-156/21 and C-157/21, published on February 16, 2022.

Subsequent actions:

European Parliament resolution of 19 May 2022 on the Commission's 2021 Rule of Law Report (2021/2180(INI)), (2022/C 479/02).

- Communication from the Commission to the Council on the remedial measures notified by Hungary under Regulation (EU, Euratom) 2020/2092 for the protection of the Union's budget, COM(2022) 687 of November 30, 2022.
- Council Implementing Decision (EU) 2022/2506 of 15 December 2022 on measures for the protection of the Union budget against breaches of the principles of the rule of law in Hungary.

On January 23, 2023, the European Court of Auditors announced that it is conducting an audit to assess whether the European Commission is effectively safeguarding the EU's financial interests against violations of the rule of law in the member states. Auditors will examine the steps taken by the EC to ensure that states receive EU funding only if they respect the rule of law. The audit will focus on the EU's cohesion policy and funding for recovery from the COVID-19 pandemic.

III. ISSUES FOR CONSIDERATION

The budgetary process and the budget of the European Union are characterized by a multi-layered and complex nature. Exercising budgetary powers involves determining the overall amount and allocation of the

EU's annual expenditures, as well as the revenues necessary to cover them, and exercising control over the budget implementation. The budgetary procedure itself entails the drafting and adoption of the budget. In the present chapter, an attempt has been made to summarise and describe the most important issues related to the Multiannual Financial Framework and the key budgetary principles; the annual budget of the EU – formation of revenues and expenditure ceilings, NextGeneration or recovery plans, which are part of the ongoing Multiannual Financial Framework. Last, but not least, the management of EU Funds, incl. the institutional framework and types of regimes as well as the rule of law are presented. The presented material can be regarded as a brief guide for familiarization with the fundamental budgetary processes, the formation of budgetary revenues, and the management of funds within the European Union.

CHAPTER 21:

LEGAL FOUNDATIONS OF SUSTAINABLE FINANCE

Reni Pantcheva

ABSTRACT

This chapter introduces the concept of sustainable finance and its underlying principles adopted by financial institutions and investors. The exploration encompasses international and European Union initiatives aiming to establish a standardised framework for sustainable finance. Strategic regulations, such as the Taxonomy for sustainable activities applied in the European Union and its member states, are reviewed as well. Learning to navigate through core tenets, regulations and sustainable finance instruments provides a comprehensive understanding of the risks and opportunities associated with fostering sustainability within the financial sector.

KEY WORDS

sustainable finance,
financial transition,
regulatory framework,
taxonomy, ESG

I. INTRODUCTION

Resource depletion, environmental pollution and climate change call for urgent measures and proper solutions. Most of the environmental challenges that humanity faces today stem from the ‘take-make-waste’ business models of the linear economy.¹ A major transformation of the global socio-economic system is necessary to address all relevant aspects, such as legal, financial, energy, manufacturing structures and social concerns. Sustainability requires collaborative efforts of governments, businesses and individuals to change not only legal frameworks but

¹ See **Bocken, N., Samuel Short**. Unsustainable business models – Recognising and resolving institutionalised social and environmental harm. // Journal Of Cleaner Production, 2021.

also business practices and social attitudes. Embracing renewable energy sources, implementing circular business models and shaping new consumer attitudes and behaviour are of utmost importance for the transformative process.

To mitigate environmental impacts, transform polluting activities, model different production and consumption patterns and restore natural capital, there is one driving force that cannot be ignored – money. Sustainable or green finance is an evolutionary innovation in the financial industry that addresses activities related to environmental and climate action supporting the green transition.² While this transition is primarily concerned with decoupling economic systems from the overexploitation of fossil fuels and other scarce resources,³ sustainable finance aspires to create financial systems that empower fully sustainable economies. The United Nations Environment Programme distinguishes three closely associated terms.⁴ Figure 1 illustrates their relationships:

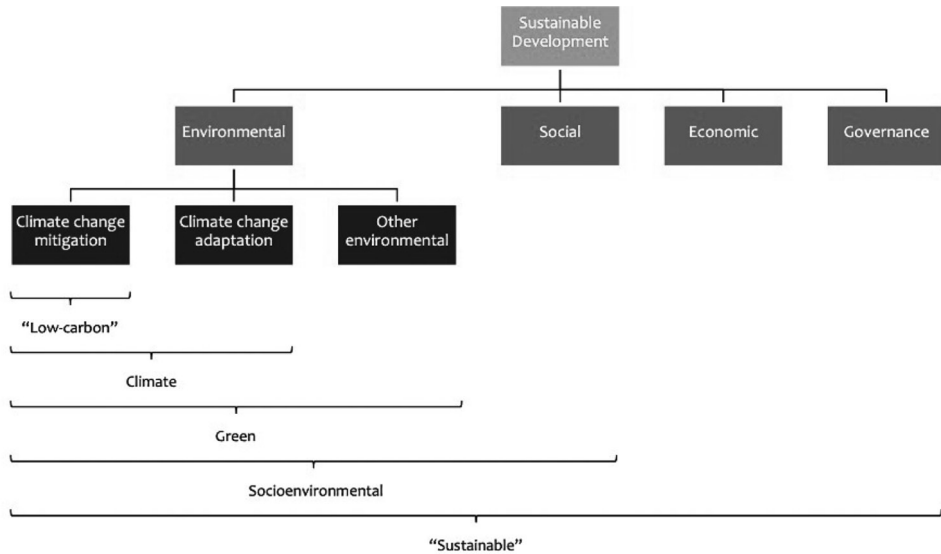
- **Sustainable finance** is the broadest concept and encompasses the pillars of sustainability: environmental, social, governance and economic aspects.
- **Green finance** is a subset of the above and primarily concerned with environmental aspects.
- **Climate finance** refers only to activities regarding climate change mitigation and climate change adaptation.

² See **Bhatnagar, S., Dipti Sharma**. Evolution of green finance and its enablers: A bibliometric analysis. // *Renewable and Sustainable Energy Reviews*, 2022, vol. 162.

³ See **Hickel, J., Giorgos Kalli**. Is Green Growth Possible? // *New Political Economy*, 2020, No. 4.

⁴ See Definitions and Concepts: Background Note. UNEP, 2016.

Figure 1. A simplified scheme for understanding broad terms on sustainable finance.



Source: Definitions and Concepts: Background Note. UNEP, 2016.

In the context of European Union policy, sustainable finance incorporates ESG⁵ considerations in investment decisions and supports ‘economic growth while reducing pressures on the environment to help reach the climate- and environmental objectives of the European Green Deal.’⁶ The **environmental aspects** generally concern climate and environmental changes. They may address biodiversity preservation,

⁵ ESG criteria help evaluate the sustainability of investments and relate to the complete lifecycle of a product or service that a business offers. As in ‘Green and Sustainable Finance’ by ISO (2022), examples of ESG criteria include: **Environmental** (climate change, natural resource depletion and environmental degradation (including land use change, habitat loss and species loss); **Social** (working conditions, local communities, conflict, health and safety, employee relations and diversity); **Governance** (executive pay, bribery and corruption, political lobbying and donations, board diversity and structure, and tax strategy).

⁶ Overview of sustainable finance. EC: https://finance.ec.europa.eu/sustainable-finance/overview-sustainable-finance_en [Accessed 12 January 2024].

pollution prevention⁷ and transition to a circular economy. **Social aspects** considerations cover human rights issues, human capital development, inclusiveness and improvement of working conditions. **Governance** aspects, which include management structure, employee relationships and remuneration policy, focus on integrating environmental and social factors in the decision-making process.

Sustainable investment should both finance environmentally friendly solutions and redirect funds from polluting activities towards sustainable alternatives. With the rapid spread of sustainable concepts, environmentally conscious practices become increasingly lucrative to investors, promising healthy returns from both financial and environmental point of view. One possible solution to global challenges is the transition to a circular economy. This alternative economic model, powered by renewable sources, keeps products and materials in circulation as long as possible to maximise their value, minimise or eliminate waste and pollution, and restore natural capital.⁸ The closed-loop system starts with eco-design and proceeds to investment recovery after options to extend the life of products and materials have run out.⁹ Despite all current efforts, environmental degradation continues to worsen. That is why it is of critical importance to promote the circular transition within industries. Green finance stands out as a promising incentive to achieve this goal by serving as an essential factor in reducing negative environmental impact while simultaneously fostering economic growth.¹⁰

The promise of a boost in the financial performance of companies which implement circular practices is a major incentive for the much-

⁷ See **Xiong, Y., Li Dai.** Does green finance investment impact on sustainable development: Role of technological innovation and renewable energy. // *Renewable Energy*, 2023, vol. 214(C).

⁸ See What is a circular economy? EMF: <https://www.ellenmacarthurfoundation.org/topics/circular-economy-introduction/overview> [Accessed 12 January 2024].

⁹ See **Yang et al.** Complementarity of circular economy practices: an empirical analysis of Chinese manufacturers. // *International Journal of Production Research*, 2019, vol. 57.

¹⁰ See **Chin, M.-Y. et al.** The impact of green finance on environmental degradation in BRI region. *Environment, Development and Sustainability*, 2022.

needed change.¹¹ As much as financial performance acts as a key driver for transforming business models, the transition still proves financially challenging. To navigate more easily in the process, it is essential to provide proper guidelines and specific tools that assist decision-making in sustainable investment. These resources have the potential to actively promote efficiency and reduce environmental degradation.¹²

This chapter reviews the concept of sustainable finance, shedding light on its catalytic role in driving the sustainable transition. The following sections cover the core principles used by financial institutions and investors and explore key international and European Union initiatives, regulations of strategic importance, sustainable finance instruments, and last but not least, the challenges and enablers that can either hinder or facilitate the transformation of the financial system into a more sustainable one.

II. BASIC ISSUES

1. Principles of Sustainable Finance

Financial institutions and investors interested in sustainable finance use common principles as guidelines in their practice. These principles are usually incorporated in a number of frameworks and relevant initiatives, such as those launched by UNEP FI:

- **Principles for Responsible Banking (PRB)**¹³

Six principles for a sustainable banking system were launched in 2019. They include the climate-related initiative **Net-Zero Banking Alliance**.¹⁴ Currently over than 330 banks (more than half the banking

¹¹ See **Yu et al.** Do circular economy practices matter for financial growth? An empirical study in China, 2022.

¹² See **Kanzari et al.** How financial performance is addressed in light of the transition to circular business models – A systematic literature review. // Journal of Cleaner Production, 2022.

¹³ Principles for Sustainable Banking. UNEP FI: <https://www.unepfi.org/banking/bankingprinciples/> [Accessed 13 January 2024].

¹⁴ Net-Zero Banking Alliance. UNEP FI: <https://www.unepfi.org/net-zero-banking/> [Accessed 13 January 2024].

industry) have signed, agreeing to align their strategies and operations with SDGs and international agreements, such as the **Paris Agreement**.¹⁵ The principles also relate to impact and target setting, clients and customers, stakeholders, governance and culture, and last but not least transparency and accountability.

- **Principles for Responsible Investment (PRI)**¹⁶

These six principles were launched as early as 2006. The framework incorporates ESG aspects in the practice of institutional investors and asset managers, influencing their ownership policies, disclosure of issues, analyses and decisions.

- **Principles for Sustainable Insurance (PSI)**¹⁷

Four principles were launched in 2012 to serve the insurance industry in its attempts to tackle ESG risks and opportunities and create innovative products that boost business performance, reduce risk and contribute to sustainable development. The principles emphasise ESG considerations in decision-making, raising ESG awareness among clients and partners, promoting ESG action across society, and demonstrating accountability and transparency.

To support and mobilise sustainable finance and its subsets, the International Organization for Standardization has undertaken the development of certain standards.¹⁸ They are meant to structuralise environmentally related investment and ensure its credibility and transparency:

- **ISO 32210**¹⁹ is designed to guide the financial sector along the incorporation of ESG practices and serve as a common framework for the development of international green finance standards. It

¹⁵ The Paris Agreement, UN: <https://www.un.org/en/climatechange/paris-agreement> [Accessed 13 January 2024].

¹⁶ Principles for Responsible Investment. UNPRI: <https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment> [Accessed 13 January 2024].

¹⁷ Principles for Sustainable Insurance. UNEP FI: <https://www.unepfi.org/insurance/insurance/> [Accessed 13 January 2024].

¹⁸ See Green and Sustainable Finance. ISO, 2022.

¹⁹ ISO 32210:2022: <https://www.iso.org/standard/77776.html> [Accessed 13 January 2024].

is complemented by the **ISO/TR 32220**²⁰ report that lays out the building blocks of sustainable finance and helps sustainable finance practitioners understand the basic concepts, key initiatives and terms in use.

- **ISO 14008**²¹ is designed for the monetary evaluation of an organisation's environmental interactions and their consequences. It is based on economic analysis of environmental management and does not include costing or accounting but simply values trade-offs between alternative resource allocations. The complementary standard **ISO 14007**²² provides guidelines on how to use this information in an environmental cost-benefit analysis.
- **ISO 14097**²³ helps financial institutions and managers to identify climate-related risks and opportunities so that they make informed decisions and successfully enhance the green transition.

2. The Role of the Financial Sector in the Sustainable Transition

While the public sector plays a major part in the transition, the private sector is also responsible for a significant share of financing on the path to achieving SDGs and the European Green Deal objectives. Presently, the financial system is still primarily focused on financing the linear economy, where risks are comparatively more limited because the life cycles of products and businesses are well studied. In this context, expected profits and the return on investment are more easily predictable. This trend, however, is gradually reversing due to technological progress, policy changes and the need for diversification. Factors, such as feed-in tariffs and the decreasing costs in the renewable energy sector, for example, contribute to a higher

²⁰ ISO/TR 32220:2021: <https://www.iso.org/standard/77786.html> [Accessed 13 January 2024].

²¹ ISO 14008:2019: <https://www.iso.org/standard/43243.html> [Accessed 13 January 2024].

²² ISO 14007:2019: <https://www.iso.org/standard/70139.html> [Accessed 13 January 2024].

²³ ISO 14097:2021 <https://www.iso.org/standard/72433.html> [Accessed 13 January 2024].

level of security, making green investments more attractive.²⁴ To finance a sustainable system, financial institutions must undergo a substantial transformation. Banks can play an important intermediary role in the allocation of resources to green projects through state monetary policy instruments. However, there are currently no mandatory standardised criteria, internationally or regionally, regarding monitoring and disclosure of environmental risk information. Lowering the risk of asymmetric information is essential to encourage more investment in nature-friendly solutions. As the common banking practice often involves overlooking ESG risks in favour of prioritising financial benefits, governments have a key role in providing proper regulations and incentives for stakeholders. National authorities can also assist financial institutions in deciding which ‘brown’ companies to finance in order to raise their spending on environmental protection during the transition.²⁵ Regarding environmental legislation, Brazil, China and Peru can serve as examples as they have set obligatory requirements for banks and companies.²⁶ Violations there are subject to strict penalties. Until established mandatory requirements are made available, however, financial institutions can voluntarily implement certain industry frameworks to mobilise sustainable finance.

A crucial step in the transformation of the financial sector is the change in its approach to risk evaluation. Climate change and environmental degradation increasingly undermine financial stability through economic transmission channels, urging financial institutions to start treating these challenges as three main risks:²⁷

- **Physical risks** relate to the physical impacts of climate change. They can be *acute* physical risks, such as those caused by natural disasters, or *chronic* physical risks, a result of gradual changes

²⁴ See Mulder, I. Financing a nature-based future. // One Earth, 2022.

²⁵ See Zhang C., Bo Zhou. Where should the money go? The green effect of governmental guidance when sustainable finance impacts brown firms. // Pacific-Basin Finance Journal, 2023.

²⁶ See Zhelyazkova, V. The Role of Banks for the Transition to Circular Economy. – In: Circular Economy – Recent Advances, New Perspectives and Applications, IntechOpen, 2020.

²⁷ See Green and sustainable finance. EP, 2021.

stemming from deteriorating environmental conditions. These risks can affect households and organisations directly or indirectly through asset damages or supply chain disruptions.

- **Transition risks** relate to the green transition, which may affect the value of various assets. Transition risks may be caused by new regulations, technological advancements or changes in consumption patterns and may result in stranded assets or higher business costs.
- **Liability risks** are a direct consequence of the above two and may result in climate-related litigation procedures.

3. International and EU Sustainable Finance Initiatives

International and EU initiatives shape sustainable finance by developing standards, promoting best practices and fostering collaboration among all interested parties at a regional and global level. There are various initiatives that guide policymakers, financial institutions, businesses and investors along the transition.

The **Task Force on Climate-Related Financial Disclosures (TCFD)**²⁸ was founded by the Financial Stability Board in 2015 to make recommendations on reporting climate-related financial information and improve the mechanisms in use. As of 2023, following its final report, the task force has been disbanded and the IFRS Foundation has been monitoring the progress of climate-related disclosures. The TCFD recommendations are widely applicable to organisations and relate to governance, strategy, risk management, metrics and targets. The seven core principles for effective disclosure state that it should be:

- representative of relevant information;
- specific and complete;
- clear, balanced, and understandable;
- consistent over time;
- comparable among companies within a sector industry or portfolio;
- reliable, verifiable, and objective;
- provided on a timely basis.

²⁸ TCFD: <https://www.fsb-tcfd.org/> [Accessed 14 January 2024].

The **High-Level Expert Group on Sustainable Finance (HLEG)**²⁹ was an early EU initiative established in 2016, consisting of 20 senior experts from the financial sector, academia, civil society, European and international observers. It acted as an advisory group to provide the European Commission with advice on managing public and private capital flows towards sustainable investment, undertaking steps towards stabilising the financial system and environmental risk protection, as well as deployment of these policies across Europe. The HLEG's final report was published in January 2018.

The **Network of Central Banks and Supervisors for Greening the Financial System (NGFS)**³⁰ was established in 2017 by eight central banks and supervisors. It currently consists of over 130 members and more than 20 observers. Its purpose is to help the financial system manage risks and mobilise green finance better by identifying and promoting best practices and disseminating tools and methodologies for environmental risk management.

The **Technical Expert Group on Sustainable Finance (TEG)**³¹ was another EU expert group. It was formed in 2018 to assist the European Commission in developing the EU Taxonomy, an EU Green Bond Standard, as well as methodologies for corporate disclosures and benchmarks. A total of 35 members from the financial and business sector, academia, civil society, European and international observers prepared the ground for the future Platform on Sustainable Finance. TEG's final report was published in March 2020, containing updated technical screening criteria for 70 climate change mitigation and 68 climate change adaptation activities, and an updated methodology for the technical screening criteria.

²⁹ The High-Level Expert Group on Sustainable Finance. EC, 2020: https://finance.ec.europa.eu/publications/high-level-expert-group-sustainable-finance-hleg_en?gclid=CjwKCAiAzJOtBhALEiwAtwj8toSip2BnCa_Yk1WdNMvdhEol4PUPHhgZ-2cE9115UuTWusjn4HIg_qxoC5soQAvD_BwE [Accessed 14 January 2024].

³⁰ NGFS: <https://www.ngfs.net/en> [Accessed 14 January 2024].

³¹ TEG. EC, 2020: https://finance.ec.europa.eu/publications/technical-expert-group-sustainable-finance-teg_en [Accessed 14 January 2024].

The **Task Force for Climate-related Financial Risks (TCFR)**³² was established by the Basel Committee on Banking Supervision in 2020 to conduct research on climate risk transmission channels and develop methodologies to measure and evaluate these risks in order to incorporate them in the Basel Framework.³³ This framework presents the full set of standards of the BCBS, the foremost standard setter of international banking prudential regulation.

Over 190 countries signed the Paris Agreement to tackle climate change and environmental degradation. The ambitious goals it set require a major economic transition calling for trillions of global green investments every year. In a collective effort to mobilise global private capital and create integrated markets for environmentally sustainable finance, the European Union launched the **International Platform on Sustainable Finance (IPSF)**³⁴ in 2019. It is a forum for cooperation among public authorities, such as ministries of economy or finance, regulators or supervisors, and central banks that are in charge of sustainable finance. The founding members were authorities of Argentina, Canada, Chile, China, India, Kenya and Morocco. Presently, 20 countries in total are members of IPSF, accounting for 58% of global greenhouse gas emissions, 54% of global GDP and 51% of the world's population. The twelve observers of the platform are the Coalition of Finance Ministers for Climate Action, the European Bank for Reconstruction and Development, the European Development Finance Institutions, the European Investment Bank, the IFRS Foundation, the International Monetary Fund, the International Organisation of Securities Commissions, the Network for Greening the Financial System, the Organisation for Economic Co-operation and Development, the United Nations Environment Programme – Finance Initiative, the United Nations Development Programme and the World Bank Group. The platform's purpose is to:

³² The Basel Committee's initiatives on climate-related financial risks. BIS, 2020: <https://www.bis.org/speeches/sp201014.htm> [Accessed 14 January 2024].

³³ The Basel Framework. BIS: https://www.bis.org/basel_framework/ [Accessed 14 January 2024].

³⁴ IPSF. EC: https://finance.ec.europa.eu/sustainable-finance/international-platform-sustainable-finance_en?gclid=Cj0KCQiAhomtBhDgARIsABcaYymbPBujlI-4w46RFEYx8HsbraXxkw-a-NMwulPmh60wwhQ8Q0aCXEQ4aAstxEALw_wcB [Accessed 14 January 2024].

- exchange information and disseminate the best of practices in environmentally sustainable finance;
- explore the various initiatives and identify barriers and opportunities for international environmentally sustainable finance;
- promote international coordination on environmentally sustainable finance issues.

The **Platform on Sustainable Finance**³⁵ is an advisory body which is subject to the European Commission's horizontal rules for expert groups. It was established under Article 20 of the Taxonomy Regulation in 2020. The platform enables the cooperation among all stakeholder groups (including international and public institutions, private financial and non-financial organisations, civil society, academia and independent experts). It provides the EC with suggestions related to sustainable finance, such as advice on the usability of the EU taxonomy and a wider sustainable finance framework, technical screening criteria for the EU taxonomy, and monitoring capital for sustainable investments. The platform is built upon the scientific and professional experience of a balanced panel of 28 experts, 7 members of EU agencies and bodies directly appointed through Article 20 of the Taxonomy Regulation (The European Environment Agency, the European Investment Bank, the European Investment Fund, the European Agency for Fundamental Rights and 3 European supervisory agencies), as well as 14 invited observers. Each mandate of the 35 members and the 14 observers lasts two years. The technical work is performed by three subgroups, which address usability and data, technical screening criteria, and monitoring of capital flows.

4. The European Union and Sustainable Finance

The **European Green Deal**³⁶ is a product of the European Union's efforts to tackle climate change and environmental degradation. The desired transformation into a competitive circular economy requires cooperation

³⁵ Platform on Sustainable Finance. EC: https://finance.ec.europa.eu/sustainable-finance/overview-sustainable-finance/platform-sustainable-finance_en [Accessed 14 January 2024].

³⁶ The European Green Deal. EC: https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal_en [Accessed 14 January 2024].

and coordination across all economic sectors as well as proper management of capital flows. The deal aspires to achieve climate neutrality by 2050, decouple economic growth from the use of exhaustible resources and ensure a just transition that includes equally all regions and individuals. In the meantime, the EU commits to reduce net greenhouse gas emissions by at least 55% until 2030 (compared to 1990 levels) through legally binding targets for all economic sectors. The overall targets are emissions reductions, a boost of natural carbon sinks, an updated emissions trading system and proper social support for individuals and small businesses. Apart from the obvious environmental benefits, the green transition has the potential to reduce energy poverty, raise energy security and reduce the dependence on foreign fossil fuels, create new jobs and improve the overall health and wellbeing of individuals.

The **EU Action Plan on Financing Sustainable Growth**³⁷ was presented in 2018. The plan proposes strategic solutions connecting finance with sustainability. Its main objectives are to repurpose capital flows towards sustainable investment, incorporate sustainability into risk management, encourage transparency, and prioritise the long-term future. The ‘taxonomy’ is one of the three key regulations it provides. This categorisation defines if an economic activity is environmentally sustainable. The other two regulations regard disclosures and benchmarks.

Investments and reforms are the building blocks of a green economy. The achievement of the EU Green Deal’s objectives until 2030 requires an increasing flow of financing every year. Apart from public sector support, a stable Capital Markets Union is needed to support the flow of private capital in the transition.

The **EU Sustainable Finance Strategy**³⁸ was updated in 2021 and incorporates a package of measures to facilitate the financing of the sustainable transition. It builds upon the 2018 action plan, and the reports of HLEG and the TEG. Four main areas are prioritised: finance

³⁷ Action Plan: Financing Sustainable Growth. EC: <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52018DC0097> [Accessed 15 January 2024].

³⁸ Strategy for financing the transition to a sustainable economy. EC, 2021: https://finance.ec.europa.eu/publications/strategy-financing-transition-sustainable-economy_en [Accessed 15 January 2024].

for the sustainable transition, inclusiveness of individuals and small and medium companies, resilience and contribution of the financial sector, and international consensus on global sustainable finance ambitions. Key objectives of the strategy are the extension of the sustainable finance toolbox and proper monitoring of the financial system to ensure its integrity. In the update, the European Commission also supplements the Taxonomy by specifying the content, methodology and presentation of disclosures made by large financial and non-financial organisations. Additionally, to encourage the development of the green bond market, the EC proposes a voluntary standard for green bonds. It provides companies and public authorities with guidelines to adhere to in their quest for financial support of large-scale investments. The ‘gold standard’ will make it possible for issuers to show that the projects they are funding are legitimate. Meanwhile, investors will be less exposed to greenwashing and will more easily assess the risks and opportunities a sustainable project offers.

Three main components lay the foundation of the **EU Sustainable Finance Framework**:

4.1. The EU Taxonomy (Regulation (EU) 2020/852)³⁹

The Taxonomy was adopted in 2020 and applies since January 2022. It is a classification system of economic activities that contribute to the achievement of environmental objectives. It acts as a foremost step in defining future legislation. One of its goals is to prevent market fragmentation and greenwashing. The taxonomy applies to financial market participants or issuers of environmentally suitable financial products, as well as undertakings obligated to publish a non-financial statement or a consolidated non-financial statement in accordance with Article 19a or Article 29a of Directive 2013/34/EU of the European Parliament and of the Council, respectively. An investment is considered environmentally sustainable if the specific economic activity addresses one or more out of the six objectives in Article 9, does not significantly harm any of them, and complies with the minimum safeguards (social and labour) and technical screening criteria. The environmental objectives are as follows:

³⁹ OJ L 198, 22.6.2020, p. 13-43.

- climate change mitigation;
- climate change adaptation;
- sustainable use and protection of water and marine resources;
- transition to a circular economy;
- pollution prevention and control;
- protection and restoration of biodiversity and ecosystems.

4.2. Disclosures

Financial and non-financial institutions are subjects to a disclosure regime in order to provide investors with the information needed to decide on sustainable investment opportunities. The **Non-Financial Reporting Directive (Directive 2014/95/EU)**⁴⁰ was adopted in 2014 and applies until the rules of CSRD come into force. NFRD requires large public-interest companies (over 500 employees) to publish information about environmental, social and labour matters, respect for human rights and diversity on company boards, as well as practices on anti-corruption and bribery.

The **Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088)**⁴¹ was adopted in 2019 and applies since March 2021. It establishes unified rules for market participants and financial advisers to ensure transparency regarding sustainability-related information on financial products, as well as their sustainability risks and adverse impacts. Financial market participants and advisers must therefore publish on their websites information about their policies on sustainability risks and where they do and do not consider adverse impacts of their investment decisions on sustainability factors.

The **Corporate Sustainability Reporting Directive (Directive (EU) 2022/2464)**⁴² was adopted in 2022 and member states will have to comply with it for the financial years starting on or after 1 January 2024. CSRD introduces sustainability reporting in the management reports of all large and listed companies, with the exception of micro undertakings. The

⁴⁰ OJ L 330, 15.11.2014, 1–9.

⁴¹ OJ L 317, 9.12.2019, 1–16.

⁴² OJ L 322, 16.12.2022, 15–80.

European Commission adopted a supplementing delegated act (Delegated Regulation (EU) 2023/2772)⁴³ to set the European Sustainability Reporting Standards (ESRS) in July 2024. These standards are aligned with EU policies and contribute to international standardisation initiatives. They specify the necessary information about environmental, social, governance and human rights factors. The ESRS also ensure the presented information is relevant, verifiable, comparable and understandable. Sustainability reporting will help interested parties assess the sustainability performance of companies and make informed decisions.

4.3. Benchmarks

The benchmarks can be used by companies, market participants and financial intermediaries which develop innovative sustainable investment solutions. The **EU Climate Transition Benchmarks Regulation (Regulation (EU) 2019/2089)**⁴⁴ was adopted in 2019 and amends Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts. The new regulation introduces the EU Paris-Aligned Benchmark (EU PAB) and the EU Climate Transition Benchmark (EU CTB). The EU PAB is positioned in context with the Paris Agreement objectives, whereas the EU CTB is a benchmark in which underlying assets are selected, weighted or excluded in a manner that ensures the resulting benchmark portfolio follows a decarbonisation trajectory. The aim of the regulation is to repurpose capital towards climate-related investments. It applies to benchmark administrators and obliges them to disclose specific information, such as excluded assets, data type, data source and methodologies in compliance with regulatory requirements.

The **European Green Bond Standard (Regulation (EU) 2023/2631)**⁴⁵ was adopted to create a ‘gold standard’ that can be used globally by all bond issuers and investors. It is voluntary and based on key requirements aligned with the Taxonomy. Its purpose is to define what is ‘green’, ensure transparency of the use of proceeds, guarantee an external

⁴³ OJ L, 2023/2772, 22.12.2023, ELI: http://data.europa.eu/eli/reg_del/2023/2772/oj.

⁴⁴ OJ L 317, 9.12.2019, 17–27.

⁴⁵ OJ L, 2023/2631, 30.11.2023, ELI: <http://data.europa.eu/eli/reg/2023/2631/oj>.

review of compliance, and provide proper supervision of the reviewers by the European Securities Market Authority to ensure the quality and reliability of their work. The most important requirement is that all proceeds of the bond are allocated to economic activities that meet EU Taxonomy requirements before maturity of the bond. Reporting requirements are aligned with the market best practice.

The European Green Deal not only presents a transformational opportunity but also serves as a means to mitigate post Covid-19 disruptions. Substantial investment from the European Union seven-year budget and a third of the **NextGenerationEU Recovery Plan**,⁴⁶ amounting to over €2 trillion in total, will be allocated to finance the deal. The NextGenerationEU is an opportunity to make the European economy more digital, resilient and, most importantly, greener. The combined funds will address three fields of interest: 1. Single market, innovation and digital; 2. Cohesion, resilience and values; 3. Natural resources and environment. The central instrument of the recovery plan is the **Recovery and Resilience Facility (Regulation (EU) 2021/241)**⁴⁷ providing loans and grants for reforms and investments in member countries. It was forged in response to the Covid-19 outbreak which critically influenced the global economic, social and budgetary perspectives and made it clear that sustainable and resilient economies can respond more adequately to shocks and recover more rapidly. The Facility applies to six areas:

- green transition;
- digital transformation;
- smart, sustainable and inclusive growth;
- social and territorial cohesion;
- health, and economic, social and institutional resilience, to increase crisis preparedness and crisis response capacity;
- policies for the next generation (education, skills, etc.).

⁴⁶ Recovery Plan for Europe. EC: https://commission.europa.eu/strategy-and-policy/recovery-plan-europe_en https://commission.europa.eu/strategy-and-policy/recovery-plan-europe_en [Accessed 16 January 2024].

⁴⁷ OJ L 57, 18.2.2021, 17–75.

Apart from RRF, funds are distributed through a number of European Union programmes: the REACT-EU, Horizon Europe, InvestEU, European Agricultural Fund for Rural Development and the Just Transition Fund.

5. Sustainable Finance Instruments

Sustainable finance instruments are usually issued and traded by financial markets just like conventional financial instruments. They direct funds towards sustainable projects or assets. The outcomes of a specific undertaking are usually measured via sustainability and circularity indicators. In response to the Covid-19 outbreak, interest in sustainable finance grew significantly. Financial markets registered more intra-day trading and higher volatility but the shock turned out favourable for ESG funds which outperformed non-ESG funds.⁴⁸

The main types of sustainable finance instruments are:

- **Green bonds and loans**

The main principles of green bonds and loans are based on four components: use of proceeds, project evaluation and selection, management of proceeds, and reporting. Their contribution to sustainability and the circular economy can be assessed through metrics, such as resource and energy efficiency, recycling and circularity of materials, waste and emissions prevention. It is important to monitor final states, as recyclable products and materials may not necessarily get recycled or recirculated at a later stage.

Green bonds⁴⁹ are fixed-income financial instruments used to raise funds for environmental and climate projects, helping enterprises invest more in innovations in the field of renewable energy, resource efficiency, eco-efficiency, climate change adaptation, etc. The green bond principles underline the need for transparency, accuracy and integrity of information. This is the most popular instrument for green financing and encouragement of private investment and the value of green bonds has grown enormously in recent years. They offer higher yields, lower variance, and an increased

⁴⁸ See Green and sustainable finance. EP, 2021.

⁴⁹ See The Green Bond Principles. ICMA, 2018.

liquidity, especially when originating from an institutional issuer.⁵⁰ The issuer's reputation or third-party verifications are essential to minimise asymmetric information and greenwashing. The ISO 14030⁵¹ series also aids decisions regarding the credibility and eligibility of green bonds and loans by offering a proper reporting mechanism for investors.

Green loans⁵² are used only to finance new or existing eligible green projects fully or partially. They have the potential to encourage low-carbon technologies in companies by providing more R&D funding and increasing management efficiency.⁵³ To harness the full benefits of green loans, enterprises need clear green credit guidelines. These guidelines will ensure that production and growth are not hindered. Instead, they will incentivise polluting companies to undergo a transformation towards more sustainable processes. Governments should collaborate with financial institutions to provide adequate policy support in the allocation of green funds. Proper supervision is also required so that green loans support environmental protection undertakings and are not diverted to undesirable but profitable projects.

- **Social bonds**⁵⁴

The proceeds of social bonds are directed exclusively towards financing new or existing eligible social projects fully or partially. The notion should not be mistaken for sustainability bonds. Since some social activities may bring environmental benefits as well, the use of proceeds should be clearly predetermined by the issuer of the bonds in accordance with their initial objectives.

⁵⁰ See **Bachelet, M. et al.** The Green Bonds Premium Puzzle: The Role of Issuer Characteristics and Third-Party Verification. //Sustainability, 2019.

⁵¹ ISO 14030-1:2021: <https://www.iso.org/standard/43254.html>; ISO 14030-2:2021: <https://www.iso.org/standard/75558.html>; ISO 14030-3:2022: <https://www.iso.org/standard/75559.html>; ISO 14030-4:2021: <https://www.iso.org/standard/76598.html> [Accessed 16 January 2024].

⁵² See Green Loan Principles. LMA, 2018.

⁵³ See **Chen, Z. et al.**, Can green credit policy promote low-carbon technology innovation? // Journal of Cleaner Production, 2022.

⁵⁴ Social Bond Principles. ICMA, 2020.

- **Sustainability bonds**⁵⁵

The proceeds of sustainability bonds are directed exclusively towards financing a combination of both green and social projects that usually contribute to the achievement of Sustainable Development Goals.

- **Sustainability-linked bonds**⁵⁶ and **loans**⁵⁷

Sustainability-linked bonds are different from sustainability bonds because the proceeds are not necessarily used for sustainability projects. They are a performance-based instrument and its financial and/or structural characteristics may change if the issuer accomplishes predefined sustainability or ESG objectives. Therefore, the issuer commits to a specific sustainability improvement and sets a time schedule for its completion. The objectives are measured by Key Performance Indicators and assessed against Sustainability Performance Targets.

Sustainability-linked loans are corporate loans that provide the borrower with funds for predetermined sustainability objectives. The borrower's performance is evaluated via Sustainability Performance Targets. These loans try to improve the sustainability profile of the borrower, not to finance a sustainability project. Therefore, the proceeds can fund general corporate purposes.

- **Transition bonds**⁵⁸

Transition bonds are a type of climate finance solution used to help companies navigate the transition and reduce their CO₂ emissions and environmental impact. These can be either green, sustainability or sustainability-linked bonds that encourage the transformation of heavily-polluting enterprises and finance decarbonisation activities. The proceeds can be directed towards new or existing eligible transition projects. Transition bonds are especially useful to firms that do not meet the criteria to issue green bonds but can significantly benefit from sustainable financing.

⁵⁵ Sustainability Bond Guidelines. ICMA, 2018.

⁵⁶ Sustainability-Linked Bond Principles. ICMA, 2020.

⁵⁷ Sustainability Linked Loan Principles. LMA, 2019.

⁵⁸ See **Riordan, R.** Transition Bonds. – In: *Climate Transition Finance Handbook*, 2020.

6. Sustainable finance challenges and enablers

Sustainable investment decisions are guided by various factors, with market signals being one such important indication. For instance, if greenhouse gas emissions or other negative externalities from production activities are calculated into the final price of output, and products or services are taxed accordingly, prices would accurately reflect the sustainability of investments. However, a significant challenge arises from the fact that addressing climate change mitigation and adaptation requires substantial changes in at least five key areas: energy, transport, buildings, industry and agriculture. In these cases, the price mechanism falls short of coordinating a transformation of such magnitude.

Distinguishing sustainable from non-sustainable investment opportunities is at the core of sustainable finance. The degree of sustainability depends on various determinants, including present and future material and energy sources, as well as the treatment of products at the end of their useful life. Organisations need a clear guide to help them assess the potential of a sustainable project and identify the environmental risks and opportunities it offers. ISO standards and the Taxonomy can significantly ease the decision-making process as they define and classify sustainable finance activities, evaluate impacts and foster credibility and transparency. ISO 14100,⁵⁹ for instance, applies to parties interested in projects, assets and activities that are supported by green finance.

Even if proper assessment frameworks are developed and put into action, various factors can influence the sustainable finance transition. Figure 2 visually summarises the most common considerations that should be taken into account to ensure effective capital flows for a sustainable and resilient global economy. Stemming from ESG principles, three main areas may increase risks related to sustainable investment decisions:

- **Environmental factors**

Negative externalities related to the environment and the risks they create for the company credit profile and its business operations should be

⁵⁹ ISO 14100:2022: <https://www.iso.org/standard/75619.html> [Accessed 16 January 2024].

identified. The generator's obligations arising from these externalities may include risks, such as penalties imposed by government agencies, litigation risk or future payments for managing negative impacts.

- **Socials factors**

Issues related to employee relationships, working conditions, product safety and sustainability may arise. The way companies treat their employees, suppliers, customers and the community as a whole is critical to investment analysis.

- **Governance factors**

The diversity, independence and qualification of management structures should be assessed. Companies need to make sure they are prepared to face future risks and take action considering the interests of business stakeholders and other interested parties.

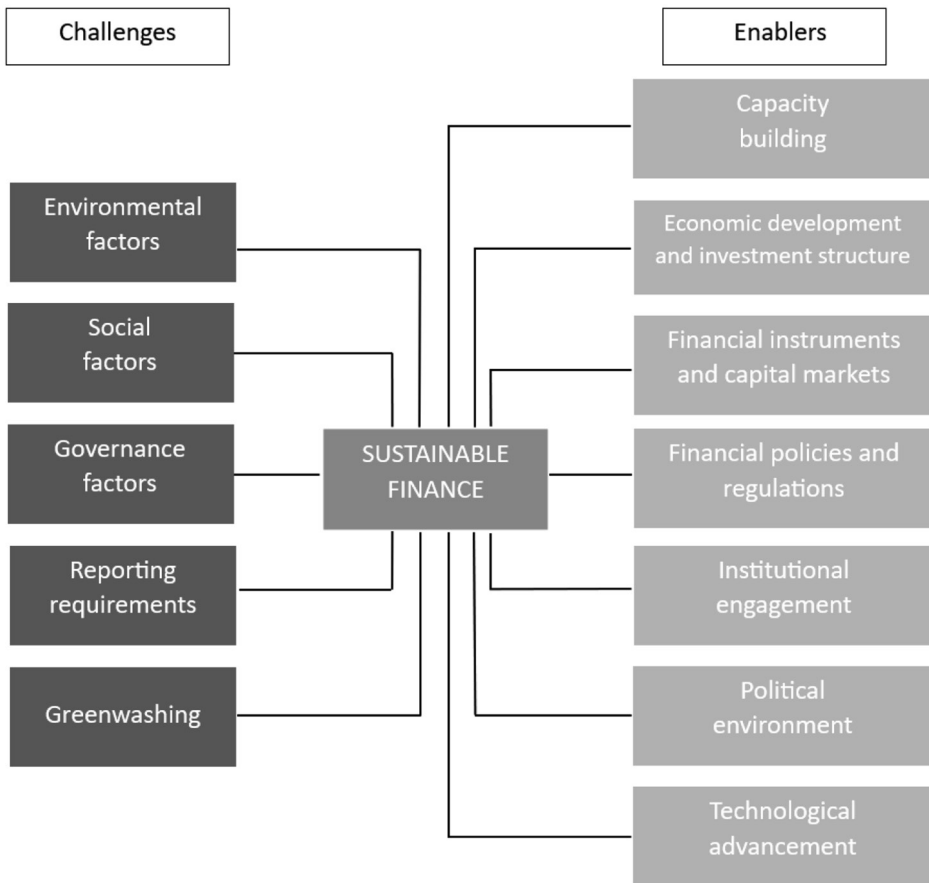
Sustainable finance is challenged beyond ESG integration and issues may also arise as a result of **reporting requirements** related to data collection and management, compliance and reporting implementation.⁶⁰ Financial institutions need to invest in the development of appropriate policies and tools to fulfil their requirements on data collection, analysis and reporting. The Taxonomy, for example, requires banks to disclose the share of their sustainability-aligned activities in the underlying assets or obligations. This calls for specific and detailed descriptions of client accounts and particularly client self-reporting which is complex and costly in some cases.

Greenwashing, being a dishonest business practice, poses an additional threat to sustainable finance as it diverts capital flows from sustainable purposes.⁶¹ Sustainable finance relies on ESG disclosures but the lack of unified mandatory reporting requirements may cause information asymmetries and prompt companies to announce only favourable information.⁶²

⁶⁰ Navigating Sustainable Finance: Challenges and Opportunities for Banks on their path to Net Zero Goals. Greenomy: <https://greenomy.io/blog/sustainable-finance-banks-challenges-opportunities> [Accessed 16 January 2024].

⁶¹ See **Johansmeyer, T.** Greenwashing and Divestment: The Hidden Problem in an Old Sustainable Finance Strategy. // The Journal of Impact and ESG Investing, 2023.

⁶² See **Lashitew, A.** Corporate uptake of the Sustainable Development Goals: Mere greenwashing or an advent of institutional change? // Journal of International Business Policy, 2021.

Figure 2. Sustainable finance challenges and enablers.

An author's representation.

Despite the potential barriers, sustainable finance can bring various benefits to the financial sector and the economy. A recent study⁶³ identifies the most common parameters that enable sustainable finance:

- **Capacity building**

Targeted and comprehensive capacity building empowers individuals and organisations to better integrate sustainable finance principles and

⁶³ See **Bhatnagar, S., Dipti Sharma**. Evolution of green finance and its enablers: A bibliometric analysis. // Renewable and Sustainable Energy Reviews, 2022.

practices into their work. Capacity building can take different forms, such as education and training programmes that cultivate experienced professionals and help policymakers make informed policy-related decisions; incorporation of ESG factors in decision-making processes; development of sustainable financial products; development of tools for data collection, analysis and reporting; as well as raising stakeholder awareness, engagement and collaboration.

- **Economic development and investment structure**

These are two of the most important factors influencing sustainable finance. Economically developed countries can allocate more resources to enhance research and development, advance technology and build capacity. Proper stimuli, such as subsidies, grants and tax incentives can reallocate capital, diversify the investor base and encourage long-term value creation that benefits both society and the environment. Aligning economic development strategies with sustainability principles creates a favourable environment for the promotion of sustainability-related investment decisions.

- **Financial instruments and capital markets**

They offer innovative solutions to stimulate private sector investments in green projects. This can be done through preferential or target funding, green bonds, green loans, credit guarantee schemes and green insurance. However, proper monitoring and financial flows disclosure is required to mitigate risks associated with the undertakings. A conducive business environment and well-developed capital markets can diminish risks in green investment sectors. The development of financial instruments can be further scaled up by setting standard reporting and disclosure guidelines for tracking the proceeds of financing.

- **Financial policies and regulations**

They emerge as the most important parameter. Clear and supportive regulatory frameworks encourage the implementation of ESG factors in decision-making. They either provide relevant incentives for investment or set disclosure requirements regarding sustainable performance. Sustainable financial policies support international collaboration and promote green finance initiatives, such as green public procurement or the establishment

of green institutions to allocate sustainable financing. Governments should make sure that public and private investment aligns with national development plans, the Paris agreement and post-pandemic recovery plans.

- **Institutional engagement**

Financial entities, regulatory bodies, industry associations, educational institutions, etc., engage in different ways to shape the sustainable finance landscape. Their joint efforts on local, regional or international level contribute to the integration of ESG principles into risk-assessment and investment-decision strategies. They raise stakeholder activism, foster collaboration and capacity building and facilitate the development and implementation of sustainable finance initiatives and frameworks.

- **Political environment**

The political environment shapes the regulatory landscape, develops consistent long-term policies and provides incentive mechanisms by incorporating sustainability objectives into national development strategies. A stable and supportive political environment fosters international collaboration, competitive market mechanisms and business development. It is conducive to green public procurement and public-private partnerships to drive economic, social and environmental projects.

- **Technological advancement**

Leveraging technology for sustainable finance solutions includes but is not limited to various tools, digital platforms, big data analytics for transparency and impact assessment, blockchain solutions for traceable transactions,⁶⁴ AI integration for identification of investment opportunities and optimisation of investment portfolios, etc. Technological progress offers innovative solutions to overcome a number of sustainable finance challenges. Digital infrastructure, for example, contributes to providing sustainability information, monitoring and risk management by making environmentally related data more available, accessible and reliable.⁶⁵

⁶⁴ See **Ren, Y.-S. et al.** Sustainable finance and blockchain: A systematic review and research agenda. // *Research in International Business and Finance*, 2023.

⁶⁵ See **Puschmann, T., Dario Quattrocchi.** Decreasing the impact of climate change in value chains by leveraging sustainable finance. // *Journal of Cleaner Production*, 2023.

Alternatively, if these parameters are poorly managed, they may well turn into obstacles to the successful transformation. Addressing unsustainable areas of the markets on which investors act and taking advantage of opportunities, can enhance the transition to a sustainable financial system that powers an environmentally healthier and more prosperous world.

III. SOME CHALLENGES AND OPPORTUNITIES

Global challenges require immediate action, but the success of the sustainable transition is subject to various obstacles. The Covid-19 pandemic majorly afflicted the global economy and once again exposed the fragile balance of the human-nature relationship. To stabilise economies, strengthen their performance and overcome the negative consequences, fresh funding is essential. Sustainable finance, which encompasses environmental, social, governance and economic considerations, emerges as the backbone of the transformative agenda.

The EU has committed to ambitious objectives in the European Green Deal and relies on its Sustainable Finance Strategy to achieve these goals. The growing interest among investors has prompted policymakers and private initiatives to develop both regulatory and non-regulatory frameworks, aiming to set unified market standards regionally or globally. However, to create a harmonised market that is capable of achieving sustainable development targets, the different measures and reporting mechanisms need standardization. This will lead to better data availability, increased transparency and proper risk evaluation procedures to scale up investment in sustainable projects and businesses. In this respect, international cooperation is critical to creating a unified global regulatory framework.

The financial sector appears to play a leading role in creating sustainable finance instruments and allocating public and private funds. It is undergoing a transformation itself by incorporating ESG factors in its procedures and assessing new risks that arise from the transmission of environmental challenges into financial stability. On the path to economic

transformation, transition finance may prove to be just as valuable as green finance. Polluting activities cannot be abruptly ceased. Until suitable alternatives to ensure satisfactory outcomes for businesses and individuals are found, these activities should be made more sustainable by limiting their negative impacts.

The sustainable finance transition faces many complexities stemming from ESG considerations and standards for reporting and compliance. Despite these challenges, the transformative potential of sustainable finance is bolstered by various factors. From capacity building to economic development, financial instruments and policies, institutional engagement, the political environment, and technological advancements, each plays a pivotal role. However, these parameters should be managed effectively, because they may just as well hinder the transition that is vital for the achievement of sustainable development goals.

CHAPTER 22:

TRENDS IN THE FIELD OF FINANCIAL CONTROL AND AUDIT IN THE PUBLIC SECTOR

Savina Mihaylova-Goleminova

ABSTRACT	KEY WORDS
This chapter presents the key aspects of financial control and audit in the public sector. 'Financial Control', 'Supervision' and 'Audit' are presented within the fourth component of the subject of legal regulation of Financial Law, stemming from their nature and legal regulation in positive law.	financial control, audit in the public sector, public finance.

I. INTRODUCTION

The main principles laying down the foundations of the contemporary Bulgarian financial system, are stated, although not exhaustively, in the Constitution of the Republic of Bulgaria and stem from Bulgarian constitutional traditions. The main EU values transferred from the constitutional traditions of Member States are the pillar of the current EU, established in its primary Community law. **Based on positive law and practice, financial theory currently reconsiders theoretical constructions such as 'control', 'financial control', 'supervision' and 'audit'.** When discussing the fourth component of the subject of legal regulation of Financial Law, namely 'control', we should also consider the terms 'Financial law',¹ 'Financial control',² 'Supervision' and 'Audit' in its scope, based on the developments of EU law and our national legislature, as well as international standards.

¹ See Chapter 18.

² See also Chapter 23.

II. BASIC ASPECTS

1. Fundamentals of Financial control

An inspiration for future developments in legal doctrine and the practice of financial law in the field of financial control provides Judgement No 2/6 Feb 2024 under case No 8/2023 of the Bulgarian Constitutional Court.³ The Constitutional Court (CC) ruled, in Constitutional Case No. 8/2024, to reject the request of the three-member chamber of the Supreme Administrative Court to establish the unconstitutionality of Article 55(2) of the Audit Office Act (promulgated in State Gazette No. 12 of 2015; amended and supplemented in State Gazette No. 84 of 06.10.2023). The CC refused to ‘repeal’ the prohibition on judicial challenges to the audit reports of the Audit Office. These are excluded from judicial review by the provision of Article 55(2) of the Court of Auditors Act (CAA), which states that “*Final audit reports shall not be subject to judicial challenge*”, which the CC unanimously held not to be unconstitutional.

It is useful to once again review the negotiating **chapters,⁴ on which the EU candidate states are currently negotiating and are required to meet the *acquis*.** Chapter 32 Financial Control provides that the *acquis* under this chapter relates to the adoption of internationally recognised frameworks and standards, as well as EU good practice in the field of **public internal financial control (PIFC)**, based upon the principle of decentralised managerial accountability. PIFC should be applied across the entire public sector, and includes the internal control of financial management of both national and EU funds. In particular, the *acquis* requires the existence of effective and transparent management systems, including accountability arrangements for the achievement of objectives; a functionally independent internal audit; and relevant organisational structures, including central co-ordination of PIFC development across the public sector. Chapter 32 also requires an institutionally, operationally

³ See Михайлова-Големинова, С. Нужен ли е нов Закон за държавната финансова инспекция? <https://rb.gy/h463zm> [Accessed on 15 January 2024].

⁴ Available in English at: https://ec.europa.eu/neighbourhood-enlargement/policy/conditions-membership/chapters-of-the-acquis_en. [Accessed on 15 January 2024]. See Chapters 5, 9, 17, 29, 32, 33.

and financially independent **external audit** institution that implements its audit mandate in line with the standards of the International Organisation of Supreme Audit Institutions (INTOSAI) and reports to the parliament on the use of public sector resources. In addition, the chapter also covers the **protection of EU financial interests** against fraud in the management of EU funds and the **protection of the Euro against counterfeiting**.

Financial control plays an important role as part of the term ‘governance’ and, as mentioned in Chapter 18, the relations related to financial control in public finances and the financial system are regulated by financial law. The first changes to financial control in Bulgaria were initiated based on the commitments undertaken under negotiation Chapter 28 Financial control as part of the preparation for our country’s membership in the EU, which in turn includes three main topics:

- External financial control (audit);
- Internal financial control and internal audit;
- Protection of the Community’s financial interests.

Within the framework of the negotiation process and monitoring under Chapter 28, the European Commission has recommended consistent application of the principles of sound financial management, transparency and lawfulness in the spending of public funds. The Regular report of the European Commission for Bulgaria for 2004 drew attention to the need for further development of legislation in the field of financial control.

The SIGMA report on the system of public internal financial control presented to the Minister of Finance on 26 April 2005 recommended drafting of legislation aimed at separation of the functions of the internal audit and the financial inspection, decentralisation of the internal audit and enhancement of managerial accountability, with three new Acts to be drafted for this purpose.

All three Acts regulate public relations related to the public sector and the management of the financial interests of the state, but while the **Public Sector Internal Audit Act (PSIAA)**⁵ and the **Financial Management**

⁵ Prom. SG. 27/ 31 March 2006, last amend. and suppl. SG. 100/20 Dec 2019.

and Control in the Public Sector Act (FMCPSA)⁶ regulate processes, activities and managerial accountability **inside the organisation**, the **Public Financial Inspection Act (PFIA)**⁷ regulates the implementation of **a specialised financial inspection function external to the organisation and having sanctioning powers**. The **Public Finance Act**⁸ is also applicable.

Many Bulgarian Financial Law scholars have focused their attention on the issues related to financial control, because ‘**control**’⁹ is an element of the concept of management. There are basically two types of control in the public sector according to the generally accepted financial legal doctrine: **internal**, established in the Financial Management and Control in the Public Sector Act (FMCPSA) and Public Sector Internal Audit Act (PSIAA), and **external**, established in the Public Financial Inspection Act (PFIA), which is carried out by specialised bodies with control competence.

2. Definitions

The legal definition of ‘**financial control**’ is provided in our current legislation in §1, item 11 of the Supplementary Provisions of the National Audit Office Act (NAOA): “**any form of control related to the management of public funds and activities, carried out through specialised powers and procedures, including budgetary control, financial inspection control, tax control, customs control and other.**”

⁶ Prom. SG. 21/ 10 March 2006, last amend. and suppl. SG. 13/12 Feb 2019.

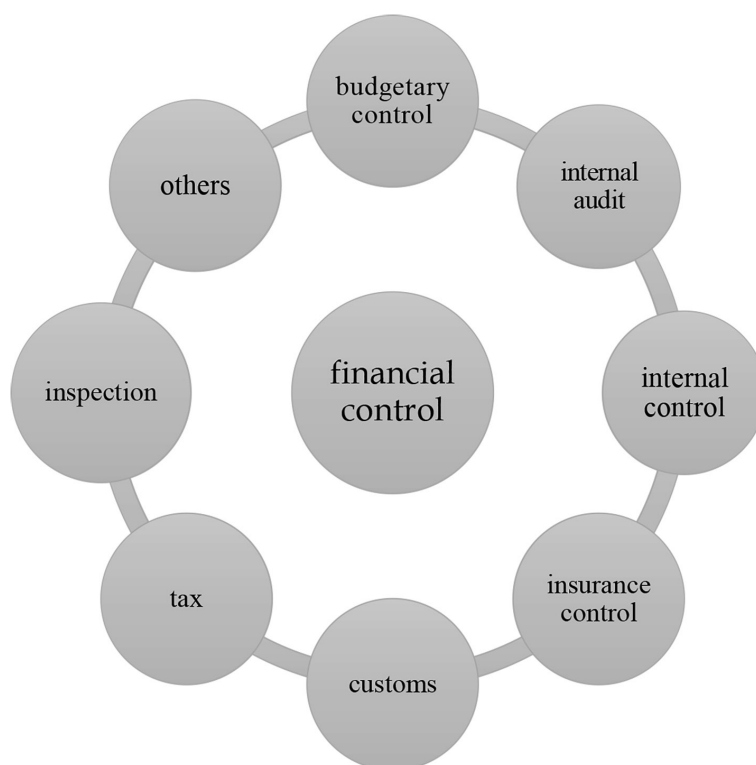
⁷ Prom. SG. 33/21 April 2006, last amend. and suppl. SG. 11/ 6 Feb 2024.

⁸ Prom. SG. 15/ 15 Feb 2013, last amen. and suppl. SG. 98/17 Nov 2020.

⁹ See also: **Стоянов, И.** Видове контрол за законност в сферата на публичните финанси. София, Фенея, 2004; **Кучев, Ю.** Държавен финансов контрол. Организация, обект, субекти и реализация на имуществената отчетническа отговорност. София, ЛиСтра, 2010; **Димитров, В.** Публични финанси, финансова система, финансово право. // Икономически и социални алтернативи, 2016, № 3; **Димитров, В.** Финансовият контрол като институт на българското право. // Правна мисъл, 2013, № 1; **Димитров, В.** Финансово право. София, Нова звезда, 2019.

The types of **financial control** specified in this definition are non-exhaustive: inspection;¹⁰ tax and insurance;¹¹ customs;¹² insurance control;¹³ internal control and internal audit;¹⁴ budgetary control;¹⁵ bank supervision;¹⁶ and financial supervision.¹⁷ They differ in scope, objectives and addressees.

Diagram 1 Types of financial control



¹⁰ See PFIA.

¹¹ See Tax and Social Security Procedure Code.

¹² See the Customs Act.

¹³ See the Social Security Code.

¹⁴ See FMCPSA and PSIAA.

¹⁵ See the Public Finance Act.

¹⁶ See the BNB Act and the Credit Institutions Act.

¹⁷ See the Financial Supervision Commission Act.

According to Article 91(1) of the Constitution of the Republic of Bulgaria, the National Audit Office exercises control over the execution of the budget. Hence, in current legislation, legal definitions of the concepts related to the concept of ‘**audit**’ are provided in NAOA.¹⁸

Generally, the definition of financial control in NAOA does not claim to be universal.¹⁹ **Control in the public sector is carried out on two levels. The internal organisation of control (internal control, including internal audit)** is the duty and responsibility of the heads of the individual public sector organisations.

At the next level, the activities of organisations in the public sector are subject to **external control**, organised and conducted by the specialised bodies of the state (audits by the Audit Office, state financial inspection, etc.).

Additionally, there are state bodies that are charged with the authority to exercise financial control over organisations outside the public sector (tax and insurance, customs, banking supervision, financial supervision, etc.).

The elements of control are differentiated into **two phases – the establishing phase and the impact phase**.

The **scope of control** includes all public funds, not only those under the Consolidated Fiscal Program²⁰ – the so-called budget funds.²¹ The state budget is the centre or integrative core around which the public finance system functions. It covers²² the budgets of the three authorities (executive, legislative and judicial), including the central budget, the independent budget of the National Assembly; the independent budget of the judiciary; the budgets of the executive authorities (Council of Ministers, ministries, state agencies and state commissions); and the budgets of other state bodies that do not belong to the three powers

¹⁸ See § 1, items 1, 2, 3, 4, 5, 6 and of the Supplementary Provisions of NAOA, including the Internal Audit Manual: <https://fukvopublic.minfin.bg/Public/DocumentList?sectionId=3&folderId=8&doctype=> [Accessed on 15 January 2024].

¹⁹ To the extent that financial control is mentioned in NAOA only among the areas of competence that the persons occupying managerial positions in the audit institution must possess.

²⁰ According to Article 4 of the Public Finance Act (PFA).

²¹ See § 1, item 6 of the Supplementary Provisions of PFA.

²² Article 42(1) PFA.

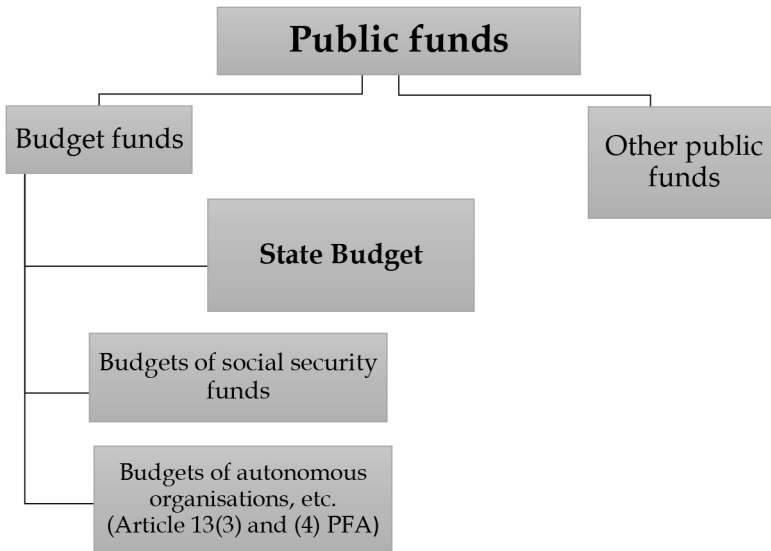
(President, Constitutional Court, Audit Office and Ombudsman), as well as other budgetary organisations.^{23,24}

The remaining budgets, although they are outside the state budget, are largely financed by the latter. These budgets are the independent budgets of the municipalities, the budgets of the social security funds, and the budgets of the following budget organisations: the Bulgarian Academy of Sciences, state universities, the Bulgarian Telegraph Agency, the Bulgarian National Television and the Bulgarian National Radio (autonomous budgets). The budget parameters of the other economic entities and structural units are included in the consolidated fiscal program.²⁵ Public funds, in addition to the specified budget funds, include the funds of other organisations from the public sector, not covered by the specified categories, such as public enterprises (state-owned enterprises and commercial companies with more than 50 percent state and/or municipal participation in the capital). In principle, dividends distributed to the state from public enterprises and from commercial companies with a minority state participation, go to a separate revenue account of the central budget.

²³ In the general case, these are state institutions, whose heads, by law, have the capacity of primary budget authorisers. Examples in this regard are the National Security Service, the National Bureau of Special Intelligence Control and State Fund Agriculture.

²⁴ When performing analysis of the structure and annual acts for the state budget, a practice of deviation from the specified norm of the PFA is observed, insofar as some budgets are adopted for the relevant bodies (e.g. the Council of Ministers and the individual state commissions), and others are adopted for the administration of the respective body – for example, the budget of a ministry, of the President’s administration, etc. Additionally, not all bodies of the executive power referred to in Article 19 of the Administration Act have budgets. Examples in this regard include deputy prime ministers (in case they are not ministers), regional governors, and executive directors of executive agencies.

²⁵ Article 42(2) PFA.

Diagram 2 Public funds²⁶

Financial control is also closely related to EU public finances and EU funds²⁷ – **the revenues and expenses of the budget of the European Union (EU) and the control over this activity** (Articles 310–325 TFEU).

In this regard, a much more accurate and complete legal definition of the concept of **control** is provided in **European financial legislation**.²⁸ *‘Control’ means any measure taken to provide reasonable assurance*

²⁶ Source: National Audit Office.

²⁷ According to § 1, item 36 of the Supplementary Provisions of PFA: “**Funds from the European Union**’ are grants and donations, as well as funds that are an element of financing, provided by funds and institutions of the European Union. Funds provided by the European Investment Bank, the European Investment Fund and other financial institutions are not considered to be funds from the European Union.” Supplementary Provisions of PFIA § 1, item 8: The definition of the term **‘financed with funds from the state or municipal budgets under international agreements or under European Union programmes, as well as the entities funded by state-owned enterprises under Article 62(3) of the Commerce’** are the natural persons and legal entities that receive grants for a general or targeted purpose from the state budget or from the municipal budgets under international agreements or under European Union programmes, as well as the entities funded by state enterprises under Article 62(3) of the Commerce Act.

²⁸ Article 2(19) of the Financial Regulation.

regarding the effectiveness, efficiency and economy of operations, the reliability of reporting, the safeguarding of assets and information, the prevention and detection and correction of fraud and irregularities and their follow-up, and the adequate management of the risks relating to the legality and regularity of the underlying transactions, taking into account the multiannual character of programmes as well as the nature of the payments concerned. Controls may involve various checks, as well as the implementation of any policies and procedures to achieve the objectives referred to in the first sentence.'

III. TYPES OF CONTROL

1. Internal control in the public sector

The FMCPSA introduces a definition for financial management and control in the public sector, which corresponds to the definition of internal control from COSO's Internal Control – Integrated Framework and is also used in the *Guidelines for Internal Control Standards for the Public Sector* of the International Organisation of Supreme Audit Institutions (INTOSAI).²⁹ That is why the concepts of 'financial management and control' and 'internal control system' from FMCPSA are identical to the concept of 'internal control'. Moreover, the requirements of the Act do not refer only to the financial aspect of an organisation's activities (the undertaking of obligations and incurring of expenses), but to all activities of the organisation and the decisions of its management.³⁰ The definition runs as follows:

'Financial management and control (FMC) is a comprehensive process integrated into the activities of organisations, carried out by management and their employees. Financial management and control is carried out through FMC systems, including policies, procedures and activities implemented by the management of the organisations in order

²⁹ Guidelines for Internal Control Standards for the Public Sector, XVIII INCOSAI in Budapest 2004.

³⁰ Methodological guidelines on the elements of financial management and control, 2020, page 9.

to provide reasonable assurance that the objectives of the organisations are achieved through: compliance with legislation, internal acts and contracts; reliability and comprehensiveness of financial and operational information; economy, efficiency and effectiveness of activities; protection of assets and information; preventing and detecting fraud and irregularities, and taking follow-up action.'

The FMCPSA, drafted within the framework of the negotiation process under Chapter 28 Financial Control for the accession of the Republic of Bulgaria to European Union and adopted in 2006, introduces requirements for the implementation of financial management and control in compliance with the principles of legality, sound financial management and transparency, through the interrelated elements based on COSO's Internal Control – Integrated Framework.³¹

The FMCPSA defines the scope, outlines some issues (definition, objectives and elements of internal control) and the responsibilities of managers. The methodological guidelines and instructions of the Minister of Finance, issued under the Act and published on the Information System on Financial Management and Control and Internal Audit in the Public Sector,³² are mandatory for public sector organisations.³³ New methodological guidelines were adopted in 2019 and 2020, which are based on the COSO's Internal Control – Integrated Framework (COSO 2013) and are aligned with the Three Lines of Defence Concept introduced in 2013 through a statement of the International Institute of Internal Auditors. These guidelines include: Methodological guidelines on the elements of financial management and control, Guidelines for risk management in public sector organisations, etc. They are more practically oriented than previous versions and emphasise issues of internal control in the public sector.

The COSO framework³⁴ is one of the most common internal control

³¹ Methodological guidelines on the elements of financial management and control, 2020, page 3.

³² <https://fukvopublic.minfin.bg/Home/> [Accessed on 15 January 2024].

³³ Article 10(3) and Article 17 of FMCPSA.

³⁴ The Committee of Sponsoring Organisations of the Treadway Commission (COSO) is a joint initiative of five authoritative non-governmental professional organisations: the American Accounting Association, the American Institute of CPAs, Financial

frameworks adopted by many countries and organisations (e.g., the EU), including in Bulgarian legislation through the FMCPSA. In 2013, COSO updated the Integrated Internal Control Framework to meet several new challenges and needs.³⁵

FMCPSA (in Article 2(2)) defines **the organisations in the public sector**.

The heads of public sector organisations are responsible for implementing financial management and control in all structures, programmes, activities and processes they manage, in compliance with the principles of legality, sound financial management and transparency. Managers at each level in the organisations are responsible and accountable to the senior manager for their activities in terms of financial management and control in the structures and units they manage.³⁶ These requirements are reproduced in the definition of the concept of ‘managerial accountability’ provided in the Supplementary Provisions of the FMCPSA (§ 1, item 2). The guidelines for the implementation of managerial accountability, approved by Order No. 3MΦ 601 of 09.07.2019 of the Minister of Finance based on Article 7(2) of the FMCPSA should be applied compulsorily by the heads of organisations in the public sector within the meaning of the Act. Legal managerial accountability can be: civil, administrative, disciplinary and criminal, and these manifestations should be thoroughly and specifically analysed.³⁷ The heads of public sector organisations implement financial management and control in accordance with the specifics of the organisation³⁸ through the following interconnected elements:³⁹

Executives International, the Institute of Internal Auditors and the Institute of Management Accountants.

³⁵ Methodological guidelines on the elements of financial management and control. 2020, page 4.

³⁶ Article 3 of FMCPSA.

³⁷ See Instructions for the implementation of managerial accountability, approved by Order No. 3MΦ 601 of 09.07.2019 of the Minister of Finance on the basis of Article 7(2) of FMCPSA.

³⁸ Regarding the management and control systems of the authorities in the EU funds system, there are additional requirements that are established in current regulations (see Chapters 23, 27).

³⁹ Article 10(1) FMCPSA.

Diagram 3 Elements of FMC systems

2. Internal audit in the public sector

The Public Sector Internal Audit Act (PSIAA), adopted in 2006, introduced the modern decentralised model of internal audit in the Bulgarian public sector, based on the model of the International Standards for the Professional Practice of Internal Auditing, issued by the Institute of Internal Auditors. The Integrated Internal Control Framework COSO 2013, respectively FMCPSA, which introduces the framework in Bulgaria, defines internal audit as part of the Observation/Monitoring element. This means that internal audit is both a part of internal control systems and a means of evaluating their effectiveness.

Internal auditing is an independent and objective assurance and consulting activity that aims to improve and add value to an organisation's operations. Internal auditing helps an organisation achieve its objectives

*by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.*⁴⁰

Internal audit is carried out in accordance with the International Standards for the Professional Practice of Internal Auditing,⁴¹ the Code of Ethics for internal auditors and in compliance with the following principles: independence and objectivity; competence and professional care; integrity and confidentiality.

Internal audits support the organisation in achieving its goals.

An assurance engagement in auditing is the impartial evaluation of evidence by the internal auditor in order to provide an independent opinion or conclusions regarding a process or system, or another audit object. The purpose and scope of each assurance engagement is determined by the head of internal audit. The assurance engagement is performed primarily through: systems audit, compliance audit, performance audit, financial audit, information systems and technology audit and status review.

A consulting engagement in auditing is the provision of advice, opinion, training, and the like, designed to improve risk management and control processes without the internal auditor assuming managerial accountability for doing so. The consulting engagement is carried out at the initiative of the head of the organisation. The purpose and scope of each consulting engagement is determined jointly with the head of the organisation.

Internal audit in the public sector is carried out by an internal audit unit built into the structure of the organisation, which is directly subordinate to the head of the organisation or the collective management body. The unit consists of internal auditors who are employees of the organisation, one of whom is the manager. An internal audit unit must be established in: the administration of the President, the National Assembly, the Council

⁴⁰ See the Internal Audit Manual (in Bulgarian) at: https://fukvopublic.minfin.bg/Public/DocumentList?sectionId=3&folderId=8&doctype=__ [Accessed on 15 January 2024].

⁴¹ The international standards for professional practice in internal auditing are issued by the Institute of Internal Auditors, Florida, USA, and their translation into Bulgarian was published by the Institute of Internal Auditors in Bulgaria.

of Ministers, the ministries, the National Insurance Institute, the National Health Insurance Fund and State Fund Agriculture; the Supreme Judicial Council and the Audit Office; the municipalities whose budget exceeds BGN 10 million; other organisations whose heads are primary budget authorisers and whose budget exceeds BGN 10 million; the organisations listed in the annex to the PSIAA, whose heads are secondary budget authorisers; public enterprises with a turnover (i.e., the total amount of income, including financing, according to their annual financial statement) over BGN 10 million for each of the last three years.

The internal audit unit carries out internal audits of: all structures, programmes, activities and processes in the organisation, including those financed with funds from the European Union; the organisations whose managers are lower-tier budget authorisers, in which there is no internal audit unit; public enterprises in which there is no internal audit unit.

At the initiative of the primary budget authoriser, respectively the body that exercises ownership rights in the capital, the internal audit unit can perform audit engagements for all organisations and legal entities in its system, including when these have an internal audit unit.

The head of the organisation ensures the independence of internal auditors in planning, performing and reporting the results of the internal audit and cannot assign the head of the internal audit and the internal auditors the performance of other functions and activities other than the internal audit activity.

The head of the organisation and other officials within the organisation must provide assistance to the internal auditors in the performance of their activities and must not invoke their own or any other person's trade or business secrets or refuse access to any assets of the organisation.

The appointment and dismissal of the head of the internal audit and the internal auditors in the organisations, excluding those in municipalities and public enterprises, are subject to the written consent of the Minister of Finance.

The head of internal audit and the internal auditors have rights established by law.

The head of internal audit and the internal auditors must comply with the International Standards of Professional Practice in Internal Audit, the Code of Ethics of internal auditors, the Charter of the internal audit unit⁴² and the methodology approved by the Minister of Finance for internal audit in the public sector.

The head of internal audit is responsible for the overall activity of the internal audit unit.

The head of internal audit develops and implements a quality assurance and audit improvement programme that includes internal and external assessments. Internal assessments include ongoing monitoring, periodic self-assessments, and periodic assessments by others in the organisation who are familiar with the practice of internal auditing. External evaluations are carried out⁴³ at least once every 5 years by persons outside the organisation who hold an ‘internal auditor in the public sector’ certificate or a valid internationally recognised internal auditor certificate.

When identifying indicators of fraud, internal auditors report immediately to the head of internal audit, who immediately notifies the head of the organisation and makes a proposal for measures and notification of the competent authorities.

The internal auditor may not undertake an assurance engagement related to activities he/she has consulted or structures in which he/she has worked within the last year. The presence of these circumstances must be declared by the internal auditor in writing to the head of the internal audit.

The head of internal audit and the internal auditors should not perform functions and activities in the organisation other than the internal audit activity.

⁴² The charter is an official document that is signed between the head of the organisation and the head of internal audit, and then approved by the Audit Committee, if one is in place. The charter describes the objectives, powers, and responsibilities of the internal audit, as well as the responsibilities of the organisation’s management regarding the internal audit activity, and the relationships between them. The charter is the primary tool for documenting the common understanding of the organisation’s management and the internal audit activity regarding its nature, objectives, powers, and responsibilities.

⁴³ See Наредба № 1 от 30 март 2017 г. за условията, реда и начина за извършване на външни оценки за осигуряване качеството на одитната дейност.

3. External audit in the public sector. Statute and powers of the Audit Office of the Republic of Bulgaria

The supreme audit institution of the Republic of Bulgaria is the Audit Office (AO).⁴⁴ The Audit Office is a constitutionally established collective state body elected by the National Assembly. Article 91 of the Constitution defines its function, which comprises control over budget implementation. According to Article 91(2) the organisation, powers and activities of the AO are regulated by law. According to Article 1(2) NAOA, the AO exercises control over the implementation of the budget and other public funds and activities in accordance with the Act and internationally recognised audit standards. Control is carried out through the audits of the AO (See § 1 of the SP of NAOA, items 1–7).

Diagram 4 Types of Audit



⁴⁴ <https://www.bulnao.government.bg/bg/> [Accessed on 15 January 2024].

The NAOA states (Article 5(2)) that the AO can carry out documentary and factual checks and other control actions in relation to legal entities assigned to it by special laws, but only within the scope of its audit activity and in accordance with NAOA.⁴⁵ In Bulgaria the AO is a professional body. The European Court of Auditors also operates on a professional basis.⁴⁶

The NAOA⁴⁷ highlights **the principles of economy, effectiveness and efficiency** in the implementation of audit activities (§ 1, item 2 NAOA).

Control by the Audit Office covers all budgets (state budget,⁴⁸ municipal budgets, autonomous budgets,⁴⁹ the budgets of social security funds⁵⁰ and the budget parameters of other persons and structural units whose indicators are included in the consolidated fiscal program).⁵¹ The Audit Office also audits the management of the budget expenses of the Bulgarian National Bank and its relations with the state budget, public debt, provision of public funds and assets outside the public sector (including privatisation and concession contracts), state-owned enterprises,⁵² commercial companies with 50 and over 50 percent state and/or municipal participation in the capital⁵³ and the reports of participants in elections.⁵⁴

Secondly, the purpose of the specific control activity of the Audit Office is primarily to improve the activity of audited organisations,

⁴⁵ See at: <https://www.intosai.org/about-us/overview> [Accessed on 15 January 2024].

⁴⁶ See at: <https://www.eca.europa.eu/bg> [Accessed on 15 January 2024].

⁴⁷ Promulgated, SG No. 12 of 13.02.2015, final amend., SG No. 7 of 19.01.2018.

⁴⁸ Including the central budget, the independent budgets of the National Assembly and the judiciary, the budgets of the bodies of the executive power, other state bodies and budgetary organisations.

⁴⁹ The budgets of the Bulgarian Academy of Sciences, the state universities, the Bulgarian Telegraph Agency, the Bulgarian National Television, and the Bulgarian National Radio, which are adopted by their governing bodies according to the laws governing their status, while ensuring compliance with their budgetary relationships with the state budget.

⁵⁰ State Social Security and the National Health Insurance Fund.

⁵¹ Article 6(1) of the National Audit Office Act in conjunction with Article 4, Article 13, and Article 42 of the Public Finance Act.

⁵² Article 62(3) of the Commerce Act.

⁵³ See the Public Enterprises Act and the regulations for its implementation.

⁵⁴ Article 159 of the Electoral Code.

including the quality of their reporting information, to ensure adherence to the requirements of the applicable legal framework and to improve management.⁵⁵

The auditing impact of the Audit Office is mainly related to the provision of reliable information on the management of public funds, activities and recommendations to interested parties, including citizens⁵⁶ and state bodies, with the National Assembly⁵⁷ being a priority. For this reason, the statements of findings issued by its bodies cannot be regarded as individual administrative acts, because the Office is an independent state body, outside executive power. The audit impact is not aimed at exercising administrative coercion, i.e., to directly seek and impose legal liability⁵⁸ or to apply coercive administrative measures on behalf of the supreme audit institution. It is recommended that only the Public Financial Inspection Agency (PFIAG) be equipped with sanctioning powers. Functions are duplicated, especially in the field of public procurement.

In the event of non-implementation of recommendations, the Audit Office sends the audit report with proposals for action to the National Assembly, the Council of Ministers or the municipal council, respectively.⁵⁹ In addition, following adoption of the final audit report, the Audit Office may⁶⁰ propose to the Minister of Finance to take measures against an audited organisation that violates the law or systematically fails to implement the recommendations given, until such violations are eliminated.⁶¹ The European Court of Auditors also does not have the authority to impose

⁵⁵ See § 1 NAOA.

⁵⁶ The audit report of the Audit Office is public and is published on its webpage (Article 59 NAOA).

⁵⁷ See Article 2 NAOA.

⁵⁸ See exceptions in Article 260 of the Public Procurement Act, Article 44 of the Political Parties Act and Article 497 of the Electoral Code.

⁵⁹ Article 50(3) NAOA.

⁶⁰ Article 53(1) NAOA.

⁶¹ The Minister of Finance can restrict or suspend transfers/limit payments to budget organisations where there has been a violation of budget discipline. The application of para. (1) cannot result in the suspension of the activities of the affected budgetary organisations or to the non-fulfilment of obligations arising from a statutory act or from an international treaty; the budgets of the National Assembly and the judiciary are not affected. (Article 107 of the Public Finances Act).

sanctions, but refers detected irregularities to the responsible institutions for action.⁶²

The Audit Office is a collective body consisting of a chairman, two vice-chairmen (proposed by the chairman) and two members (one each on the proposal of the Institute of Certified Public Accountants and the Institute of Internal Auditors) who are elected by the National Assembly with a mandate of 7 years, following a public procedure. The governing bodies of the Audit Office are the chairman and the vice-chairmen.

The Audit Office makes public those final audit reports, which do not constitute a secret protected by law, including on audits of EU funds, as well as statements of opinion, on the website of the Audit Office.⁶³

The Audit Office announces, through its website, the non-fulfilment of obligations under Article 40, the failure to implement recommendations under Article 52, as well as other circumstances determined by a decision of the Audit Office.

External Audit on the implementation of the EU budget is carried out by the European Court of Auditors (ECA) as a collective body that assists the European Parliament and the Council in exercising their control function in relation to the implementation of the budget. The ECA is an EU institution that does not have the power to issue binding acts that can be challenged by the courts. The institutional arrangement of the auditor of the Union is laid down in the TFEU.⁶⁴

4. Subsequent control for legality. Statute and powers of the Public Financial Inspection Agency

PSIAA and FMCPSA regulate the processes, activities and managerial accountability **within the organisation**; PFIA regulates the implementation of **a specialised financial inspection function external to the organisation, with sanctioning powers arising from the provisions**

⁶² See TFEU, Article 289(2).

⁶³ See at: <https://www.bulnao.government.bg/en/audit-activity/reports/> [Accessed on 15 January 2024].

⁶⁴ Part Six Institutional and Financial Provisions, Title I Institutional Provisions, Chapter 1 Institutions, Section 7.

of Article 106 of the Constitution of the Republic of Bulgaria (CRB). Under current legislation, the Public Financial Inspection Agency (PFIaG) is an administration under the Minister of Finance.

With the adoption of the Public Financial Inspection Act, **the best European practices in the field of budgetary discipline and the protection of public financial interests and public finances were adopted, in accordance with European principles for financial control, but the Act needs to be improved in view of new public relations and changes in current European and national legislation. This book also aims to present new good practices that have been adopted in practice in the field of financial control, but are not regulated in detail in the PFIA.** A set of regulations for the implementation of PFIA have also been adopted.⁶⁵

The external financial control carried out by PFIaG is specialised control. This is a special form of control designed to monitor and verify the applicability of financial and other legal provisions governing the handling of public funds.

The current legal **framework** does not define **state financial inspection** as a special type of administrative control, including control within deficiency proceedings. Current legislation does not regulate state financial inspection in a special law to which the provisions of the Administrative Procedure Code (APC),⁶⁶ respectively the Tax and Social Security Procedure Code (TSSPC)⁶⁷ apply for unresolved issues, as the statements of findings issued by the administrative bodies are not subject to review for legality by administrative courts on the basis of Article 120 of the Constitution of the Republic of Bulgaria.⁶⁸ In its current edition,

⁶⁵ Adopted by Decree No. 197 of the Council of Ministers of 01.08.2006. Promulgated in SG No. 65 of 11 August 2006, latest amendment in SG No. 63 of 1 August, 2014.

⁶⁶ Promulgated SG No. 30 of April 11, 2006, latest amendment SG No. 102 of 23 December, 2022.

⁶⁷ Promulgated SG No. 105 of December 29, 2005, latest amendment SG No. 8 of 25 January 2023.

⁶⁸ Article 120. (1) The courts shall supervise the legality of the acts and actions of the administrative bodies.

(2) Citizens and legal entities shall be free to challenge any administrative act which affects them, except those listed expressly by the laws.

the PFIA **is not** a special law with regards to APC in terms of inspection proceedings and the statements of findings issued at the end of the financial inspection.

Control is subsequent and its subject is related to the legality of the activities of organisations and persons under Article 4 PFIA and to the identification of possible offences from which different types of legal liability may arise. **State financial inspection is a type of financial control. The financial inspection thus differs from the audit** carried out by the independent supreme audit institution of the Republic of Bulgaria.

The main purpose of state financial inspection is to protect public financial interests (Article 2(1)), including the public financial interests of the European Union through subsequent control for legality.

The law establishes a legal toolkit for impact measures against the controlled activity and against the inspected organisations and persons.

The main objective of state financial inspection is achieved through the performance of the following main tasks (Article 2(1) PFIA): carrying out subsequent financial inspections for compliance with the statutory acts that regulate budgetary, financial-economic or reporting activities, as well as the activity on the award and execution of public contracts to the organisations and persons under Article 4 PFIA; establishing violations of the regulatory acts governing the budgetary, financial-economic or reporting activities, as well as indicators of committed fraud; disclosure of damages caused to the property of the organisations and persons under Article 4 PFIA; bringing the perpetrators to administrative penal and financial liability if there are relevant legal grounds; detection of fraud and violations affecting the financial interests of the European Communities. State financial inspection is guided by **the principles of legality, objectivity, official status and confidentiality** (Article 3 PFIA).

The rest of the established principles underlying the management of European and national public funds should also be considered, because the main purpose of the state financial inspection is to protect public financial interests (Article 2(1) PFIA).

Addressees of financial inspection control are the following entities and organisations:

- ✓ according to Article 4 PFIA:
- budgetary organisations;⁶⁹
- state-owned enterprises under Article 62(3) of the Commerce Act (see also Chapter 8), as well as municipal enterprises;⁷⁰
- commercial companies with a blocking quota of state or municipal participation in the capital;
- commercial companies in whose capital a person under item 2 or 3 participates with a blocking quota;
- legal entities that have obligations guaranteed by state or municipal property;
- legal entities under the Non-profit Legal Entities Act and unincorporated companies under the Obligations and Contracts Act, in the capital of which the state or a municipality participates directly or indirectly;
- aid administrators, recipients of state or minimum aid, persons financed through funds from the state or municipal budgets, under international treaties or programmes of the European Union, as well as persons financed with funds from state-owned enterprises under Article 62(3) of the Commerce Act – regarding the expenditure of these funds.

⁶⁹ § 1 SP, item 5 PFA: ‘Budget organisations’ are all legal entities whose budgets are incorporated in the state budget, the budgets of municipalities, the budgets of social security funds, as well as any other legal entities whose funds, revenues and payments are included in the consolidated fiscal program by virtue of a legislative instrument or pursuant to Article 171.

⁷⁰ Public (State-Owned) enterprises are regulated by the Public Enterprises Act (PEA) (prom. SG No. 79 of 8 October 2019, final amendment SG No. 11 of 9 February 2021), as well as the Regulations on the Implementation of the Public Enterprises Act (prom. SG No. 40 of 5 May 2020, amended. SG No. 89 of 26 October 2021, amended. and supplemented SG No. 11 of 2 February 2023), including Decision No. 1045 of the Council of Ministers of 21 December 2022 for the Adoption of a Programme for the Transformation of State-Owned Enterprises established through Special Laws pursuant to Article 62(3) of the Commerce Act.

- ✓ According to Article 238(4) of the Public Procurement Act⁷¹ – contractors who do not fall under the scope PFIA, based on an approved annual plan.
- ✓ According to the Energy Act – the energy enterprises carrying out activities at regulated prices, including at preferential prices, of electricity. The control covers their financial-economic and reporting activities at regulated, including preferential prices.⁷²

General regulatory acts also apply, such as PEA and the regulations for its implementation, the Commerce Act (CA), the Public Finance Act (PFA), the Accountancy Act (AA), the Administration Act (AdA), the Financial Management and Control in the Public Sector Act (FMCPSA), Public Procurement Act (PPA), etc., as well as special laws with regard to CA and PEA: the Gambling Act (GA), the Execution of Sentences and Detention in Custody Act (ESDCA), the Employment Promotion Act (EmPA), the Environmental Protection Act (EPA), the Safe Use of Nuclear Energy Act (SUNEA), the Water Act (WA), the Maritime Space, Inland Waterways and Ports of the Republic of Bulgaria Act (MSIWPRBA), the Railway Transport Act (RTA), the Civil Aviation Act (CAA), the Forestry Act (FA), the Animal Husbandry Act (AHA), various of by-laws – rules and regulations on the implementation of the Acts, including zoning regulations.

Financial inspections are carried out on a planned basis or upon signals or requests. According to PFIA, financial inspections are carried out (Article 5 PFIA):

1. upon received applications, complaints and reports of violations of the budget, financial, economic or accounting activities of

⁷¹ In force as of 15.04.2016, prom. SG No. 13 of 16 February, 2016, amended and supplemented SG No. 102 of 31 December 2019.

⁷² Item 24 of the Supplementary Provisions of the Energy Act: An **‘Energy Enterprise’** is an entity which carries out one or more of the activities of production, transformation, transmission, storage, distribution, delivery and supply of electricity, thermal energy or natural gas, on the basis of a licence issued under this Act, or a person who extracts energy resources on the basis of an extraction concession, or a person who carries out the activity of production of electricity and/or thermal energy and/or carries out storage of electric energy, and/or trades in natural gas, without being obliged to obtain a license for the activities carried out under this Act, or a person who carries out activity in the transportation of oil and oil products through pipelines.

- the organisations and entities under Article 4 PFIA filed by state bodies, individuals and legal entities;⁷³
2. upon request by the Public Procurement Agency or the Audit Office in the cases stipulated by law;⁷⁴
 3. for verification of the lawful provision and absorption of state or minimum aid and the expenditure of targeted subsidies provided under the State Budget of the Republic of Bulgaria Act for the respective year and Decrees issued by the Council of Ministers;
 4. upon request by the Council of Ministers or the Minister of Finance;
 5. upon assignment by the Prosecutor's Office pursuant to Article 145(1)3 of the Judiciary System Act;⁷⁵
 6. upon alerts for irregularities affecting the financial interests of the European Communities established by the Protection of the European Union's Financial Interests (AFCOS) Directorate of the Ministry of Interior;⁷⁶

⁷³ The requests, complaints and reports under Article 5(1)1 PFIA can be submitted by mail, fax or electronic means and must contain: the name and registered office of the organisation or the person under Article 4 of the Act where the violations were committed; sufficiently specific data on the violations committed to the budget, financial, economic or accounting activity, as well as the activity of awarding and execution of public contracts of the organisations and persons under Article 4 PFIA; individualising data of the sender – name, contact address and signature, as well as in what capacity the alleged violations became known to him. Requests, complaints, and reports that do not contain the specified details will not be considered. Requests, complaints, and reports containing allegations of violations, for which the legal time limits for administrative penal and/or financial liability have expired, will also not be considered. (Article 4 of the Regulations on the Implementation of PFIA).

⁷⁴ According to Article 6 of the Regulations on the Implementation of PFIA (RIPFIA) when assigning a financial inspection under Article 5(1)2 PFIA, the request must identify the subject scope of the financial inspection, specifying precisely the issues that should be inspected.

⁷⁵ According to Article 8 RIPFIA, when a financial inspection is assigned by the prosecution authorities under Article 145(1), item 3 of the Judicial System Act, the awarding decree specifies the subject scope of the financial inspection, indicating precisely the issues that should be inspected.

⁷⁶ According to Article 8a RIPFIA when a financial inspection is assigned under Ar-

7. in compliance with the instructions and deadlines under Article 18(1)(1) and paragraph (2) PFIA.

In addition to the cases above, according to PFIA, financial inspections of the activity of awarding and execution of public procurements are carried out **regularly** on the basis of an approved annual plan, the implementation of which is mandatory. The regularity of financial inspections in this case and the specific public procurement contractors subject to control in the relevant year are determined on the basis of an analysis of information on the activity of awarding and executing public procurement contracts, assessment of risk factors and according to the administrative capacity of the Agency. The procedure for drawing up the plan and the criteria for assessing risk factors are set out in the Regulations on the implementation of the Act (Article 5(2) and (3) PFIA).

PFIAG bodies carry out their activities, including in the field of public procurement, based on PFIA (during financial inspections), PPA (in the inspection under Article 238(4) PPA) and EA (Article 80a EA). Checks on the lawful provision and absorption of state and minimum aid and on the spending of targeted subsidies, including checks on compliance with the instructions and deadlines under Article 18(1)1 and (2) PFIA are carried out under written instructions from the director of PFIAG.

Under the current legislation, PFIAG exercises its powers in the field of public procurement control in the form of: financial inspection; inspection under Article 238(4) PPA and inspection. The financial inspection is a form of exercise of subsequent external control over the awarders of public contracts falling within the scope of Article 4 PFIA. The financial inspection is carried out in accordance with the procedures provided for in PFIA and RIPFIA. All public procurement contractors who do not fall within the scope of Article 4 PFIA are inspected by PFIAG through the inspection under Article 238(4) PPA. As a form of control, the inspection is fully regulated in Article 239241 PPA and refers not only to the awarding of public contracts, but also

ticle 5(1), item 6 of the Act, the report of the Protection of the European Union's Financial Interests (AFCOS) Directorate of the Ministry of Internal Affairs must specify the subject scope of the financial inspection, indicating precisely the issues that should be checked.

includes control over the execution of public procurement contracts and framework agreements.

State financial inspection is carried out by the bodies of PFIaG's specialised administration. PFIaG is an administration under the Minister of Finance and is a legal entity supported by the budget. The structure, composition and organisation of the agency's work are determined on the basis of organisational regulations adopted by the Council of Ministers (Article 6 PFIA). Bodies of the agency are the director and the financial inspectors (Article 7 PFIA).

The functions of PFIaG are established in Article 8 PFIA.

The requirements for the director of PFIaG are specified in Article 9 PFIA, and the relevant powers are described in Article 10 PFIA, in conjunction with Article 9 RIPFIA. The director is a secondary budget authoriser under the budget of the Ministry of Finance. Depending on the results of the performed inspection activity, **the director** of PFIaG or officials authorised by him/her undertake(s) **measures to influence the controlled activity and persons (Article 18 PFIA), including issuing penal orders** to implement administrative penal liability for administrative violations provided for in the laws (Article 35 PFIA, Article 101(2)1 of the Persons with Disabilities Act, Article 58(6) of the Municipal Debt Act, Article 79(2) of the State Aid Act).

Financial inspectors have powers established in Article 13 and 14 PFIA in view of the control activities carried out by them. In case of non-fulfilment of their duties, the financial inspectors may also bear administrative penal liability pursuant to Article 34 PFIA: *'Anyone, being a body or officer of the Agency, who violates or fails to fulfil duties under this Act or exceeds their rights, provided that the act does not constitute a crime, shall be penalised with a fine from BGN 200 to BGN 1,000.'* Violations under Article 34 are established by statements of violations issued by the financial inspectors, and penal orders are issued by the Director of the Agency or officials authorised by him/her (Article 35(2) PFIA).

When an organisation is inspected, its employees are obliged to assist the inspectors in their tasks (as per Article 15 PFIA). Any person from the inspected organisations or entities under Article 4 PFIA is obliged to:

- cooperate with and not hinder the financial inspectors in the performance of their duties;
- ensure unrestricted access of the financial inspectors to the relevant business premises and to all documentation;
- provide documents, certified copies of documents, information, references, declarations on bank accounts and written explanations, as well as the reports under Article 13, item 7 PFIA within the time limits set by the financial inspectors;
- submit accurate data, statements, declarations, documents and certified copies of documents within the time limits set by the financial inspectors;
- submit documents in foreign languages along with a certified translation into Bulgarian within the time limits set by the financial inspectors.

Inspected entities are not entitled to refuse access to information by referring before the financial inspectors to their own or another's trade or bank secret, as well as to information classified as a state or official secret, subject to compliance with the requirements of the Classified Information Protection Act. The persons under Article 13, item 8 PFIA are obliged to submit certified copies of documents, information and references to the agency's bodies within the specified time limits, as requested. PFIA stipulates as an administrative violation the failure to provide assistance or the obstruction of performance of the tasks of the financial inspector pursuant to Article 32(1), items 2–5 PFIA.

The **Public Financial Inspection Agency (PFIaG)** submits an annual report on the results of its activities to the Council of Ministers through the Minister of Finance by 31 May of the following year. The report must be sent for information purposes to the National Assembly (Article 8(1) PFIA).

The powers of PFIaG bodies are regulated in Article 10 PFIA.

The state financial inspection is a process based on two separate stages, which are interconnected and consistent, and regulated in current legislation (PFIA, RIPFIA, Civil Procedure Code, Administrative Procedure Code, Administrative Violations and Sanctions Act (AVSA),

etc.), i.e., at the various stages of the inspection process there are various legal relations within the framework of PFIaG and between PFIaG and third parties.⁷⁷

PFIa establishes the authority of PFIaG to carry out, through financial inspections, subsequent control of the implementation of budgetary discipline (observance of budget, financial, economic and reporting legislation). The investigative and sanctioning powers of PFIaG authorities are associated with the establishment of administrative violations, as well as indicators of fraud, disclosure of damage caused to the property of the organisations and entities under Article 4(1) of the Act, imposing administrative penal and financial liability on perpetrators in the presence of the relevant legal prerequisites.

The effective application of these powers is ensured by high requirements for the position of ‘financial inspector’ and for the director. Functions include the elaboration of financial inspection methodology, responsibility for maintaining and increasing the professional qualifications of employees and for the quality of inspection activities. The rights and obligations of financial inspectors are detailed in the Act.

Following the principle of managerial accountability, the law provides for the possibility for the director of PFIaG to delegate his/her functions to other officials with the express provision that this does not exempt the director from his or her responsibility for the overall activity of the agency.

Control activities include **two main stages**:

- ✓ **Determinative;**
- ✓ **Taking of impact measures.**

Within these two main stages, separate sub-stages can be differentiated.

The Energy Act (Article 80a) and the Public Procurement Act (Articles 238–241 and Article 261) are special laws in relation to PFIa. This is also the case with the Persons with Disabilities Act,⁷⁸ the Municipal

⁷⁷ With regard to the state financial inspection, see **Пенов, С.** Финансово право. Обща част. Учебен курс. София, УИ „Св. Климент Охридски“, 2021, 399–541.

⁷⁸ See Article 101.

Debt Act,⁷⁹ the Agricultural Land Protection Act,⁸⁰ the Cooperatives Act,⁸¹ the Concessions Act,⁸² the Accountancy Act,⁸³ the State Aid Act,⁸⁴ the Local Taxes and Fees Act,⁸⁵ the Health Insurance Act,⁸⁶ the Insurance Code.⁸⁷

The documents issued upon completion of control activities are:

✓ **Report**

The report contains the findings supported by evidence (mandatory). The relevant financial inspector prepares **a report** on the results of the financial inspection under the PFIA, which contains the findings supported by evidence. Following delivery of the report, the head of the inspected organisation or entity may give a written opinion within 14 days of delivery of the report. The financial inspector having carried out the financial inspection issues a motivated written conclusion within 14 days from receipt of the written opinion, which is then made available to the relevant individuals (Article 17(2)–(4) PFIA and Article 21 RIPFIA). The report, the reasoned written conclusion and the written opinions must be submitted within three working days to the body that issued the order for the inspection for follow-up measures. The conclusion is presented to the persons to whom the report or the findings on it were handed, within 14 days of its preparation, and becomes an integral part of the report (Article 21(5) RIPFIA). The report does not have material evidentiary value in relation to the facts contained in it. Based on the report, the director of PFIAG may take subsequent impact measures under Article 18(1) PFIA;

✓ **Statement of administrative violation (SAV)** (where administrative violations are found).

⁷⁹ See Article 58.

⁸⁰ See Article 15.

⁸¹ See Article 63.

⁸² See Article 202–203.

⁸³ See Article 78.

⁸⁴ See Article 79–80.

⁸⁵ See Article 130.

⁸⁶ See Article 70.

⁸⁷ See Article 466.

If administrative violations are found, **the financial inspectors** will draw up a SAV,⁸⁸ on the basis of which proceedings will be initiated for administrative penal liability through the issuance of penal orders pursuant to AVSA by the director of PFIaG or officials authorised by him/her (Article 35 AVSA). The main requirements for the regularity of a SAV is the participation of **the offender** in its compilation, the presence of all **elements** required by AVSA and compliance with the form required by law. The role and importance of SAV is that it outlines **the subject** of proof in the proceedings; **the evidence** on the basis of which the issuer has built the factual and legal conclusions; **the competence** of the issuer; **compliance** with the procedural rules when issuing it and the correct application of the substantive law; **the offender**. The functions of a SAV are: ascertaining; accusatory; referring; evidential (presumptive evidentiary force).

The director of PFIaG is an administrative sanctioning authority (ASA). The **acts subject to appeal in the judicial phase** are the penal order, the warning under Article 28 AVSA and the resolution to terminate administrative penal proceedings. The establishment of violations, the issuance, appeal and execution of penal orders are carried out according to the procedure set out in AVSA. Fines and pecuniary sanctions are collected in accordance with TSSPC, because they are public state receivables within the meaning of Article 162(2)7 TSSPC (state and municipal receivables under penal orders that have entered into force are public). Regarding administrative violations, the statutory act in force at the time of perpetration applies (Article 3(1) AVSA).

The Statement of Administrative Violation (SAV) should comply with the procedural rules for its issuance. SAV should be issued by a competent authority and it should be drawn up within the time limits laid down in the law (attention should be paid to the correlation between general and special law). SAV should contain the requisite elements prescribed by law as to minimum required content – Article 42 AVSA. Its issuance must comply with the relevant procedure and should involve a regular procedure of service. The burden of proof in administrative and criminal proceedings lies on the sanctioning authority by virtue of Article 84 AVSA

⁸⁸ Administrative penal liability is personal and is borne by the individual, while pecuniary liability is borne by a legal entity.

in conjunction with Article 103(1) of the Criminal Procedure Code. In its assessment whether to issue a penal order, the issuing body must base its decision on the findings set out in SAV, which, within the framework of administrative sanctions, are presumed to be correct until proven otherwise. However, that is not the case in judicial proceedings, in which they have no binding evidentiary value. In the proceedings, the court is obliged to examine the facts, through the admissible means of proof, and to assess whether there has been a violation of the legal qualification specified by the PFI Ag director. Any proceedings before an appellate instance (the relevant regional court) are appellate in nature and are conducted in accordance with the procedural rules laid down in the Criminal Procedure Code. Pursuant to Article 339(2) of the Criminal Procedure Code, the appellate instance must state the grounds on which it does not accept the arguments put forward in support of the appeal. The absence of factual and legal conclusions on the arguments put forward by the appellant vitiates the judgment and is grounds for its annulment. The court is not bound by the decision of the ASA and cannot be prevented from fully examining the facts relevant to the dispute raised before it. The absence of a ruling under Article 339(2) of the Criminal Procedure Code, in accordance with current case-law, amounts to a lack of reasoning and always constitutes a substantive breach of procedural rules – grounds for cassation of a judicial act. The cassation proceedings do not resolve the substantive dispute between the parties, but are concerned with the assessment of the correctness, admissibility and validity of the appellate judgment. The court of cassation (the relevant administrative court) examines the conformity of the judgment with substantive law based on the facts established by the court of first instance. Its task is limited solely to verifying whether the facts have been correctly brought within the terms of legal rule and whether the legal consequences provided for in that rule have been correctly applied.

Article 34(2) AVSA provides for longer time limits for initiation of administrative proceedings: *“For violation of a regulatory act regulating budgetary, financial, economic and accounting activities under Article 32(1)(1) of the State Financial Inspection Act, ... no administrative proceedings shall be initiated if no infringement report has been drawn up within six months of the discovery of the offender or if more than five years*

have elapsed since the offence was committed. In these cases, the terms provided for in para. (1) do not apply. The instituted administrative penal proceedings shall be terminated if a penal order has not been issued within six months of the drawing up of the statement, Article 34(3) AVSA.”

Statute of limitations for administrative violations: for administrative penal prosecution, see Interpretative Resolution No. 1 of 27.02.2015 of the Supreme Court of Cassation (SCC) under interpretative case No. 1/2014, General Assembly of Criminal Chambers (GACC) and the General Assembly of Judges of the II Chamber of the Supreme Administrative Court (SAC); for the execution of an administrative penalty/property sanction, see Interpretative Decision No. 3 of 03.07.2014, SAC No. 5/2013, GAJ, I and II Chamber.

The time limits under Article 34 AVSA are statute-barred. *The limitation period has two elements: objective (expiry of a certain period of time) and subjective (an objection raised for the expiry of the limitation period). The legal consequences of the expiration of the limitation period are that the creditor loses the possibility to seek judicial redress. What has been paid after expiry of the limitation period is duly paid if no plea of limitation has been made.*

It should be noted that the provisions of Article 34(1) and (2) AVSA (limitation periods after the expiry of which no administrative penal proceedings may be brought before the ASA)⁸⁹ implies the application of the rules and principles concerning the correlation of ‘**general law**’ to ‘**special law**’ **regarding the time limits set out in the special Acts above.**

Extinction of the administrative penal prosecution – Article 34(3) AVSA (the initiated administrative penal proceedings are terminated if no penal order is issued within six months of the drawing up of the Statement of Violation).

In the judicial phase, the provisions on limitation and absolute limitation under the Criminal Code (CC) apply. Absolute statute of limitations is regulated by Article 81(3) in conjunction with Article 80(1)(5) CC

⁸⁹ The court monitors compliance with the deadlines, and non-compliance constitutes a violation of procedural rules.

(Interpretative Resolution No. 1/27.02.2015 under interpretative case No. 1/2014 of the Supreme Court of Cassation and the Supreme Administrative Court). Pursuant to the said Interpretative Resolution No. 1/27.02.2015, the statute of limitations is a period of time determined by the law, upon expiry of which the holder of a right loses the opportunity granted by law to exercise such right. The statute of limitations applies *ex officio*, whereby the State loses its substantive right to impose a penalty on the offender and to enforce the penalty already imposed, thereby extinguishing penal liability and in turn rendering the criminal proceedings inadmissible. The operative part of the said interpretative resolution expressly holds that the provision of Article 11 AVSA refers to the rules on the limitation of penal prosecution in the Criminal Code.

The limitation of penal prosecution is laid down in Chapter 9 of the Criminal Code, the time limits being determined by the type and severity of the penalty provided for the offence concerned (see Decision No. 6826/19.11.2021 under administrative penal case No. 8823/2023 of Sofia City Administrative Court). Extinction of penal prosecution by prescription is regulated by Article 80 and Article 81 of the Criminal Code. Article 81(3) of the Criminal Code regulates the so-called absolute statute of limitations, which is a circumstance that excludes administrative penal prosecution. According to this legal text, regardless of the suspension or interruption of the limitation period, penal prosecution is excluded if a period of time has elapsed which exceeds by one half the period provided for in the preceding Article. In Article 80(1)(5) CC the term is three years, i.e., the absolute limitation period occurs upon the expiry of four and a half years. The date of the offence is the beginning of the absolute limitation period.

Regarding the enforcement of the penalty under an enforceable Statement of Administrative Violation, Article 82(1)b provides that the administrative penalty should not be enforced if two years have elapsed, when the penalty imposed is a fine. The limitation period starts to run from the entry into force of the Statement imposing the penalty and is interrupted by any action taken by the competent authorities to enforce the penalty. Following completion of the action because of which the limitation period was interrupted, a new limitation period begins to run

(Article 82(2) AVSA). Notwithstanding the suspension or interruption of the limitation period, the administrative penalty is not enforced if a period exceeding by one half the period referred to in paragraph (1) of Article 82 (Article 82(3) AVSA) has elapsed. The provisions of Article 82(3) AVSA do not apply with regards to the fine, where enforcement proceedings are initiated for its collection within the time limit set out in Article 82(1). This also applies to pending cases for which the limitation period has not expired by the entry into force of this paragraph. The provisions of Article 82(1), note ‘a’ in conjunction with paragraphs (2) and (3) AVSA are not applicable to pecuniary sanctions imposed by an enforceable Statement of Administrative Violation. The above provisions of AVSA are special in relation to the general provisions of Article 171 of the Tax and Social Security Procedure Code. In contrast to civil law, where the statute of limitations does not apply *ex officio* (Article 120 of the Obligations and Contracts Act), the statute of limitations in administrative penal law applies *ex officio*.

✓ **Deficit Instrument** (in the case of ascertained damages and in the presence of the prerequisites under Article 21(1) PFIA).

The Deficit Instrument is an independent document, issued in the case of deficiency proceedings initiated during the financial inspection for the establishment of financial liability for damages caused to organisations under Article 4, items 1–3 PFIA. According to Article 22(1) in conjunction with Article 37 RIPFIA, during the period of the financial inspection, provided that the prerequisites under Article 21 PFIA are in place, the financial inspector initiates deficiency proceedings by drawing up a deficit instrument. The factual findings in the deficit instrument are considered true until proven otherwise (Article 22(5) in conjunction with Article 44 RIPFIA), as the person who caused the damage⁹⁰ bears the evidential burden of overturning the findings in the instrument. The amount of the damage under the Act is determined on the day of its occurrence, and when this day cannot be determined – on the day of discovery of the damage. The amount of the damage is determined by the higher of the market price or accounting value (Article 24 PFIA). Damage caused in foreign currency is reimbursed in the same currency or in BGN at the highest exchange

⁹⁰ The subjects of financial liability are established in Article 23 PFIA.

rate of the Bulgarian National Bank on the day of occurrence, discovery or recovery (Article 25 PFIA). The persons responsible for causing the damage owe legal interest from the day it was caused, and if this day cannot be established – from the day it was discovered until the day of recovery (Article 26 PFIA).

The presumption gives the deficit instrument special evidentiary power in warrant proceedings under the Civil Procedure Code (CPC) (Article 417⁹¹ and 418).⁹² The factual findings in the deficit instrument must be supported by evidence (Article 22(2) PFIA, in conjunction with Article 44(1)–(3) RIPFIA). The deficit instrument is drawn up by the financial inspector who performed the financial inspection. There are requirements regarding the content of the deficit instrument (Article 43 RIPFIA). In this case, two instruments will be drawn as a result of the financial inspection: **the report**, in which a comprehensive assessment of the inspected object is given, and **the deficit instrument**, which describes the factual composition that gives rise to the financial liability (the composition of the tort – damage, illegal behaviour, causation relationship and culpability). When issuing the deficit instrument, special deficiency proceedings are initiated (Article 22 PFIA in conjunction with Articles 45–49 RIPFIA).

Where the objections presented and the evidence to them fundamentally change the findings in the deficit instrument and where at least one of the elements of the factual composition of financial liability under Article 21(1) PFIA is not supported by the collected evidence, a reasoned proposal for termination of the proceedings under the deficit instrument is prepared to the director PFIAG (Article 49(2) and (3) RIPFIA). Based on the proposal, the director of PFIAG terminates the initiated proceedings with a resolution or sends the deficit instrument to the prosecutor's office (Article 49(4) RIPFIA). Proceedings instituted under the deficit instrument are also terminated in cases where the perpetrator passes away before the deficit instrument is submitted to the prosecutor's office (Article 49(6)

⁹¹ **The applicant** may request the issuance of an execution order and when the claim, regardless of its price, is based on a deficit instrument (Article 417(1)9 CPC).

⁹² The injured organisation should actively seek the application of the warrant proceedings for immediate execution. Competent is the district court at the permanent address or seat of the debtor according to Article 411(1) of the CPC.

RIPFIA). According to Article 50 RIPFIA, the deficit instrument and the findings therein are grounds for accounting recognition of the obligation of the person, responsible for the deficiency, in the manner established by the Accountancy Act and the applicable accounting standards. The organisations and persons under Article 4, items 1–3 PFIA are obliged to send the deficit instrument to the relevant court for issuance of an order for immediate execution in accordance with the procedure of Article 418 of the Civil Procedure Code (Article 27(5) in conjunction with Article 51 RIPFIA).

According to PFIA, there are measures against the controlled activity and measures against controlled persons. When taking impact measures based on the collected evidence and the findings of the control bodies from the establishment phase, legal acts affect the activity or behaviour of the entities exercising the activity in order to bring them into line with the requirements of statutory instruments and to achieve the goals of the controlled activity.

The legal regulation of subsequent impact measures is contained in Articles 18–31 PFIA and Articles 25–36 RIPFIA.

If there is data of a committed crime, a copy of the report under Article 17(1) PFIA together with the evidence to it, the opinions under Article 17(2) and 3 and the conclusion under Article 17(4) PFIA must be sent to the prosecution authorities within 7 working days (Article 19 PFIA).

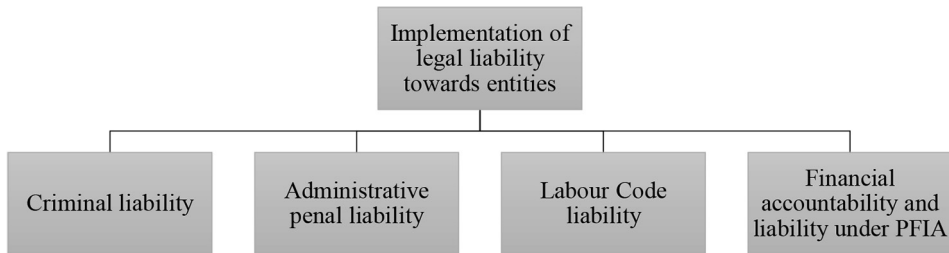
The legal consequences of the control activity over the form for realisation of legal responsibility for the persons carrying out the activity can be imposed only in the case of control for legality pursuant to PFIA.

Financial liability is implemented on the basis of the deficit instrument. **The deficit instrument and the annexes to it** are sent to the prosecutor's office for verification whether there is evidence of a committed crime of a general nature (Article 22(7) PFIA). In the establishment phase above (second stage), facts are established and evidence is collected related to the object of control, in order to establish its factual state and its compliance with the requirements of regulatory acts or with the objectives of its activity. The deficit instrument is drawn up in four identical copies – one each for

the prosecutor's office, for the inspected organisation or entity, for the agency and for the person responsible for the deficiency. When the deficit instrument is drawn up against a manager or a member of a collective body for management and control of a legal entity under Article 4, items 2–3 PFIA, it is drawn up in five identical copies, with one copy also being sent to the body exercising the property rights of the state or municipality (Article 45(1)). According to Article 27(5) PFIA, organisations and persons under Article 4, items 1–3 PFIA are obliged to request from the court an order for immediate enforcement of the claim under the deficit instrument as well as a writ of execution. There is no regulated deadline for submitting the request, but according to Article 27(4) PFIA, on the basis of the deficit instrument, an order for immediate execution will be issued in accordance with Article 418 CPC. Article 27(6) provides that the organisations and persons under Article 4, items 1–3 PFIA cannot waive the claim under the deficit instrument, including interest. Regardless of any suspension and interruption of the statute of limitations, financial liability under PFIA expires with the lapse of 10 years following occurrence of the damage (Article 27(2) PFIA).

Where violations under **Articles 32, 32a, 32b, and 33 PFIA** are in place, the financial inspectors will, as stated above, draw up **statements of administrative violations**, based on which proceedings will be initiated for administrative penal liability **through the issuance of penal orders pursuant to AVSA by the director of PFIa or officials authorised by him/her** (Article 35 AVSA). These elements comprise the framework of impact measures on controlled persons.

The establishment of violations and the issuance, appeal and execution of penal orders are carried out pursuant to AVSA. In the case of **incorrect actions**, measures are taken to improve the activity, e.g., **by issuing written instructions**.

Implementation of legal liability towards entities:

According to Article 2(1) PFIA, the main purpose of the state financial inspection is to protect public financial interests. This is achieved by the Agency by performing one of the main tasks under Article 2(2), item 5 PFIA, namely detection of fraud and violations affecting the financial interests of the European Communities. In this way PFIAG protects the financial interests of the EU budget as well. Chapter Three ‘a’ PFIA also refers to the protection of the financial interests of the EU by PFIAG: ‘Assisting the controllers of the European Commission in gaining access to premises and/or documentation for the implementation of on-site checks and inspections under Regulation (EURATOM, EC) No. 2185/96 of the Council of November 11, 1996 concerning on-the-spot checks and inspections carried out by the Commission in order to protect the European Communities’ financial interests against fraud and other irregularities.’⁹³

According to Article 5(1)6 PFIA financial inspection is carried out on the basis of statements of violations affecting the financial interests of the European Communities, established by the Protection of the European Union’s Financial Interests (AFCOS) Directorate of the Ministry of the Interior. The scope of inspection control also includes the funds from the EU budget, which are managed according to current EU law for the relevant programming period; the principles concerning their management are also applicable.⁹⁴

⁹³ OJ L 292, 15.11.1996, 2–5. See also Article 52a–52h of the RIPFIA.

⁹⁴ For example, see Article 2(1) of the Management of EU funds under Shared Management Act (see Chapter 23 and 28).

CHAPTER 23:

PROTECTION OF THE FINANCIAL INTERESTS OF THE EUROPEAN UNION. THE BULGARIAN CASE

Savina Mihaylova-Goleminova

ABSTRACT	KEY WORDS
This chapter presents the key aspects of protection of the financial interests of the European Union, including the relevant legal and institutional framework, theory and practice of irregularities and financial corrections, issues related to implementation of the Recovery and Resilience Facility, rule of law and the management of EU Funds.	EU budget, national budget, irregularities, fraud, EU funds, rule of law.

I. INTRODUCTION

The budget¹ plays a fundamental role in public finances and the financial system of the EU and Bulgaria as a Member State (see also Chapters 18, 19, 20, 22, 24, 27).² Regarding the protection of the financial interests of the EU, the provisions of Article 317 TFEU apply, namely: sound governance in the use of the EU budget by Member States in cooperation with the Commission; control and audit of budget implementation, as well as the responsibilities arising from this. According to Article 310 and Article 325 of the TFEU, the European Commission and Member States must fight fraud and any illegal activity that may harm the financial interests of the EU. Member States are required to adopt the same measures to fight fraud affecting the

¹ Regarding the EU budget see: <https://eur-lex.europa.eu/legal-content/BG/TX-T/?uri=LEGISSUM:budget> [Accessed on 15 January 2024].

² See also: **Пенов, С.** Финансово право. Обща част. Учебен курс. София, УИ Св. „Климент Охридски“, 2021; **Пенов, С.** Финансово право. Специална част. Учебен курс. София, УИ Св. „Климент Охридски“, 2020.

EU's financial interests as they do to fight fraud affecting their own national financial³ interests.⁴

Member States must coordinate their actions aimed at protecting the financial interests of the Union against fraud.⁵ For this purpose, they need to organise, together with the Commission, close and regular cooperation between competent authorities. According to Title V TFEU Area of Freedom, Security and Justice, provisions on judicial cooperation in criminal matters (Chapter 4) and police cooperation (Chapter 5) should be put in place to ensure the prevention, detection and investigation of crime. The fight against fraud and corruption is also subject to the mandate of the European Anti-Fraud Office (OLAF)⁶ and the European Public Prosecutor's Office (EPPO).⁷ The European Court of Auditors (ECA) also plays an enormous role as an 'advisor' and as an **independent external auditor** of EU institutions. Its special reports are of great significance.⁸

³ See Report from the Commission to the Council and the European Parliament. 33rd Annual Report on the protection of the European Union's financial interests and the fight against fraud – 2021.

<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52022DC0482> [Accessed on 15 January 2024]. See also The European Commission Anti-Fraud Strategy <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52011DC0376>. See also The National Anti-Fraud Strategy can be found on the website of the AFCOS Directorate at: <http://www.afcos.bg/bg/node/256> . [Accessed on 15 January 2024].

⁴ See Доклад относно дейността на съвета за координация в борбата с правонарушенията, засягащи финансовите интереси на европейския съюз през 2021 г.: <https://www.afcos.bg/sites/default/files/uploads/docs2022-07/Doklad.pdf> [Accessed on 15 January 2024].

⁵ See **Христов, Х.** Право на Европейския съюз – наказателноправни въпроси, София, Сиела, 2012; **Кузманова, Н.** Обхват на наказателноправната защита на финансовата система. Част първа. // Правна мисъл, 2022, № 1, 27–43; **Кузманова, Н.** Обхват на наказателноправната защита на финансовата система. Част втора. // Правна мисъл, 2022, № 2, 20–47.

⁶ https://anti-fraud.ec.europa.eu/index_en [Accessed on 15 January 2024].

⁷ <https://www.eppo.europa.eu/bg> [Accessed on 15 January 2024].

⁸ See ECA special reports: Special report 14/2022: The Commission's response to fraud in the Common Agricultural Policy – Time to dig deeper; Fighting fraud in EU spending: action needed; Protecting the EU budget: Better use of blacklisting needed, etc., available at: <https://www.eca.europa.eu/en/multiple-reports> [Accessed on 15 January 2024].

II. BASIC ISSUES

1. Managing the EU budget

The Financial Regulation⁹ regulates that the European Commission may implement the budget in any of the following ways:¹⁰

- **directly (direct management)** according to Articles 125–153, by its departments, including through its staff in the Union delegations under the authority of their respective Head of Delegation, in accordance with Article 60(2), or through executive agencies as referred to in Article 69;
- **under shared management with Member States ('shared management')** as set out in Articles 63 and 125–129;
- **indirectly ('indirect management')** as set out in Articles 125–149 and Articles 154–159, where this is provided for in the basic act or in the cases referred to in points (a) to (d) of Article 58(2).

Member States use contributions from the funds to provide support to beneficiaries in the form of (*Article 52 Financial Regulation*): grants; financial instruments; or rewards or as a combination thereof.

As set out in Article 2 of the Financial Regulation, entitled 'Definitions', the following definitions apply:

(7) 'budget implementation' means the carrying out of activities relating to the management, monitoring, control and auditing of budget appropriations in accordance with the methods provided for in Article 62;

⁹ Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012.

¹⁰ See also Financial Regulation, Article 62 (Methods of execution of the EU budget), in connection with Article 5 (Measures for the protection of the Union budget) of Regulation (EU, Euratom) 2020/2092 of the European Parliament and of the Council of 16 December 2020 on a general regime of conditionality for the protection of the Union budget (OJ L 433I, 22.12.2020, 1–10).

(42) ‘Member State organisation’ means an entity established in a Member State as a public law body, or as a body governed by private law entrusted with a public service mission and provided with adequate financial guarantees from the Member State;

(59) ‘sound financial management’¹¹ means implementation of the budget in accordance with the principles of economy, efficiency and effectiveness;

2. Legal and institutional framework for the protection of the financial interests of the European Union

The protection of the EU’s financial interests covers all forms of management under the Financial Regulation of EU funds originating from its budget; the following regulations apply:

- Council Regulation (EC, Euratom) No 2988/95 of 18 December 1995 on the protection of the European Communities financial interests;¹²
- Council Regulation (Euratom, EC) No 2185/96 of 11 November 1996 concerning on-the-spot checks and inspections carried out by the Commission in order to protect the European Communities’ financial interests against fraud and other irregularities;¹³
- Regulation (EU, Euratom) No 883/2013 of the European Parliament and of the Council of 11 September 2013 concerning investigations conducted by the European Anti-Fraud Office (OLAF) and repealing Regulation (EC) No 1073/1999 of the European Parliament and of the Council and Council Regulation;¹⁴
- Council Regulation (Euratom) No 1074/1999 of 25 May 1999 concerning investigations conducted by the European Anti-Fraud Office (OLAF);¹⁵

¹¹ For ‘sound financial management’ see Chapters 18, 19, 22.

¹² OJ L 312, 23.12.1995, 1–4.

¹³ OJ L 292, 15.11.1996, 2–5.

¹⁴ OJ L 248, 18.9.2013, 1–22.

¹⁵ OJ L 248, 18.9.2013, 1–22.

- Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law;¹⁶
- Council Regulation (EU) 2017/1939 of 12 October 2017 implementing enhanced cooperation on the establishment of the European Public Prosecutor's Office ('the EPPO');¹⁷
- Directive (EU) 2019/1937 of the European Parliament and of the Council of 23 October 2019 on the protection of persons who report breaches of Union law;¹⁸
- Directive (EU) 2019/1937 of the European Parliament and of the Council of 23 October 2019 on the protection of persons who report breaches of Union law;¹⁹ and
- others.

The sectoral regulations for the relevant programming period are also applicable; for the 2021–2027 programming period these are:

- Regulation (EU) 2021/2115 of the European Parliament and of the Council of 2 December 2021 establishing rules on the support for strategic plans to be drawn up by Member States under the common agricultural policy (CAP Strategic Plans) and financed by the European Agricultural Guarantee Fund (EAGF) and by the European Agricultural Fund for Rural Development (EAFRD), and repealing Regulations (EU) No 1305/2013 and (EU) No 1307/2013;²⁰
- Regulation (EU) 2021/2116 of the European Parliament and of the Council of 2 December 2021 on the financing, management and monitoring of the common agricultural policy and repealing Regulation (EU) No 1306/2013;²¹
- Regulation (EU) 2021/2117 of the European Parliament and of the Council of 2 December 2021 amending Regulations (EU)

¹⁶ OJ L 198, 28.7.2017, 29–41.

¹⁷ OJ L 283, 31.10.2017, 1–71.

¹⁸ OJ L 305, 26.11.2019, 17–56.

¹⁹ OJ L 305, 26.11.2019, 17–56.

²⁰ OJ L 435, 6.12.2021, 1–186.

²¹ OJ L 435, 6.12.2021, 187–261.

No 1308/2013 establishing a common organisation of the markets in agricultural products, (EU) No 1151/2012 on quality schemes for agricultural products and foodstuffs, (EU) No 251/2014 on the definition, description, presentation, labelling and the protection of geographical indications of aromatised wine products and (EU) No 228/2013 laying down specific measures for agriculture in the outermost regions of the Union;²²

- Regulation (EU) 2021/1060 of the European Parliament and of the Council of 24 June 2021 laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund and financial rules for those and for the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy;²³
- Regulation (EU) 2021/1059 of the European Parliament and of the Council of 24 June 2021 on specific provisions for the European territorial cooperation goal (Interreg), supported by the European Regional Development Fund and external financing instruments;²⁴
- Regulation (EU) 2021/1058 of the European Parliament and of the Council of 24 June 2021 on the European Regional Development Fund and on the Cohesion Fund;²⁵
- Regulation (EU) 2021/1057 of the European Parliament and of the Council of 24 June 2021 establishing the European Social Fund Plus (ESF+) and repealing Regulation (EU) No. 1296/2013;²⁶
- Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility;²⁷ and
- others.

²² OJ L 435, 6.12.2021, 262–314.

²³ OJ L 231, 30.6.2021, 159–706.

²⁴ OJ L 231, 30.6.2021, 94–158.

²⁵ OJ L 231, 30.6.2021, 60–93.

²⁶ OJ L 231, 30.6.2021, 60–93.

²⁷ OJ L 57, 18.2.2021, 17–75.

According to Article 63(2) Financial Regulation:

‘2. When executing tasks relating to budget implementation, Member States shall take all the necessary measures, including legislative, regulatory and administrative measures, to protect the financial interests of the Union, namely by:

- (a) ensuring that actions financed from the budget are implemented correctly and effectively and in accordance with the applicable sector-specific rules;*
- (b) **designating bodies responsible for the management and control of Union funds in accordance with paragraph 3, and supervising such bodies;***
- (c) **preventing, detecting and correcting irregularities and fraud;***
- (d) cooperating, in accordance with this Regulation and sector-specific rules, with the Commission, OLAF, the Court of Auditors and, for those Member States participating in enhanced cooperation pursuant to Council Regulation (EU) 2017/1939, with the European Public Prosecutor’s Office (EPPO).’*

According to Article 71(1) of the Common Provisions Regulation (CPR):²⁸ *‘For the purposes of Article 63(3) of the Financial Regulation, the Member State shall identify for each **programme a managing authority and an audit authority**. Where a Member State entrusts the accounting function to a body other than the managing authority in accordance with Article 72(2) of this Regulation, the body concerned shall also be identified as a programme authority. Those same authorities may be responsible for more than one programme.’*

The legal and institutional framework for the management and control of EU funds in shared management is regulated in national legislation, in the Management of Resources from the European Structural and Investment Funds Act (MRESIFA) and the Agricultural Producers Assistance Act (APAA). These are special laws with regard to the Administrative Procedure

²⁸ Regulation (EU) 2021/1060 of the European Parliament and of the Council of 24 June 2021 laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund and financial rules for those and for the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy.

Code (APC), containing substantive and procedural norms, and serve to regulate the protection of the financial interests of the EU. More than 15 normative acts have been adopted pursuant to MRESIFA²⁹ and APAA. The powers of the bodies within the system of public resources arising from funds in shared management are established in the regulations (e.g., in the CPR). In national legislation, the head of the governing body is the head of the administration³⁰ or organisation in which the governing body is located, or a person designated by him/her as the head of the governing body; the powers of the head of the governing body may also be exercised by a person authorised by him (Article 9(5) MRESIFA). The managing authority is responsible for the overall programming, management and implementation of the relevant operational programme, as well as for the prevention, detection and correction of irregularities, including financial corrections.³¹

Decision No. 712 of 6 October 2020 of the Council of Ministers defines the structures responsible for the management, control, accountability, coordination and audit of the programmes co-financed by the ERDF, ESF+, CF, European Maritime, Fisheries and Aquaculture Fund (EMFAF), the Just Transition Fund (JTF), EAGF, EAFRD, the Internal Security Fund, the Asylum and Migration Fund and the Instrument for Financial Support of Border Management and Visas as part of the Integrated Border Management Fund and the cooperation programmes in which the Republic of Bulgaria participates for the 2021–2027 programming period.³² Only one Paying Agency has been created for the funds of the common agricultural policy in Bulgaria, which is institutionalised in State Fund Agriculture.³³

In accordance with the Financial Regulation, Regulation (EU, Euratom) No 883/2013 of the European Parliament and of the Council

²⁹ See: <https://www.eufunds.bg/bg/taxonomy/term/680> [Accessed on 15 January 2024].

³⁰ § 1, item 1 of the Supplementary Provisions of the APC: ‘administrative body’ is the body that belongs to the executive power system, as well as any holder of administrative powers authorised on the basis of law, including persons performing public functions and organisations, providing public services.

³¹ See Решение № 14414/ 29.12.2016 г. по а. д. № 8790/2016 г., VII отд., ВАС; Решение № 1220 от 31.01.2017 г. по а. д. № 10508/2016 г., VII отд., ВАС; Решение № 1089 от 26.01.2017 г. по а. д. № 10251/2016 г., VII отд., ВАС; Решение № 827 от 20.01.2017 г. по а. д. № 6913/2016 г., VII отд., ВАС.

³² See: <https://www.eufunds.bg/bg/node/6992> [Accessed on 15 January 2024].

³³ <https://www.dfz.bg/bg/home> [Accessed on 15 January 2024].

(18) and Regulations (EC, Euratom) No 2988/95 on the protection of the European Communities financial interests, (Euratom, EC) No 2185/96 and (EU) 2017/1939 of the Council, the financial interests of the Union must be protected by means of proportionate measures, including by means of measures related to the prevention, detection, correction and investigation of fraud, corruption and conflicts of interests and, when appropriate, with the imposition of administrative sanctions.

In particular, in accordance with Regulations (Euratom, EC) No. 2185/96 and (EU, Euratom) No. 883/2013, OLAF has the power to carry out administrative investigations, including on-the-spot checks and inspections in order to establish the presence of fraud, corruption, conflicts of interest or other illegal activity affecting the financial interests of the Union.

In accordance with Regulation (EU) 2017/1939, the European Public Prosecutor's Office is empowered to investigate and prosecute fraud, corruption, conflicts of interest and other crimes against the Union's financial interests as provided for in Directive (EU) 2017/1371 of the European Parliament and the Council.

In accordance with the Financial Regulation, all persons or entities receiving Union funds must fully cooperate in the protection of the financial interests of the Union, grant the necessary rights and access to the Commission, OLAF, the Court of Audits and, in respect of those Member States participating in enhanced cooperation under Regulation (EU) 2017/1939, EPPO, ensure that any third parties involved in the implementation of Union funds grant equal rights.³⁴

The fight against irregularities and fraud is carried out in accordance with applicable law: **administratively (managing authorities, paying agencies, audit authorities, accounting authorities, the anti-fraud coordination service (AFCOS), the Audit Office, etc.) and criminally (OLAF), ECA,³⁵ European Commission through its directorates-**

³⁴ See: EU Funds Anti-Fraud Knowledge & Resource Centre, Prevent and Detect Fraud in EU Funds: https://antifraud-knowledge-centre.ec.europa.eu/video-modules_en [Accessed on 15 January 2024].

³⁵ Special Report 14/2022: The European Commission and the fight against fraud in the Common Agricultural Policy – more effort needed: <https://www.eca.europa.eu/bg/publications?did=61337> [Accessed on 15 January 2024].

general, etc.), and in two levels, in accordance with the application of the principles of subsidiarity, proportionality and shared competence: at national and at supranational level.

Diagram 1 – By administrative means

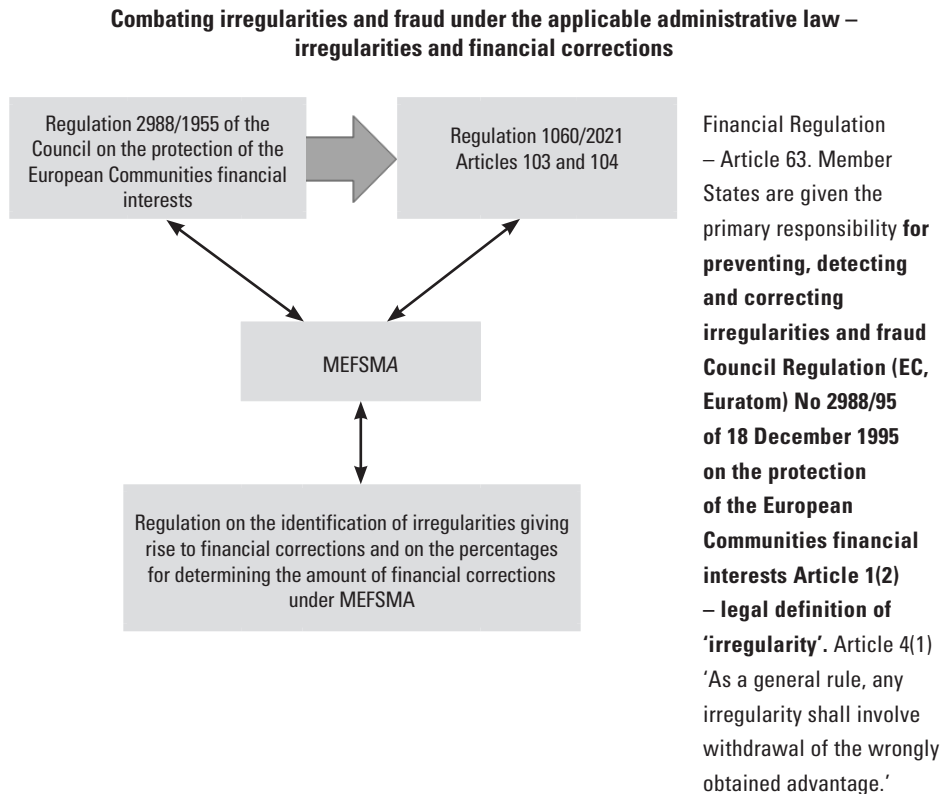


Diagram 2 – By penal means

Combating irregularities and fraud under the applicable criminal law

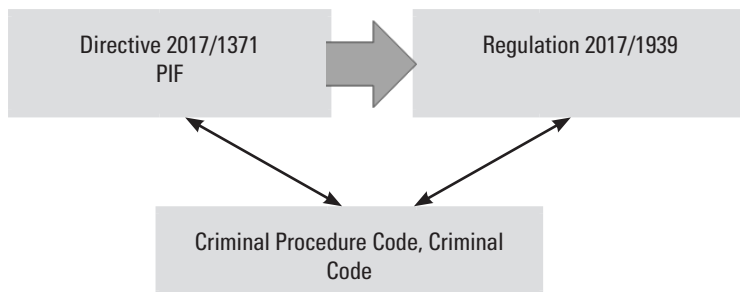


Diagram 3 – Responsible authorities at EU level



Diagram 4 – National Authorities³⁶

3. Irregularities and financial corrections

With regard to the irregularities within the revenue part of the budget, we have to mention some results listed in the latest Activity Report of the *Coordination Council for Countering Offences Affecting European Union's Financial Interests* for 2021.³⁷ **Council Decision (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom³⁸** lays

³⁶ Including income and expenditure protection of financial interests.

³⁷ See: Доклад относно дейността на съвета за координация в борбата с правонарушенията, засягащи финансовите интереси на европейския съюз през 2021 г.: <https://www.afcos.bg/sites/default/files/uploads/docs2022-07/Doklad.pdf> [Accessed on 15 January 2024].

³⁸ OJ L 424, 15.12.2020, 1-10.

down rules on the allocation of own resources to the Union in order to ensure the financing of the Union's annual budget.

In its capacity as a member of the Coordination Council for Countering Offences Affecting European Union's Financial Interests, the National Revenue Agency has dual responsibility – to protect the revenue part of the Republican budget, from which part of the EU's own resources are deducted and replenished (in the form of membership fees from the Member States, based on VAT and GNI), as well as to implement forced collection of unlawfully allocated, spent and refundable funds under EU funds and programmes related to the expenditure part of the EU budget.

One of the main priorities of the customs administration³⁹ remains the control over excise goods, aimed at combating their illegal distribution, as well as the smuggling of tobacco products. In 2021, the customs authorities, when carrying out their control functions and imposing administrative penal liability on individuals, drew up a total of 5,936 statements of administrative violation, which exceeded by approximately 7% those in 2020. The number of decisions issued for termination of administrative penal proceedings was 858, thus marking a significant increase compared to 2020. The number of statements establishing customs violations was 3,992, which, compared to those in 2020, marked an increase of about 18%. According to the Excise Duties and Tax Warehouse Act, there were 1,659 statements of administrative violations. There were 172 violations of foreign exchange legislation, a number which, compared to 2020, is almost double in size. As a result of control actions for compliance with the *Counter-Corruption and Unlawfully Acquired Assets Forfeiture Act*, 3 cases were established, under the Roads Act – 9 cases. According to the Road Traffic Act, 95 cases were established, which, compared to 2020, marked a large increase – approximately 150%. According to the Waste Management Act, customs officials have established 2 administrative violations. There are 3 cases of violations under the Tobacco, Tobacco and Related Products Act. Customs authorities have established 1 violation under the Defence-Related Products and Dual-Use Items and Technologies Export Control Act. The Customs Agency participates in international operations and inspections. In 2021, employees of the Customs Agency were involved in 45 new OLAF investigations related **to suspected evasion of anti-dumping, countervailing**

³⁹ See: Customs Act, Article 1.

and conventional duties, declaration of lower values of goods admitted for free circulation, evasion of VAT on imports, illegal import or transit of goods infringing intellectual property rights, counterfeit and health-hazardous goods, goods in violation of prohibitions and restrictions. Work continues on investigations from previous periods, including on new information received. Actions and inspections have been undertaken, including with the assistance of the NRA. The results of investigations are immediately communicated to OLAF.

Regulation (EC, Euratom) No. 2988/95 of the Council of 18 December 1995 on the protection of the European Communities financial interests adopts general rules relating to uniform controls and administrative measures and penalties concerning irregularities with regard to Community law. It contains **a definition of an irregularity**, as well as administrative measures and sanctions to be applied in cases of irregularities and the option of adopting additional regulations regarding on-site inspections. ‘Irregularity’ means any infringement of a provision of Community law resulting from an act or omission by an economic operator, that has or would have, the effect of prejudicing the general budget of the Communities or budgets managed by them, either by reducing or losing revenue accruing from own resources collected directly on behalf of the Communities, or by an unjustified item of expenditure. As per Article 4(1) of the same regulation ‘As a general rule, any irregularity shall involve withdrawal of the wrongly obtained advantage’ Therefore, the establishment, prosecution and sanctioning of infringements of the EU budget could be systematised according to applicable law: **administrative** law (administrative, financial and tax law), applicable to irregularities, and **criminal** law, applicable to fraud.

A definition of fraud has already been introduced, which is the deliberate deception for the purpose of personal benefit or damage to another party. **Fraud** is generally defined as any intentional act or omission designed to deceive others, resulting in the victim suffering a loss and the perpetrator achieving a gain. For example, if a grant recipient deliberately attempts to deceive the grantor in order to claim unreasonably high costs, this will constitute fraud. The legal definition is provided in Article 3 of Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union’s financial interests by means of criminal law (Directive on the protection of financial interests). **Fraud** of

public funds is sometimes associated with corruption, which has traditionally been defined as any act or omission that abuses power or is intended to lead to the abuse of power in order to obtain an improper advantage. For example, if a grant recipient bribes an official so that the latter will approve improperly high expenditures, then both fraud and corruption are involved. Directive (EU) 2017/1371, in its Article 4(2), requires from Member States to take the necessary measures to ensure that passive and active corruption, when committed intentionally, constitute criminal offences.

The Directive introduces a more detailed definition of fraud, as well as criminal liability for legal entities. It also introduces the concept of ‘public official’, which provides for stricter liability for persons involved in the management and control of EU funds, including private individuals.

The term ‘**fraud indicator**’⁴⁰ is established in PFIA. Directive (EU) 2017/1371 is transposed into our national legislation in the provision of § 3, Article 201(2) of the Criminal Code⁴¹ and Article 83a–83g of the Administrative Violations and Sanctions Act (AVSA). These provisions introduce the requirements of the Directive into criminal law. According to the Directive, Member States must take the necessary measures to ensure that legal persons can be held liable for any of the relevant criminal offences.

⁴⁰ §1, item 9 of the Supplementary Provisions of PFIA. ‘Fraud indicator’ is a sign wherefrom a reasoned conclusion can be drawn for intentional incorrect or inaccurate presentation of facts.

⁴¹ Also see Article 201(1) (Amend. – SG 28/82, in force from 01.07.1982; amend. – SG 10/93, suppl. – SG 50/95, suppl. SG 50/95, declared unconstitutional with Decision No. 19 of the Constitutional Court – SG 97/95; amend. SG 75/06, in force from 13.10.2006, previous text of Article 201 – SG 83/19) An official who misappropriates another person’s money, property or other valuables, entrusted to him in his official capacity or entrusted to his custody or management, shall be punished for misappropriation in public office by imprisonment for a term of up to eight years, and the court may order the confiscation of up to one half of the property of the perpetrator and deprive him of rights under Article 37(1), items 6 and 7(2). (New, SG No. 83 from 2019) The penalty under paragraph (1) shall also be imposed when the act is committed by a foreign official.

An irregularity⁴² is a broader concept than fraud⁴³ and affects both the revenue and expenditure side of the EU budget. If this infringement of Union law is committed intentionally, it constitutes fraud. Therefore, what distinguishes fraud from other wrongdoing is intent on the part of the perpetrator.

Article 1(2) of Regulation (EC, Euratom) No. 2988/95 of the Council provides a legal definition of the term ‘irregularity’, and, in some cases, sectoral regulations further develop the definition, including the practice of the Court of Justice of the EU. The Supreme Administrative Court has rich case law in the field of irregularities in the expenditure part of the EU budget.⁴⁴

To the extent that the **European and national budget** is in the centre of the system of **public funds from the EU, administrative bodies in the system act primarily under conditions of bound competence** and

⁴² §1 Supplementary Provisions, item 7 of the Financial Management and Control in the Public Sector Act (FMCPSA):

7. “irregularity affecting the financial interests of the European Communities’ is any infringement of a provision of Community law resulting from an act or omission by an economic operator, that has or would have, the effect of prejudicing the general budget of the Communities or budgets managed by them, either by reducing or losing revenue accruing from own resources collected directly on behalf of the Communities, or by an unjustified item of expenditure.’

⁴³ §1 Supplementary Provisions, item 6 of the FMCPSA:

‘Fraud affecting the financial interests of the European Communities’ shall mean any intentional act or omission:

a) **in respect of expenditure** related to the use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds from the general budget of the European Communities or budgets managed by, or on behalf of, the European Communities; non-disclosure of information in violation of a specific obligation, with the same effect; misapplication of such funds for purposes other than those for which they have been originally granted;

b) **in relation to revenue**, related to the use or presentation of false, incorrect, or incomplete statements or documents, which has as its effect the wrongful reduction of funds from the general budget of the European Communities or budgets managed by, or on behalf of, the European Communities; non-disclosure of information in violation of a specific obligation, with the same effect; misappropriation of a legally obtained benefit with the same effect.

⁴⁴ See **Янкулова, С.** Практика на Върховния административен съд относно решаването на спорове по усвояване на средства от фондове на Европейския съюз. // Адвокатски преглед, 2018, № 1.

on the basis of Article 120 of the Constitution of the Republic of Bulgaria; **administrative courts control the legality of the acts and actions of the administrative bodies managing public resources under the EU funds.**

Relations within the management and control system of public resources from European funds in shared management and the funds of the Common Agricultural Policy are regulated by an authoritarian method of legal regulation, since one of the subjects is always the state, represented by its respective state body. The authoritarian method of legal regulation predetermines the organisation of legal relations within the system of public resources managed under shared management. The powers of the authorities in the system (Managing Authority, Accounting Authority, Audit Authority and Paying Agency) are defined in the EU acts, some of them mentioned above. The functions of and procedures for determining these authorities are set out in the Financial Regulation, the sectoral regulations on cohesion and the Common Agricultural Policy, respectively national legislation. Each Member State builds its own institutional model of resource management in shared management, based on current legislation and its constitutional regulations. The European Public Prosecutor's Office is an independent body of the European Union responsible for **the investigation and prosecution of crimes against the EU's financial interests**, including: fraud; corruption; money laundering; cross-border VAT fraud. It **commenced activity on 1 June 2021**. EU institutions and bodies, as well as the competent authorities of the 22 Member States participating in the European Public Prosecutor's Office, must report to it of any criminal behaviour affecting the EU budget. Individuals may also report suspected cases of fraud and other crimes. The EC, OLAF, Eurojust and Europol do not have the mandate to conduct criminal investigations.

Implementation of the normative and strategic documents of the EU and the Member State is a guarantee for effective and efficient management of EU funds, as the measures of the European Commission on the protection of the EU budget aim to ensure that only legitimate expenditure (i.e., expenditure incurred in accordance with applicable EU law, including national law) is co-financed by the EU budget. First of all, management and control authorities and the competent national executive authorities have the obligation to prevent, detect and correct irregularities deriving from current regulations. If the EC discovers that irregular expenditure

was co-financed or is likely to be co-financed, it can intervene and apply **corrective measures to such co-financed expenditure** or prevent, through **preventive measures, the future co-financing** of irregular expenditure in the declarations of expenditure.

MRESIFA introduces the concepts of ‘irregularity’, ‘suspected fraud’ and ‘fraud’ (e.g., in Article 34(4)(2), Article 64(1), Article 70(1), Article 73(1) MRESIFA; ‘general administrative acts’ – application guidelines within the meaning of Article 26 MRESIFA; by-laws), **including ‘administrative contracts’**.

An indisputable contribution of MRESIFA is that it contains the first definition of the ‘administrative contract’ as a legal institution.⁴⁵ Following the adoption of MRESIFA (currently bearing the name Management of Resources from European Funds under Shared Management Act), the administrative contract found legal regulation in Article 19a–19g of the Administrative Procedure Code (APC). Relations are intended to arise on the basis of two different institutes of administrative law:

- *the administrative contract, which is the main form in the provision of grant-in-aid⁴⁶ (resp. order);*
- *the individual administrative act, which determines the basis and size of financial corrections.*

It should be noted that 80% of the irregularities and financial corrections **are due to violations in the award and execution of public contracts. The practice of the Supreme Administrative Court (SAC) in this field is the richest in the scope of public procurement irregularities** (see

⁴⁵ Decision No. 2126/30.03.2015 under administrative case No. 8513/2013 of Sofia City Administrative Court: *‘The MAs under the OP are legally entrusted with the functions of approving projects and spending public funds (of mixed origin – in the case of co-financing between the state budget and ERDF). The combination of the capacity of a state body and financial resource administrator (state and European) defines it as a subject of public law – a holder of powers of an administrative nature, regardless of its entry into the complementary status of a party to a contract... This function of the contract does not change the nature of the legal relationship (equivalent to the concept of ‘administrative contract’ developed by the theory, the features of which have not yet found legal expression)’*.

⁴⁶ See: Решение № 13764/16.12.2015 по адм. дело № 7197/2015, 7 отд. на ВАС; Решение № 1915 от 19.02.2016 по адм. дело № 13687/2016 на 5-членно жури, 2 отд. на ВАС, etc.

Chapter 24 regarding public procurement issues and Chapter 22 regarding financial control in this field).

It is clear from current legislation and judicial practice that **the procedure for financial support of projects under operational programmes takes place in three phases:**

- 1. approval, resp. rejection of the application for assistance;*
- 2. provision of grant-in-aid (based on an order or administrative contract) and verification;*
- 3. determination of the basis and amount of the financial correction,⁴⁷ respectively confiscation of grant-in-aid through voluntary execution, forced execution and other repayment methods provided for in current legislation.*

The violation of Community and/or national law, through which an irregularity is committed, is qualified according to the normative act in force at the time of the violation, and the basis and amount of the financial correction – as of the date of issuance of the financial correction act (Decision No. 15953 of 29 December 2020 of the SAC under administrative case No. 6056/2020, 7th department). Neither national legislation, nor the legislation of the European Union requires the existence of actual harm. Failure to comply with the rules for awarding public procurement constitutes an irregularity, only if it has, or would have, the effect of prejudicing the budget. Therefore, such an infringement must be considered to be an irregularity insofar as it is capable, as such, to have a budgetary impact, and there is no requirement that the existence of a specific financial impact be demonstrated (see paragraphs 44 and 45 of Judgment C-406/14). This conclusion follows from the literal linguistic interpretation of the expression ‘has, or would have’.

⁴⁷ In national legislation, Articles 69–77 MRESIFA regulate the procedure for **administering irregularities and imposing financial corrections**. Pursuant to §8 of the Transitional and Final Provisions of MRESIFA, the old Ordinance on Determining the Procedures for the Administration of Irregularities under Funds and Programmes co-financed by the EU retains its effect during the new 2014–2020 programming period, as it has a broader subject of regulation, while the new Ordinance on the Administration of ESIF Irregularities concerns only the five funds included in the scope of the Common Provision Regulation (CPR).

In each of the phases, the beneficiary⁴⁸ can seek judicial protection against illegal acts and actions by the governing body, with administrative courts exercising control over legality. Last but not least, the general provision regulating the procedure for establishing public receivables is Article 166 of the Tax and Social Security Procedure Code (TSSPC). On the basis and under the terms of Article 166, in conjunction with Article 162(2), item 8 TSSPC,⁴⁹ an individual administrative act (statement of public claim) must be issued, the role of which is played by the decision under Article 73(1) MRESIFA,⁵⁰ but the same is not listed among the enforcement grounds under Article 209 TSSPC. Following final payment for the project, the outstanding financial corrections are a public claim according to Article 162(2)8 TSSPC.

In practice, there was a dispute as to whether the financial correction is **an administrative measure, materialised in an individual administrative act, which in turn determines, by reason and amount, whether the correction is a sanction.** This dispute was resolved by the adoption of Judgment of the Court of Justice of the European Union (Fifth Panel) of 26 May 2016 in joined cases C-260/14 and C-261/14, according to which Article 98 § 2 of Regulation No. 1083/2006 must be interpreted as meaning that the financial corrections that Member States are required

⁴⁸ The beneficiary is the recipient of the aid – there is no definition of the term in national legislation, but it is clear from the content of MRESIFA that the legislator uses it with the exact opposite meaning as that defined in EU regulations, which have as their subject public relations related to resources from EU funds. In MRESIFA, the recipient of the aid is called a ‘beneficiary’, but the beneficiary is the legal entity that provides the funds, not the one that receives them. (**Решение № 7116 от 7.06.2017 на ВАС по адм. дело № 10738/2016, 7 отд.**)

⁴⁹ See Решение № 1128 of 21.01.2017 по адм. Дело № 9183/2016, 7 отд. на ВАС.

⁵⁰ The decision on financial correction can be contested before a court according to the procedure of the APC and the provisions of Article 27(2) and (3) and para. (5)– (7). (See Решение № 473 от 16.01.2017 адм. д. № 9161/2016, 7 отд., ВАС; Решение № 219 от 01.01.2017 адм. д. № 9165 /2016, 7 отд., ВАС; Решение № 9251 от 27.07.2016 по адм. Дело № 6588/2016, 7 отд., ВАС; Решение № 5964 от 26.09.2016 по адм. дело № 4909/2016 на АССГ, 3 отд., 7 състав; Решение № 1848/14.02.2017 по адм. дело № 10458/2015, 7 отд., ВАС. Disputing does not stop payment: Решение № 6304 от 27.05.2016 по адм. дело № 4728/2016 на ВАС; Решение № 6362 от 30.05.2016 по адм. дело № 4584/2016 на ВАС; Решение № 6569 от 2.06.2016 по адм. Дело № 6247/2016 на ВАС, Решение № 6865 от 06/08/2016 по адм. дело № 4964/2016 на ВАС.).

to adopt due to an irregularity affecting the co-financed operation are an **‘administrative measure’**⁵¹ within the meaning of Article 4 of Regulation No. 2988/95. **In other words, the factual composition of an irregularity should be present in order for a financial correction (FC) to be imposed through a unilateral authoritative declaration of will** in the form of an individual administrative act issued by the head of the MA under Article 73(1) MRESIFA, **based on which the wrongly obtained advantage can be withdrawn** in accordance with Article 4 of Council Regulation (EC, EURATOM) No. 2988/95 of 18 December 1995 on the protection of the European Communities financial interests. Establishing the irregularity is a precondition for issuing the individual administrative act. **In the judicial practice of the Supreme Administrative Court (SAC), the factual composition of an irregularity has already been examined and the conclusions provided in the grounds of the Court’s decisions under many of the cases can be applied elsewhere.**⁵² *FC can be cumulated with administrative penal liability and administrative penalty (fines and property sanctions) and with the obligation to pay interest (as per Article 162(2), item 9 TSSPC). FC are not an administrative sanction. They are also not a penalty under the administrative contract. The principle of the more favourable law does not apply.*

When determining the financial correction by basis and amount, the MA applies the principles of sound financial management, legality and proportionality, i.e., implements the Financial Regulation and the principles established therein, further developed in sectoral regulations. The statute of limitations under the TSSPC is 5 years, and the absolute statute of limitations is 10 years (Article 171 TSSPC). See decision under case 341/13 (When a Member State uses the option granted to it by Article 3(3) of Regulation No. 2988/95, the principle of proportionality does not allow

⁵¹ See: Решение № 2761 of 07.03.2017 по адм. дело № 13784/2016 of SAC, 5-членно жури, 2 отд.; Решение № 2761 от 07.03.2017 по адм. дело № 13784/2016 на ВАС, 5-членно жури, 2 отд., etc.

⁵² See in detail the case law of the SAC on irregularities and financial corrections, Chapter nine: **Съдебна практика по закона за управление на средствата от европейските структурни и инвестиционни фондове**. Академия по устойчиви инвестиции и финанси. Сборник с учебни материали. 2022. Available at: <https://elearn.uni-sofia.bg/mod/folder/view.php?id=956965> [Accessed on 15 January 2024].

the application of a thirty-year limitation period for the return of a tax illegally received from the Union budget (C-465/10 and C-465/10).⁵³

The financial correction is an administrative measure, which is a unilateral authoritarian statement of will of the administrative body, materialised in the individual administrative act. The basis for determining FC is an irregularity detected by the head of the MA (cases of irregularities, Article 70(1) MRESIFA). FC consists of withdrawing the wrongfully obtained advantage by means of prescribed methods. The application of the measures is limited only to the withdrawal of the advantage, plus interest, if interest is provided, at a fixed interest rate. The measures are not regarded as sanctions and are aimed only at the impossibility of obtaining an advantage or its withdrawal. The individual administrative act also plays the role of an act establishing public state claims, by determining the financial correction by basis and amount as a public state claim within the meaning of Article 162(2), items 8 and 9 TSSPC. The methods for calculating financial corrections are: **proportional** (a certain percentage is applied on eligible costs, representing ESIF funds and the corresponding national co-financing without own contribution, to determine the amount of the FC (e.g., see Decision No. 3237/14.03.2018 SAC under administrative case No. 8148/2017); **differential** – for irregularities under Article 70(1), items 2, 8 and 10 MRESIFA. **Is it only the financial support from ESIF that is cancelled or is national co-financing included?** (Decision No. 400 of 12.01.2017 under administrative case No. 8135/2016, VII Dept., SAC; Decision No. 2471 of 27.02.2017 under administrative case No. 13298/2016; Decision No. 6028/15.05.2017 under administrative case No. 14581/2016 of the Seventh Department, SAC.) **The legislator has ruled on the question of what forms the basis for determination of financial corrections. National co-financing is also included, but without the beneficiary's own contribution.**⁵⁴ **The FC is determined, in terms of**

⁵³ Regarding the statute of limitations for financial corrections, see Решение № 7183 от 28.06.2023 на ВАС по адм. дело № 11436/2022, 7 отд.

⁵⁴ See Article 1(2) MRESIFA (Amended, SG No. 85 of 2017, amended, SG No. 51 of 2022, effective as of 01.07.2022, amended, SG No. 102 of 2022, effective as of 01.01.2023) 'Resources from ESMF within the meaning of this Act are resources from the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund, the funds for the financing of the Community-led Local Development

basis and amount, by means of a reasoned decision of the head of the MA (on the issue of reasons, see the Charter, Article 41(1), letter ‘c’; the Financial Regulation, sectoral regulations, the principle of sound financial management, principles in MRESIFA, Article 59(2) APC). The court must verify the legality of the act determining the FC in terms of basis and amount on the grounds established in Article 146 APC in conjunction with Article 168 APC. It is the burden of the head of the MA to prove that all the elements of the FC and the basis for its calculation are in place, as well as to provide reasons for the type and amount of the correction.

The lack of factual and legal grounds for issuance of the act determining FC is grounds for annulment of the act (Decision No. 5174 of 20.04.2018 under administrative case No. 12367/2017 of the SAC). **The factual composition of an irregularity must be in place for a financial correction to be imposed by means of a unilateral authoritative statement of will,** materialised in an individual administrative act, issued by the head of the MA under Article 73(1) MRESIFA, **which will serve to withdraw the wrongly obtained advantage. The elements of the factual composition of an irregularity have been examined from an objective point of view in the practice of the Supreme Administrative Court** (See, for example, Decision No. 14420/30.12.2016 under administrative case No. 6844/2016 of the SAC):

1. *action or inaction of an economic operator;*
2. *which leads to a breach of the EU law or national law related to its application,*
3. *which has or would have the effect of causing damage to the general budget of the Union by accounting for unjustified expenditure in the general budget.*

Regarding damages, **the presence of real damage is not required.** An irregularity can also exist when there is only the possibility of causing damage to the general budget, and there is no requirement to prove the

(CLLD) approach of the European Agricultural Fund for Rural Development, the European Maritime, Fisheries and Aquaculture Fund, the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy provided under the programmes of the Republic of Bulgaria. The national co-financing provided for in the programmes shall also be considered as ESF funds.’

existence of a specific financial impact (C-199/03, C-406/14). Neither national legislation, nor the legislation of the Union, and in particular Regulation No. 1303/2013, respectively Regulation No. 1083/2006 in view of Article 152 of Regulation No. 1303/2013, sets as a requirement the existence of actual damage. This interpretation is permanently established in the practice of the Court of the European Union given on the occasion of the identical definitions in Regulation No. 2988/1995, Regulation No. 1083/2006 and other sectoral regulations (see *Judgment of the Court (Second Chamber) of 15 September 2005. Ireland v Commission of the European Communities. C-199/03*, EU:C:2005:548, paragraph 31; *Judgment of 21 December 2011 in Chambre de commerce et d'industrie de l'Indre, C-465/10*, EU:C:2011:867, paragraph 47, as well as the latest Wrocław judgment, EU:C:2016: 562, paragraph 44, and, as the defendant points out, *Judgement Firma, C-59/14*, EU:C:2015:660, paragraph 24).

According to the practice of the Bulgarian Supreme administrative court, *Judgement under administrative case No 4803/2021*, the Supreme Administrative Court distinguishes the infringement of applicable law as one of the three cumulative elements of an irregularity and notes that the basis for the determination of FC is not the violation of applicable law, but the irregularity, upon examination of all three elements of its factual composition. According to the definition of irregularity, it is not necessary for there to be evidence of actual damage to the Union budget. The potential possibility of such is sufficient and, where the case concerns non-compliance with procurement rules, an irregularity exists 'insofar as the possibility cannot be excluded that the failure will have an impact on the budget of the Fund' – *Judgment of 14 July 2016, Wrocław, C-406/14*, EU: C: 2016: 562, paragraph 45 (see: ***Decision of the Supreme Administrative Court in Case No 4803/2021***). Since the financial impact of the infringement on Community budget is an element of the factual composition of the irregularity, its absence is a ground for termination of the procedure for lack of irregularity. If the infringement has no financial impact, an element of the factual constitution of the irregularity will be missing and therefore no irregularity will be in place (***Decision of the Supreme Administrative Court in administrative case No 11019/2019***). It is inadmissible to set a zero-percentage indicator of correction, since a correction is set in the presence of an irregularity and in the absence of damage there is no irregularity. *MEFSMA* regulates two methods of

determining the amount of the FC: proportional and deferential. The former is used when it is not possible to determine the actual financial impact on the Community budget – Article 72(3) *MEFSMA* (title amended in SG 51/22). The statutory percentage of the correction is applied to the basis for FC calculation, which is the amount of eligible expenditure representing resources from ESIF (following amendment of Article 1(2) *MRESIFA*, SG No. 85/2017, the basis also includes national co-financing) for the 2014–2020 programming period. Following the amendment promulgated in SG 51/22, for the 2021–2027 programming period this basis refers to eligible costs representing ESMF funds. See *Decision of the Supreme Administrative Court in administrative case No 9372/2017*. The amount of the financial correction should be determined in accordance with the provisions of Article 72 *MEFSMA*. The differential method for FC calculation is used where it is possible to determine the actual financial impact of the irregularity on the Community budget – Article 72(2) *MEFSMA* (title amended in SG 51/22). Pursuant to Article 70(3) *MEFSMA* – new, SG 51/22, for irregularities under para. (1), items 1, 3–7 and 9, FC shall be determined by the proportional method when the amount of the actual financial consequences of the infringement cannot be established, and for irregularities under para. (1), items 2, 8 and 10, the differential method shall apply.

‘Fraud’ is a type of ‘irregularity’. The difference between ‘irregularity’ and ‘fraud’ lies in the element of intent: irregularity is a situation in which the implementing rules (national law or EU law) are objectively not followed; fraud is a situation in which the rules of implementation (national law or EU law) are **deliberately** not observed and the act is carried out with a special purpose: **obtaining an advantage**. Therefore, **fraud affecting the Union’s financial interests constitutes a criminal offence when committed intentionally**. **‘Suspected fraud’ is an irregularity that leads to the initiation of administrative or judicial proceedings at national level to establish whether intentional conduct is involved.** Public interest and the protection of the EU budget naturally predetermined the establishment of the European Public Prosecutor’s Office (EPPO) at EU level, **as it appeared that the fight against fraud at national level was ineffective**. The Office commenced effective operation with the start

of the new 2021-2027 programming period. **Currently, only national authorities have the power to investigate and prosecute crimes against the EU budget, but their powers stop at national borders.** Existing EU bodies such as Eurojust, Europol and OLAF do not have the necessary powers to carry out criminal investigation and prosecution. Administrative investigations to protect the financial interests of the EU are carried out by the AFCOS services in the EU, in accordance with their assigned competence, and OLAF; and criminal investigation and prosecution – by the EPPO and national prosecution authorities, in the cases excluded from the scope of Regulation 2017/1939. Article 2 of Directive (EU) 2017/1371 of the European Parliament and of the Council of 5 July 2017 on the fight against fraud to the Union's financial interests by means of criminal law, which was adopted in 2017 and had to be transposed by the Member States by mid-2019 also applies.

There should be no confusing of verification and financial correction procedures. The verification is a check of the admissibility of expenses – Article 62(1) MRESIFA, while the financial correction is the cancellation of financial support due to an irregularity committed by the beneficiary – Article 71(1) MRESIFA. Cost verification proceedings are regulated in Articles 60–68 MRESIFA. According to these provisions, interim and final payments are made following verification in order to confirm the eligibility of incurred costs and in the presence of physical and financial progress of the project. **Only eligible costs verified by the managing authority** are reimbursed through interim and final payments. According to Article 62(3) MRESIFA, the MA verifies the expenditure based on verification of the documents submitted with the payment request and on-the-spot checks, where applicable. The general conditions for admissibility of expenses are regulated in Article 57 and Article 58 MRESIFA. According to Article 59(1) MRESIFA the specific national rules and the detailed rules for admissibility of costs for the relevant programming period for each programme under Article 3(2) of the Act are determined by a normative act of the Council of Ministers. According to Article 62(1) MRESIFA interim and final payments are made after verification in order to confirm the admissibility of the incurred expenses, and according to Article 71(1) MRESIFA, by carrying out financial corrections, the financial support provided under Chapter Three with resources under shared management is **cancelled or the amount of funds spent is reduced – allowable costs per**

project. That is, a financial correction is determined only on admissible, respectively – verified costs, **and the presence of an irregularity constituting a basis for determining a financial correction cannot be a reason for refusing verification; the court cannot verify. The court cancels the act and returns it to the administrative body for a ruling. Verification is carried out at the request of the beneficiary. It is within the powers of the court under the APC to rule on monetary claims resulting from the established illegality of an administrative act outside the scope of the State and Municipal Liability for Damages Act, as long as there is a claim objectively joined with the complaint. MRESIFA prohibits this, that is why the court returns the file (See Decision No. 5499 Sofia, 26.04.2018 under administrative case No. 4908/2017 of the SAC, 7th Dept.).**

The Ordinance on the Specification of Irregularities constituting Grounds for Financial Corrections and the Percentage Indicators for determining the Amount of Financial Corrections under the procedure set out in MRESIFA specifies the cases of irregularities constituting violations of the rules for contractor election under Chapter Four of MRESIFA, carried out through actions or inactions by the beneficiary, which have or would have the consequence of causing damage to ESIF funds and which constitute grounds for imposing a financial correction under Article 70(1), item 9 of MRESIFA; the minimum and maximum values of the percentage indicators of the financial corrections determined for irregularities on the basis of Article 70(1), items 1, 3–7 and 9 of the MRESIFA. The Ordinance on the Administration of Irregularities under ESIF and the Ordinance on the Procedures for the Administration of Irregularities on Funds, Instruments and Programs Co-financed by the EU are also applicable.

The FMCPA introduces the concepts of irregularity and fraud, through the definitions of irregularity and fraud affecting the financial interests of the European Communities. At the same time, fraud under national legislation is a crime punishable under the Criminal Code, the composition of which has similarities, but also differences, with that of the definition under the FMCPA. Regardless of differences in definition, irregularities and fraud are wrongful acts that result in property damage to public sector organisations. In this regard, organisations must develop

and implement internal control systems aimed at preventing, detecting and correcting the consequences of fraud and irregularities.

III. RECOVERY AND RESILIENCE FACILITY AND PROTECTION OF FINANCIALS INTERESTS OF THE EU

1. Introduction

Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing a Recovery and Resilience Facility⁵⁵ establishes an instrument that provides for direct financial support linked to the achievement of results and the implementation of reforms and public investments of the Member States in response to challenges identified in the context of the European Semester, including the European Pillar of Social Rights and the UN Sustainable Development Goals, and with a view to having a lasting impact on the productivity and economic, social and institutional resilience of Member States.

Bulgaria submitted its Recovery and Resilience Plan (RRP) on 15 October 2021. The Commission's positive assessment on 7 April 2022 and the Council's approval on 4 May 2022 paved the way for €6.3 billion in grants under the Recovery and Resilience Facility (RRF) for the period 2022-2026.

Member States were invited to effectively implement all or a substantial part of the relevant country-specific recommendations made by the Council in 2019 and 2020 in their RRP.

The latest Report on Bulgaria for 2022 dated 23 May 2022, accompanying the Council's recommendation on Bulgaria's national reform programme for 2022 and containing the Council's opinion on Bulgaria's convergence programme for 2022,⁵⁶ indicates that at this early stage of the RRP implementation, overall 53% of the CSRs subparts of the country-specific recommendations,⁵⁷ focusing on structural issues in 2019 and

⁵⁵ OJ L 57, 18.2.2021, p. 17–75, <https://eur-lex.europa.eu/legal-content/BG/TX-T/?uri=CELEX%3A32021R0241> [Accessed on 15 January 2024].

⁵⁶ https://ec.europa.eu/info/sites/default/files/com_2022_366_1_bg_act_part1_v2.pdf [Accessed on 15 January 2024].

⁵⁷ <https://eur-lex.europa.eu/legal-content/BG/TXT/?qid=1627675454457&uri=CELEX%3A32021H0729%2802%29> and <https://eur-lex.europa.eu/legal-content/BG/TXT/?>

2020 have recorded at least ‘some progress’, while 47% recorded ‘limited progress’ (see pp. 28–30 in Appendix 4: Progress in implementation of the country-specific recommendations). The report states that in the coming years significant further progress is expected in the implementation of the structural country-specific recommendations in relation to the further implementation of the recovery and resilience plan.

The European Commission’s assessment of Bulgaria’s monitoring and control measures was based on systems that had not yet been implemented. In line with the RRF Regulation, the Commission must ensure that Member States have put in place appropriate control systems to protect the EU’s financial interests. Audit and control measures within the RRF rely mainly on the respective systems of each Member State. Member States must provide sufficient information on the control systems they will put in place, in particular to confirm compliance with the basic principles of sound financial management.

Criteria for evaluating Member States’ control measures:⁵⁸

- the internal control system described in the RRP is based on robust processes and structures and identifies clear participants (bodies/entities) and their roles and responsibilities; it ensures appropriate segregation of relevant functions;
- the control system and other relevant arrangements, including for the collection and making available of data on final recipients described in the recovery and resilience plan, in particular to prevent, detect and correct corruption, fraud and conflicts of interests when using the funds provided under the Facility are adequate;
- the arrangements described in the recovery and resilience plan to avoid double funding from the Facility and other Union programmes are adequate; and
- the actors (bodies/entities) responsible for controls have the legal empowerment and administrative capacity to exercise their foreseen roles and tasks.

qid=1526385017799&uri=CELEX%3A32020H0826%2802%29.[Accessed on 15 January 2024].

⁵⁸ Appendix V, Section 2.10 of the RRF regulation.

The European Commission has drawn up guidelines for Member States and has provided a self-assessment checklist which is Soft Law: Commission guidelines for Member States – recovery and resilience plan.⁵⁹

The types of financing and methods of implementation according to **Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing a Recovery and Resilience Facility** should be chosen on the basis of their ability to achieve the specific objectives of the actions and to deliver results, taking into account, in particular, the costs of controls, the administrative burden, and the expected risk of non-compliance. Non-repayable financial support under the Facility should take the form of a *sui generis* Union contribution to be determined on the basis of a maximum financial contribution calculated for each Member State and considering the estimated total costs of the recovery and resilience plan, which should be paid based on the achievement of results by reference to milestones and targets of the recovery and resilience plans.

Therefore, this contribution should be established in accordance with the sector-specific rules under the simplification rules on Financing not linked to costs, provided for in Article 125(1) of the **Financial Regulation**. The relations under the RRF follow rules and procedures in compliance with the general principles of budget management according to the Financial Regulation, regarding the distribution, implementation and control of non-reimbursable financial support.

It is primarily **the responsibility of the Member State to ensure that the Facility is implemented in accordance with applicable Union and national law**. For this to happen, when implementing the Facility, Member States should ensure the functioning of an effective and efficient system of internal control over refund amounts unlawfully paid or improperly used.

Unlike Regulation (EU) 2021/1060 of the European Parliament and of the Council of 24 June 2021 establishing the provisions of general application for the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime and Fisheries Fund and aquaculture, as well as the financial rules for them and

⁵⁹ https://ec.europa.eu/info/sites/default/files/document_travail_service_part1_v2_en.pdf [Accessed on 15 January 2024].

for the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy⁶⁰ (hereinafter referred to as CPR),⁶¹ **Regulation (EU) 2021/241** of the European Parliament and of the Council of 12 February 2021 establishing a Recovery and Resilience Facility **does not contain specific requirements regarding the management and control systems of the bodies involved in the management and control of funds under the RRF**. This circumstance creates additional difficulties for the national legislator and the executive power when organising the management and control systems. This weakness in the legal framework at European level is transferred to national level, because there are only guidelines of the European Commission, which are Soft Law.⁶² Overcoming these difficulties can be sought in the direction of adopting the good practices and lessons learned from the two previous programming periods regarding the management and control systems of the bodies in the system of managing funds under shared management, regulated by regulations for generally applicable provisions.⁶³

2. National legislation

MRESIFA **is not part of the legal framework of relations under the Recovery and Resilience Plan**,⁶⁴ because the funds under the plan are managed under direct management. The provisions of the APC apply.

⁶⁰ See Annex XI Key Requirements of Management and Control Systems and Their Classification – Article 69(1); Annex XII Detailed Rules and Template for the Reporting of Irregularities – Article 69(2) and (12); Annex XIII Elements for the Audit Trail – Article 69(6); Annex XVI Template for the Description of the Management and Control System – Article 69(11), etc.

⁶¹ OJ L 231, 30.6.2021, 159–706.

⁶² Commission Guidelines for Member States – Recovery and Resilience Plans.

⁶³ For the 2014–2020 programming period, Regulation (EU) No. 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down provisions of general application for the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down common provisions for the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006.

⁶⁴ See: The relations regarding the implementation of the Recovery and Resilience Plan should be regulated by law

<https://news.lex.bg/%D0%BE%D1%82%D0%B%D0%BE%D1%88%D0%B5%>

Relationships are regulated by by-laws as follows:

- Decree No. 114 of the Council of Ministers of June 8, 2022 laying down detailed rules for the disbursement of Recovery and Resilience Facility funds to final beneficiaries;
- Decree No. 80 of the Council of Ministers of May 9, 2022 laying down the rules for the procurement of investment activities by final recipients of funds from the RRF;
- Decree No. 157 of the Council of Ministers 7 July 2022 designating the bodies and structures responsible for the implementation of the RRP of the Republic of Bulgaria and their main functions;
- Decision No. 568 of the Council of Ministers 2 August 2021 on the organisation and coordination of the participation of the Republic of Bulgaria in the EU's RRF;
- Decision No. 719/2021 of the Council of Ministers approving the National Recovery and Resilience Plan of the Republic of Bulgaria, outlining the assistance from the EU's RRF.

Depending on the role of the organisation in the implementation of the RRP, there are 3 hypotheses: it implements an investment/reform as a final recipient (FR); is responsible for the selection, in the cases where such is foreseen, for the negotiation of financing with final recipients, for the summarisation of financial and technical information and for implementation of control over the financial and technical implementation of the investments as a MRS; it monitors the implementation of the stages and goals of investments and reforms as a Monitoring Structure (MS).

There are Monitoring and Reporting Structures (MRS): when the investment or part of it is implemented through selection or requires negotiating of financing with the FR, the relevant line ministry performs the functions of MRS; if a given investment requires its implementation to be ensured through the provision of funding to a FR for specific activities to be implemented through FR selection and for the implementation of which

D0%BD%D0%B8%D1%8F%D1%82%D0%B0-%D0%BF%D0%BE-%D0%B8%D0%B7%D0%BF%D1%8A%D0%BB%D0%BD%D0%B5%D0%BD%D0%B8%D0%B5-%D0%BD%D0%B0-%D0%BF%D0%BB%D0%B0%D0%B-D%D0%B0-%D0%B7%D0%B0/ [Accessed on 15 January 2024].

different ministries are responsible, the specific rights and obligations are regulated in the operational agreement between the MF and the relevant line departments.

The head of the MRS is: The minister or the head of a department appoints the MRS responsible for the control and compilation of financial and technical information on the investment for which he/she is responsible under the agreement with the Ministry of Finance; the head of the MRS is the head of the line ministry/department that has signed an agreement with the Ministry of Finance, or a person designated by him; in the event that the same ministry is responsible for more than one investment, its head may designate one MRS for all investments, setting up the relevant organisation to ensure all monitoring, control, summary and reporting processes of the investments, according to the signed agreements with the MF.

When concluding an operational agreement with the Ministry of Finance, the head of the department within which the MRS is appointed, guarantees the administrative capacity to perform the functions of the MRS. The persons responsible for performing preliminary and subsequent control must be independent from the Contracting Authority in the performance of their functions. The MRS carries out preliminary control of key elements of the award of public contracts in accordance with the Public Procurement Act (PPA). This preliminary control covers procedures whose values are greater than or equal to those specified in Article 20(1) of the PPA.⁶⁵ In the cases in which the Public Procurement Agency (PPAg) carries out control in accordance with Article 229(1), item 2, letter 'd' in conjunction with Article 232 PPA, respectively according to the procedure set out in Article 229(1), item 2, letter 'e' in conjunction with Article 235 PPA, MRS carries out control only for compliance with the principle of 'do no significant harm'. The MRS carries out a review to obtain assurance that the contracting authority, where applicable, has provided, in the technical specification, measures containing conditions related to the principle of 'do no significant harm' within the meaning of Article 17 of Regulation (EU) 2020/852 of the EPPO and of the Council of June 18, 2020. The activities subject to the order should have a minor

⁶⁵ Regarding Public Procurement issues, see Chapter 19.

predictable impact on the environment. In the event that contracting authorities use standardised requirements and documents for the selection of a contractor for construction, delivery or service, agreed by the Ministry of Finance, or if they use the dynamic procurement systems and electronic catalogues provided for in the PPA, prior control of public procurement documentation is not carried out by the MRS.

In the event that an investment implemented by the MRS includes the award of activities for which the Contracting Authority is the MRS, preliminary control is carried out by the National Fund Directorate.⁶⁶ The MRS carries out subsequent control over completed procedures for the selection of a contractor in accordance with the PPA or Decree No. 80 of the Council of Ministers of May 9, 2022 laying down the rules for the procurement of investment activities by final recipients of funds from the RRF based on a risk assessment. In the event that the procedure is the subject of preliminary control, the opinion with which such preliminary control was concluded is considered by the examining expert. When indicators of fraud, corruption or conflict of interest and double financing are identified in the course of MRS control activities, the procedure for reporting serious irregularities is applied.

Corrective actions are imposed in the case of serious irregularities (embezzlement of payments from the MRS with funds from the RRF to the FR, fraud or corruption (bribery), concerning an investment by the RRP), established by an act of the competent authority – the inspectorate at the relevant primary budget authoriser or the *Counter-Corruption and Unlawfully Acquired Assets Forfeiture Commission* (CCUAAFC). In case of suspicion of fraud, corruption or conflict of interest in respect of an official in connection with the performance of his/her official functions and concerning the implementation of an investment under the RRP, the person must be excluded from carrying out activities in respect of that project.

Depending on the nature of the serious irregularity, the competent authorities to carry out an investigation in order to establish a crime or violation and a subsequent investigation in accordance with the Code of Criminal Procedure are: in case of suspicion of fraud, corruption (bribery)

⁶⁶ <https://www.minfin.bg/bg/55> [Accessed on 15 January 2024].

or conflict of interests (related parties) – The Prosecutor’s Office of the Republic of Bulgaria and the European Prosecutor’s Office; in case of suspected conflict of interest under Article 52 of the *Counter-Corruption and Unlawfully Acquired Assets Forfeiture Act* – the inspectorate at the relevant first-tier administrator or the CCUAAFC. In the case of gaps in the application of the principle of sound financial management under the RRP, outside the cases of indicators of serious irregularities, when indicators of violations of the normative acts that regulate budgetary, financial and economic or reporting activities, as well as the assignment and implementation of public procurements from the FR are in place, the information is processed to PFI Ag. PFI Ag carries out inspection activities according to the rules of the PFIA and works to establish violations under the PPA (see Chapter 17).

IV. RULE OF LAW AND PROTECTION OF FINANCIALS INTERESTS OF THE EU

1. Fundamentals

The Rule of Law is the backbone of any modern constitutional democracy. This is one of the basic principles stemming from the common constitutional traditions of all EU Member States and, as such, one of the fundamental values on which the Union is founded. Currently, Regulation (EU, Euratom) 2020/2092 of the European Parliament and of the Council of 16 December 2020 on a general regime of conditionality for the protection of the Union budget lays down the rules for the protection of the Union budget in the event of breaches of the Rule of Law in Member States. It applies where other procedures provided for in Union law do not allow for more effective protection. Currently, the EU is trying to protect its values through the mechanisms of Article 7 TEU, Article 258 TFEU and the options provided in the new Rule of Law Framework, which, however, appear insufficiently effective in practice.

EU Values are enumerated in Article 2 TEU (democracy, the rule of law and fundamental rights) *‘The EU, as its power has increased, also*

needs to address questions of democracy, accountability, respect for fundamental rights and for national and local diversity. It should not be measured against the same benchmarks of legitimacy as a State, as it will always fail, but it does need to achieve legitimacy. It needs, in short, values. And its Treaties aspire to grant it values. The author concludes ‘I hope the EU will be able to live up to its values’⁶⁷

The Republic of Bulgaria shall be a State governed by the rule of law, by the Constitution and by the laws adopted by Parliament (Article 4(1) of the Bulgarian Constitution). Bulgaria shall guarantee the life, dignity and rights of the individual and shall create conditions conducive to the free development of the individual and of civil society (Article 4(2)). The power of the State shall be divided to legislative, executive and judicial branches (Article 8 of Constitution). Fundamental rights are listed in Articles 25–61 of the Constitution. The rule of law is a dynamic concept that predetermines the lack of its definition in positive law and the lack of regulation of its main features (Decision No 1/2005 in constitutional case No 8/2004). The values are also contained in EU law, including basic legal principles and rights of the EU (the Charter of Fundamental Rights of the EU, including the European Convention on Human Rights), including in the practice of the Court of Justice of the EU. The Charter of Fundamental Rights is a horizontal enabling condition and monitoring for its effective implementation is carried out according to Regulation (EU) 2021/1060 of the European Parliament and of the Council of 24 June 2021 laying down common provisions on the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund and the European Maritime, Fisheries and Aquaculture Fund and financial rules for those and for the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy.

TEU Article 3(1) states that the Union **aims to promote peace, its values** and the well-being of its peoples. Article 3(2) expressly affirms that the Union provides its citizens with an area of freedom, security and justice without internal frontiers, in which the free movement of persons is ensured

⁶⁷ **Weatherill, S.** *Law and Values in the European Union*. Oxford University Press. Clarendon Law Series. 2016, Preface and p. 415.

in conjunction with appropriate measures with respect to external border controls, asylum, immigration and the prevention and combating of crime. According to Article 3(3) TEU, the Union establishes an internal market. It works for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment. It promotes scientific and technical progress. Article 3(5) notes that in its relations with the wider world, the Union will uphold and **promote its values** and interests and contribute to the protection of its citizens. It will contribute to peace, security, sustainable development of the planet, solidarity and mutual respect between peoples, free and fair trade, eradication of poverty and the protection of human rights, and in particular the rights of the child, as well as to the strict observance and the development of international law, including respect for the principles of the United Nations Charter. The Union respects the rights, freedoms and principles set out in the Charter of Fundamental Rights of the European Union of 7 December 2000, adapted on 12 December 2007 in Strasbourg, which has the same legal force as the Treaties (Article 6(1)). The provisions of the Charter do not extend in any way the areas of competence of the Union defined in the Treaties (Article 6(1)). **Fundamental rights**, as guaranteed by the European Convention for the Protection of Human Rights and Fundamental Freedoms of the Member States, **are part of Union law as general principles** (Article 6(3) TEU). Article 7 TEU **complements the protection of the fundamental values established in Article 2 TEU by providing a protection procedure in the event of ‘a clear risk of a serious breach by a Member State of the values referred to in Article 2 TEU’**.

At the same time, the Union has an institutional framework which aims to promote its values, advance its objectives, serve its interests, those of its citizens and those of the Member States, and ensure the consistency, effectiveness and continuity of its policies and activities, evident from the provision of Article 13(1) TEU. Last but not least, the Court of Justice of the EU ensures **compliance with the law** in the interpretation and application of the Treaties (Article 19(1)). Member States ensure effective protection, including in the implementation of the EU budget. And finally, Article 49 TEU provides **that any European State which respects the**

values referred to in Article 2 and is committed to promoting them may apply to become a member the Union. The requirement for **the rule of law** is among the core requirements for accession. Currently, negotiating chapter 23 ‘Justice and fundamental rights’ covers the *acquis* in this area.

2. The Rule of Law Regulation

Regulation (EU, Euratom) 2020/2092 of the European Parliament and of the Council of 16 December 2020 on a general regime of conditionality for the protection of the Union budget has its own place with regard to protection of the financial interests of the EU and its values. This was evidenced by recent ECJ practice with regard to the Rule of Law Regulation and the Judgments of the European Court of Justice of 16 February 2022: Hungary / Parliament and Council (C-156/21, EU:C:2022:97); Poland / Parliament and Council (C-157/21, EU:C:2022:98). When Member States implement the Union budget, including the resources made available through the European Union Recovery Instrument established by Council Regulation (EU) 2020/2094 (direct management) and through loans and other instruments guaranteed by the Union budget, whatever the method of implementation used, respect for the principles of the rule of law is an important prerequisite for compliance with the principle of sound financial management, enshrined in Article 317 TFEU. The **‘Rule of Law Regulation’**⁶⁸ is applicable when the other procedures provided for in the Union legislation do not ensure a more effective protection of the EU budget and a clear link between respect for the rule of law and the effective implementation of the EU budget in accordance with the principles of **sound financial**

⁶⁸ **‘The rule of law’** refers to the Union value enshrined in Article 2 TEU. It includes the principles of legality implying a transparent, accountable, democratic, and pluralistic law-making process; legal certainty; prohibition of arbitrariness of the executive powers; effective judicial protection, including access to justice, by independent and impartial courts, also with regard to fundamental rights; separation of powers; and non-discrimination and equality before the law. The rule of law shall be understood as having regard to the other Union values and principles enshrined in Article 2 TEU. **‘Government entity’** means a public authority at any level of government, including national, regional, and local authorities, as well as Member State organisations within the meaning of point (42) of Article 2 of the ‘Financial Regulation’

management. The Regulation establishes the rules necessary for the protection of the Union budget in the case of breaches of the principles of the rule of law in Member States.

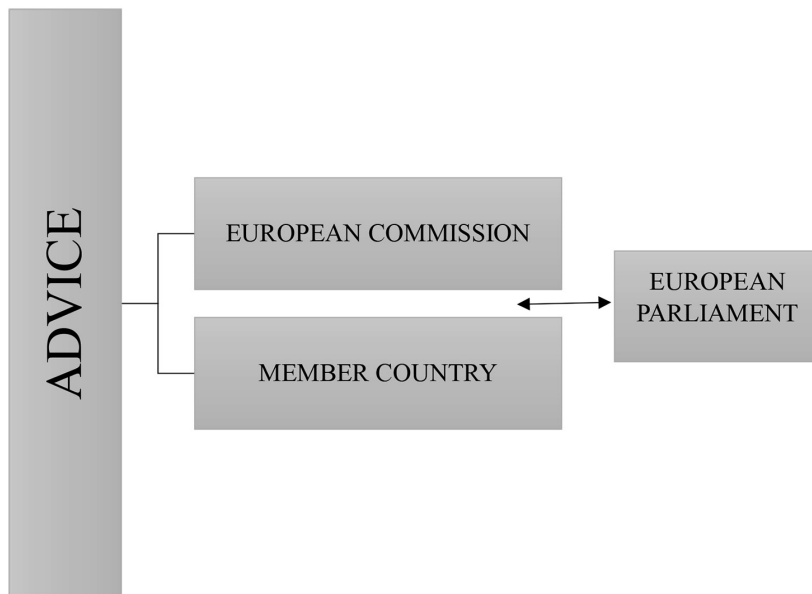
Breaches of the principles of the rule of law are set in Article 3 of the Regulation. Conditions for the adoption of measures are stipulated in Article 4. Where the conditions stipulated in Article 4 are breached, one or more of the appropriate measures established in Article 5 may be adopted in accordance with the procedure specified in Article 6; in the case of shared management with the Member State, it is possible to alternatively reach: suspension of approval of one or more programmes or its amendment; suspension of commitments; reduction of commitments, including through financial corrections or transfers to other spending programmes; reduction of pre-financing; interruption of payment deadlines; suspension of payments. *‘The measures taken shall be proportionate. They shall be determined in light of the actual or potential impact of the breaches of the principles of the rule of law on the sound financial management of the Union budget or the financial interests of the Union. The nature, duration, gravity and scope of the breaches of the principles of the rule of law shall be duly taken into account.’* (Article 5(3)).

Guarantees for the protection of beneficiaries and final recipients are also provided. Payments to them are not stopped, i.e., the Member State with national and municipal public resources provides the payments for their projects. *‘The Commission shall provide information and guidance for the benefit of the final recipients or beneficiaries on the obligations of the Member States referred to in paragraph 2 via a website or an internet portal. The Commission shall also provide, on the same website or internet portal, adequate tools for final recipients or beneficiaries to inform the Commission of any breach of those obligations that, in the view of these final recipients or beneficiaries, directly affects them.’* (Article 5(4)) Guarantees for the protection of whistle-blowers are provided in accordance with the principles of Directive (EU) 2019/1937 of the European Parliament and of the Council of 23 October 2019 on the protection of persons who report breaches of Union law. Information provided by the final recipients or beneficiaries [...] shall be accompanied by proof that the concerned

final recipient or beneficiary has lodged a formal complaint with the relevant authority of the Member State concerned (Article 5(4)). On the basis of the information provided by the final recipients or beneficiaries in accordance with paragraph 4 of this Article, the Commission shall do its utmost to ensure that any amount due from government entities or Member States in accordance with paragraph 2 of this Article is effectively paid to the final recipients or beneficiaries in accordance with in particular Article 63, point (b) of Article 68(1) and Article 98) of Regulation EU (2021/1060) (Article 5(5)).

The relevant procedure and participants are defined in Articles 6 and 7.

Diagram 5



In addition to the Rule of Law Directive, **other measures may lead to suspension of payments, cancellation of contribution, etc. Such measures are provided, for example, in the CPR:**

- Enabling conditions, as well as a short and comprehensive set of objective criteria for their evaluation – when the specified conditions are not met, expenditure related to operations linked

to the specific objective should not be reimbursed by the Commission – Articles 15–18, Annex No. 3

- Measures related to sound economic management and in response to exceptional or unusual circumstances – Articles 19–20.
- Mechanisms to ensure a link between Union funding policies and the economic governance of the Union should be further refined, allowing the Commission to make a proposal to the Council to suspend all or part of the commitments or payments for one or more of the programmes of the Member State concerned where that Member State fails to take effective action in the context of the economic governance process. The obligation of the Commission to propose a suspension should be suspended when and for as long as the so-called general escape clause under the Stability and Growth Pact has been activated.
- Interruption and suspension of the payment deadline – Articles 96–97
- Financial corrections by Member States – Article 103
- Financial corrections by the Commission – Article 104.

CHAPTER 24:

PUBLIC PROCUREMENT – EUROPEAN AND NATIONAL LEGAL AND INSTITUTIONAL FRAMEWORK: BASIC CONCEPTS

Mario Milov

ABSTRACT	KEY WORDS
This chapter presents information on the overall process of public procurement (forecasting, planning, preparation, procurement and appeals), not claiming to be exhaustive and comprehensive, but aiming to present the norms in action and provide an idea of how the abstract rules for procurement manifest in practice, what challenges and what paths are considered to be in line with the law by contracting authorities, who are called upon to protect legal order in the spending of public funds. It must be noted that skills, and not so much knowledge itself, can make the difference in overcoming the challenges that may be faced by those professionally involved in procurement matters. This in turn can result in increased personal expertise and, more broadly, to meeting the objective of lawful but efficient use of public resources.	Public Procurement Act, European Union (EU), Rules on Implementation of the Public Procurement Act, objects of public procurement, procedure, Public Procurement Agency, Centralised Automated Electronic Procurement Information System, European Funds Management under Shared Management Fund.

I. INTRODUCTION

Good procurement preparation stems, above all, from a proper understanding of the meaning, substance and content of each of the documents prepared. Knowledge of the Public Procurement Act (PPA) is no guarantee that the contracting authority or bidder is prepared for every situation that may arise in the course of a procurement. Public procurement relations are financial relations (See also Chapters 18, 22, 23).

In order to successfully outsource, it is necessary, but far from sufficient, to be familiar with the fundamentals of current legal framework. Another essential element is in-depth knowledge of the practice of appeal bodies, such as the Competition Protection Commission and especially the Supreme Administrative Court of the Republic of Bulgaria, as the second and final instance in proceedings under the Public Procurement Act. It is in jurisprudence that public procurement experts can fully comprehend the meaning, significance and purpose of statutory provisions in the field, both individually and in their totality.

1. Public Procurement Act

1.1. Basic provisions

The public procurement legal framework has undergone a global change in all European Union (EU) Member States with the adoption of Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC¹ and Directive 2014/25/EU of the European Parliament and of the Council of 26 February 2014 concerning the procurement by entities operating in the water, energy, transport and postal services sectors and repealing Directive 2004/17/EC², cited. European public procurement is a key driver of economic growth, job creation and innovation.

In accordance with Articles 26 and 34, Article 53(1) and Articles 56, 57, 62 and 114 of the Treaty on the Functioning of the European Union³ (TFEU), all procedures must comply with the principles of EU law, in particular the free movement of goods, the freedom of establishment and the freedom to provide services, as well as the principles deriving therefrom, such as equal treatment, non-discrimination, mutual recognition, proportionality and transparency.

¹ See: <https://eur-lex.europa.eu/legal-content/BG/ALL/?uri=celex:32014L0024> [Accessed on 05 March 2023].

² See: <https://eur-lex.europa.eu/legal-content/BG/ALL/?uri=CELEX%3A32004L0017> [Accessed on 05 March 2023].

³ See: <https://eur-lex.europa.eu/BG/legal-content/summary/treaty-on-the-functioning-of-the-european-union.html>. [Accessed on 05 March 2023].

The current Public Procurement Act⁴ was promulgated in State Gazette (SG), issue 13 of 16.02.2016. This entirely new law entered into force on 15.04.2016 (*last amended, State Gazette, issue 88 of 20.10.2023*). For the first time, two directives adopted by the European Parliament (EP) and the Council of the European Union in 2014 were transposed into national law – Directive 2014/24/EU, repealing Directive 2004/18/EC (*applicable to public contracting entities*) and Directive 2014/25/EU, repealing Directive 2004/17/EC (*applicable to sectoral contracting entities*). The legislative initiative was launched by the European Commission (EC) in December 2011 and the content of the two Directives is hailed as the result of subsequent consultations between the EP, the EC and the Council of the European Union (EU).

The Public Procurement Act is a framework law, i.e., its application would not be possible without the accompanying Implementing Rules. The Act, although a framework law, is impressive in scope and covers all the essential elements of the procurement process, while the Rules on Implementation of the Public Procurement Act (RIPPA) supplement it in a way that provides the necessary detail without changing the principal provisions. The law does not allow the regulations to change the adopted guidelines.

The existence of a ‘public contract’ implies the simultaneous manifestation of three main elements – the subject (*the contracting authority, which is an obliged person*), the object and subject matter (*the activity to be awarded*) and the value (*which determines the applicable award procedure*).

1.2. Principles

Public contracts are awarded in accordance with the principles of the Treaty on the Functioning of the European Union, in particular those of free movement of goods, freedom of establishment and freedom to provide services and mutual recognition, and with the principles derived therefrom:

1. equality and non-discrimination;

⁴ See: <https://www2.aop.bg/zakonodatelstvo/nacionalno-zakonodatelstvo/> [Accessed on 10 March 2023].

2. free competition;
3. proportionality;
4. publicity and transparency.

When awarding public contracts, contracting authorities must not restrict competition by including conditions or requirements which give undue advantage or unreasonably restrict the participation of economic operators and which are not appropriate to the subject-matter, value, complexity, quantity or volume of the public procurement.

1.3. Objects of Public Procurement

The objects of public procurement are regulated in Article 3 of the Act. These are generally construction, supply of goods and services.

In the case of construction as an object of public procurement, two hypotheses are distinguished:

- execution or design and execution of works related to one of the activities listed in Annex № 1 of the Public Procurement Act;
- execution or design and execution of construction.

With regard to supplies as the subject of public procurement, different types of legal transactions are associated, through which the contracting authority may acquire or use various goods. These are purchase, sale, and lease. As part of public supply procurement, all the activities preliminary to the use of goods, such as installation and assembly works, testing of machinery and equipment, etc. are also procured.

In the case of services as subject of public procurement, there is a certain distinction between the types of services, and the Act allows some of them (*those listed in Annex 2 of the Public Procurement Act*) to be procured under a more relaxed procedure, within the regulated value thresholds. These include services related to healthcare, social, administrative, educational and cultural services, hotel and restaurant services, legal services (*beyond those that fall within the exceptions from the scope of the Act*), security services, postal services and others.

1.4. Contracting Authorities / Procuring Entities

Public procurement entities, which have the obligation to award public contracts in compliance with the rules of the applicable legal framework, are referred to as natural persons under the current PPA. It is customary to refer to procurement entities as ‘contracting entities’. That is to say, the contracting authority (*representing an administrative body*) is the one empowered to issue decisions under the PPA. Previous PPA provisions, which were later repealed, defined two types of contracting authorities: administrative authorities and legal persons (*Article 7 PPA (repealed)*). The unification of the status of contracting entities as natural persons has one important consequence and that is in the area of administrative and criminal liability for PPA violations.

Contracting authorities are public and sectoral. Public procuring entities are budget authorisers or financed/capitalised with budget funds. Sectoral contracting authorities are operators in certain economic sectors (*transport, energy, water supply, etc.*)

The Act distinguishes between the main category of contracting authorities, which are obliged to apply public procurement rules and are described in Article 5(2) and (4) PPA, and case-specific contracting authorities or so-called ‘ad hoc’ contracting authorities. The latter are obliged to apply the provisions PPA only when public funds are used to directly finance more than 50 % of works with an estimated value equal to or higher than BGN 10,526,116.00 or services related to the same works when their estimated value is equal to or higher than BGN 420 497,00. In these cases, the entity awarding the contract (*whether it is the funding body or the funded body*) acts as the contracting authority for the specific case and must select a contractor for the funded activity under the PPA.

A peculiarity in the regulatory framework of public procurement in the current PPA is the concept of the public contracting authority. The definition is laid down in Article 5(2) PPA, where public contracting authorities, heads of legal entities, are referred to as entities exercising management or representation of the organisations they represent. This is a new approach of the Bulgarian legislator.

1.5. Delegation of powers

The delegation of powers or the so-called ‘delegation’ in the PPA is also regulated, and here the law distinguishes between the concepts of ‘delegation’ and ‘substitution’. An explicit addition is introduced, namely: unless a specific person is expressly authorised to carry out public procurement in the absence of the contracting authority, its powers relating to the award of public contracts shall be exercised by the person who replaces it in accordance with a normative, administrative or other act, which determines the representation of the contracting authority or of a person who exercises administrative management in the contracting authority’s organisation. The authorised persons must be officials in the contracting authority’s organisation. The authorisation may not be used for the purpose of splitting up procurement and for the purpose of circumventing the law. The process shall be regulated to the extent that it is possible to know who the responsible official is in each separate case. That is to say, during the period of substitution, the substitute is responsible as contracting authority and, accordingly, any penalties are borne by it.

The existence of an authorisation does not preclude both the contracting authority’s obligation to exercise control and its right to make a separate award at any time.

1.6. Joint Procurement

The PPA addresses aspects of joint procurement with contracting authorities both in the country and from other EU Member States. Addressing of this matter, both in the directives (*Directive 2014/24/EU and Directive 2014/25/EU*) and in the Act, is an indicator of ongoing market processes. The market is becoming more general. Contracting authorities are increasingly given the opportunity to act as part of groups with common interests and not just as separate entities.

The legal framework for joint procedures is set out in Article 8(1) of the Public Procurement Act. This provision states that *‘Two or more contracting authorities may conclude a joint procurement agreement which shall govern all organisational, technical and financial matters relating to*

the conduct of the procedure, the conclusion of contracts, the allocation of the works, supplies or services which are the subject of the contract, etc.’. This wording provides a detailed description of the practical aspects that may arise, both in terms of the contracting authority, and the conditions and stages of the procedure itself.

1.7. Reserved Public Procurement

In the course of the public consultation on the content of Directive 2014/24/EU and Directive 2014/25/EU, the EC conducted a survey on the issue of the so-called ‘reserved procurement’ among Member States. In the end, the opinion prevailed that public procurement should also be used as a social tool.

By Decision No. 591 of the Council of Ministers of 18 July 2016, a List of Goods and Services under Article 1(1) of the Public Procurement Act was published on the website of the Public Procurement Agency. The contracting authorities are obliged to separate these goods into separate public contracts reserved for specialised enterprises or cooperatives of disabled persons on the basis of Article 12 PPA, in conjunction with Article 80 RIPPA, which are intended for supply by specialised enterprises or cooperatives of disabled persons or for economic entities whose main objective is the social and professional integration of disabled or disadvantaged persons.

Entities may participate in the award of reserved procurement contracts, provided that at least 30% of their roster is composed of disabled or disadvantaged persons.

Specialised enterprises or cooperatives of people with disabilities may participate in the public procurement provided that they can carry out at least 80 % of their main activity with their own machinery, equipment and human resources.

Other interested parties may also participate in reserved procurements, but their bids will only be considered if no bids from entities which are specialised enterprises or cooperatives of persons with disabilities are admitted.

1.8. Exceptions from the scope PPA – general rules

Contracting authorities need not apply the Act where certain preconditions are met. The Public Procurement Act regulates a series of exceptions, the existence of which allows the selection of a contractor without complying with public procurement rules.

The exceptions in which contracting authorities need not apply the Act are detailed in Articles 13–15 PPA, and are subdivided into:

- general exceptions under Article 13 of the Public Procurement Act that apply to public and sectoral contracting authorities;
- exceptions under Article 14 of the Public Procurement Act, applicable only to public procuring entities;
- exceptions under Article 15 of the Public Procurement Act applicable to sectoral contracting entities.

There are also exceptions provided for in Article 149 PPA, applicable to defence and security procurements.

In this sense, each contracting authority, according to the type and nature of the activity, may apply the general exceptions and the exceptions applicable solely to it or to the contracts it awards (*in the case of the defence and security hypothesis*).

Some of the exceptions in the Act relate to legal representation (*Article 13(1), item 7 PPA*), for loans, regardless of whether they are related to the issuance, sale, purchase or transfer of securities and other financial instruments (*Article 9 PPA*), as well as legal relationships arising from a contract other than an employment contract, where a service is assigned to a person in the contracting authority's organisation who is capable of performing such service (*e.g. analyses, studies, etc.*).

II. AWARD RULES

Different value thresholds under the PPA define different award regimes. Article 18 PPA defines 13 types of procedures. In Bulgaria, the value thresholds requiring compliance with certain award rules have always been below those of the Directives. In other words, although the European thresholds are higher, the Bulgarian legal framework has systematically used an approach of national thresholds being lower, rather than equal to European ones. This leads to the situation that, despite having lower procurement values, we stick to more complex rules.

Pursuant to Article 160(2) of Regulation (EU) No. 2018/1046, competition must be ensured on the broadest possible basis in all procedures, except where the procedure referred to in Article 164(1)(d), i.e., the negotiated procedure without prior notice, is used.

The procedures under the Act are described in Article 18 of the Public Procurement Act which uses the following classification:

– **Procedures awarded by public contracting authorities:**

1. open procedure;
2. restricted procedure;
3. competitive procedure with negotiation;
4. competitive dialogue;
5. innovation partnership;
6. negotiated procedure without prior publication;
7. design competition;
8. public competition;
9. direct negotiation.

– **Procedures awarded by sectoral contracting authorities:**

1. open;
2. restricted procedure;
3. negotiation with prior invitation to tender;
4. competitive dialogue;

5. innovation partnership;
6. negotiation without prior invitation to tender;
7. design competition;
8. public competition;
9. direct contracting.

Another distinction that the current PPA creates is the division into procedures that go through the **European procurement** procedure and those that go through the **national procurement** procedure.

European awarding is referred to in Article 1 of the Act and applies to contracts at values specified in the provision.⁵ In these cases, contracting authorities may apply all the procedures under the Act except public competition and direct negotiation.

National awarding is set out in Article 20(2) of the Act and applies to contracts at values specified in the provision.⁶

The rules mentioned here for European and national contracting are the general rules; Article 20 PPA offers specific rules for sectoral contracting authorities, those in the field of defence and security and others.

⁵ See: Article 20(1) (*amend. – SG 88/2023, in force from 01.01.2024*) The procedures under Article 18(1), items 1–11 shall apply when: 1. public procuring entities as well as their associations award public contracts with an estimated value greater than or equal to:

- equal to or greater than BGN 10 526 116.00 – for constructions
- BGN 273,812.00 – for supplies and services
- BGN 1,466,850.00 – for services under Annex 2 to the Act (services related to healthcare, educational services, social protection, hotel services, legal services insofar as they are not excluded under Article 1(7) of the Act, postal services, international services, detective and security services, etc.).

⁶ See: Article 20(2) (*amend. – SG 88/2023, in force from 01.01.2024*) Contracting authorities shall apply the procedures under Article 18(1), item 12 or 13 where the public procurement has an estimated value:

- from BGN 300,000.00 to BGN 10,526,116.00 for construction,
- for supplies and services, including those referred to in Annex 2 to the Act, from BGN 100,000.00 to the relevant threshold under para. (1) (the threshold specified in the European procurement) depending on the type of contracting authority and the subject of the contract.

1. Collection of bids through notice or invitation to certain entities

Article 20(3) of the Act, applicable to contracts at values specified in the provision.⁷ This is not a procedure under the Act.

1.1. Collection of bids through notice

Contracting authorities may launch the award of a contract for a value referred to in Article 20(3) of the Public Procurement Act by publishing, in the public procurement register, a notice inviting bids, which need to be drawn up in accordance with the relevant template and contain, as a minimum, the information referred to in Annex 20 of the Public Procurement Act.

1.2. Invitation to certain entities

Contracting authorities may, instead of publishing a notice, publish an invitation in the PPR and extend it to a certain entity/entities, where any of the grounds provided for in Article 1 PPA are in place.

2. Direct award

Article 20(4) of the Act, applicable to contracts with values less than those specified in the provision.⁸

⁷ (3) Contracting authorities shall apply the procedure for awarding contracts by inviting bids through notice or invitation to certain entities where the public contracts have an estimated value:

- for construction – BGN 80,000.00 – BGN 300,000.00
- for supplies and services, except for services under Annex 2 to the Act – from BGN 50,000.00 to BGN 100,000.00.

⁸ See: (3) Contracting authorities shall apply the procedure for awarding contracts by inviting bids through notice or invitation to certain entities where the public contracts have an estimated value of:

- BGN 80,000.00 – for construction;
- BGN 100,000.00 – for services under Annex 2 to the Act;
- BGN 50,000.00 – for supplies or services outside those listed in Annex 2 to the Act.

In the case of direct award for public contracts relating to services and supplies, no written contract need be concluded and evidence must be provided by means of primary accounting documents.

Contracting authorities may award the specific public contract under the procedure applicable to higher values, in which case they are obliged to apply all the rules applicable to the procedure they have chosen (*Article 20(9) PPA*).

3. Methods for calculating the estimated value of procurements

The value of the procurement is the guide in determining the applicable award procedure. The estimated value of a public contract is determined on the date of the decision to launch the procedure (*Article 21(2) PPA*). It is important to note that the estimated value includes all payments, exclusive of VAT, to the future contractor, including the options and contract renewals expressly provided for in the terms of the contract. Where the contracting authority provides for awards or payments to candidates or tenderers, these must be included in the estimated value of the contract.

Where the procurement involves several lots, each of which is the subject of a contract, the value of the contract must be equal to the sum of the values of all the lots. Where a lot is awarded separately, the procedure to be followed is the one applicable to the total value of the whole contract.

The method for calculating the estimated value of a procurement must not be used for the purpose of applying an award procedure for lower values. A contract may not be divided into lots for the purpose of applying a lower-value award procedure.

The award of two or more contracts within a 12-month period will not be considered as splitting, where the object of the contracts is:

- a) execution of construction or design and execution of construction;
- b) identical or similar, which was not known to the contracting authority at the time when the award of a previous procurement with such subject-matter was initiated.

The Act allows a separate item to be awarded in the manner applicable to the individual value of each of them, provided that the value of the respective separate item does not exceed BGN 154,464.00 for supplies of services and BGN 1,000,000.00 for construction, and the total value of the separate items awarded in this way does not exceed 20 % of the total value of the contract (*in the latter case, regardless of the residual value, it is awarded in the manner applicable to the total value of the entire contract – Article 21(6) of the Act*). Each construction will be considered separately (for example, if the schedule contains 10 construction orders in a year, these will be 10 separate orders).

4. Market research and market consultations

The estimated value of the procurement may also be determined as a result of market studies or consultations. The matter is regulated in detail in Article 44 PPA.

Market research involves checking and collecting publicly available data – NSI, stock exchanges, auctions, catalogues, guides, brochures, other publications, information from the public procurement market (EU IA, RPP), surveys provided by the designer/evaluator, previous contracts/offers, visits to commercial outlets, archives and databases from preliminary research, information from the Internet, etc.

Market consultations is a tool that contracting authorities have the right (*but not the obligation*) to use to determine the estimated value of procurement. Market consultations are carried out by requesting and receiving indicative bids. Market consultations may be used provided that they do not lead to distortions of competition and of the principles of non-discrimination and transparency. The results must be made public through the buyer's profile so that everyone can become familiar with them (*Article 44(3)(1) PPA*). Of particular importance in the case of market consultations is the right of the persons who participated in them to submit bids in the future procedure, i.e., such participation is not inherently prohibited.

The use of external assistance in the preparation of procurement documents is also tantamount to market consultation. Article 29 of the RIPPA requires that, where external persons have been involved in the preparation of

procurement documents, they must be identified by the contracting authority in the information referred to in Article 44(1) of the RIPPA.

5. Certain features of mixed public procurement

Article 11 of the Public Procurement Act provides that where a public contract involves activities comprising more than one object (*works, supplies or services*), it should be awarded in accordance with the procedure applicable to those activities which constitute the main subject of the contract.

Where the procurement involves services and supplies, the main subject matter is determined according to the service or supply with the highest estimated value.

Where the procurement includes services under Annex 2⁹ PPA and other services, the main subject matter is determined according to the service with the highest estimated value.

The Public Procurement Act does not allow the award of a general contract in order to apply more lenient rules or to exclude the contract from the scope of the Act. Where the subject-matter of a public contract contains objectively indivisible parts, it must be awarded in accordance with the procedure applicable to the part which defines the main subject-matter of the contract.

In the case of contracts which include the subject of a public procurement and concession, the contract is awarded:

1. under the rules of the Public Procurement Act, when the contracting authority decides to award a joint procurement;
2. under the rules of the Public Procurement Act, where the subject matter is objectively indivisible;
3. under the rules applicable to each of the activities – in all other cases.

⁹ Services relating to health, social and other similar activities; administrative, educational, health and cultural services; religious services; hotel and restaurant services; legal services; prison services, public security services and emergency safety services, in so far as they are not excluded under Article 14(1); detective and security services; postal services, etc.

III. RULES OF PROCEDURE

When awarding public contracts, contracting authorities may freely choose open or restricted procedures. The other types of procedures applicable to contracting authorities may be chosen by them only on the grounds expressly and exhaustively listed in the PPA.

Sectoral contracting authorities have greater freedom, being able to choose, without any requirement for specific grounds, open or restricted procedures, negotiated procedures with prior invitation to tender and competitive dialogue, subject to the conditions of the Act (*see Part Three of the Act*).

1. Open procedure / public competition

All contracting authorities are free and unrestricted to choose an open procedure. The principles of the Public Procurement Act are fully applied in the conduct of an open procedure. Any interested person¹⁰ may submit a tender containing a technical and a price proposal, accompanied by data relating to the personal situation of the tenderers and their compliance with selection criteria. Minimum time limit for receipt of tenders – 30 days from the date of dispatch of the notice.

The public competition, as a type of national procedure (*national award*) under Article 1(12) of the Public Procurement Act, is analogous to the open procedure, but is applied at lower values, pursuant to Article 20(2) of the Public Procurement Act. In the case of public competition, some of the requirements of the open procedure are more relaxed, which makes the procedure more onerous.

¹⁰ See: Paragraph 14 of § 2 of the PPA defines the term: ‘Interested person’ means any person who has or had an interest in obtaining a particular public contract and who is or may be harmed by the alleged infringement.

2. Restricted procedure

All contracting entities are free to choose the restricted procedure. This is a two-phase procedure, whereby in the first phase persons submit an application to participate. Any person may submit an application to participate, in which it must provide the information requested by the contracting authority concerning the absence of grounds for exclusion and compliance with the selection criteria. The minimum time limit for receipt of applications is 25 days from the date of dispatch of the notice. On the basis of these applications, the contracting authority carries out a pre-selection procedure which ends with a decision, subject to appeal. The second phase of the procedure provides for the submission of bids only by those candidates who successfully passed the pre-selection stage. The minimum time limit for the submission of bids is 25 days from the date of dispatch of the call for bids.

3. Competitive procedure with negotiation / negotiated procedure with prior call for bids / negotiated procedure with publication of a contract notice

These are identical procedures with three different names.

The above-mentioned procedures are two-phase procedures; in the first phase all interested parties may submit an application for participation, in which they provide the information requested by the contracting authority concerning the absence of grounds for exclusion and compliance with the selection criteria. The minimum time limit for submission is 30 days from the date of dispatch of the contract notice. The pre-selection phase ends with a decision of the contracting authority. The second phase of the negotiation is restricted to candidates who have successfully passed the pre-selection procedure, who may submit initial bids as a basis for negotiations. Minimum period for submission of initial bids – 30 days from the date of dispatch of the invitation.

The competitive negotiated procedure may be chosen and applied by public contracting entities only if the grounds under Article 76 PPA are present, while in the case of sectoral contracting entities, negotiation with prior call for participation may be freely chosen.

4. Competitive dialogue

This type of procedure may be freely chosen by sectoral contracting authorities, while public contracting authorities may conduct it only on the grounds explicitly and exhaustively specified in the PPA (*Article 73(2) PPA*). The grounds for competitive dialogue are aligned with those of the competitive negotiated procedure.

The procedure consists of three main stages (*three-phase procedure*) – submission of an application, dialogue and submission of final bids.

In the first phase, the contracting authority sends a contract notice for publication on the basis of which anyone may submit a request to participate, with a minimum time limit of 30 days from the date of dispatch of the contract notice. Only candidates who have been invited by the contracting authority after pre-selection may participate in the next stage of the procedure, dialogue (*second phase*). During the dialogue, the issues relating to the contract may be discussed with a view to defining the parameters which best meet the contracting authority's needs. The dialogue may be conducted in stages, and this should be indicated in the notice. Once the dialogue has been declared closed, the contracting authority will invite the tenderers to submit final bids (*third phase of the procedure*), based on the solutions specified during the dialogue. In the case of a contract awarded by means of a competitive dialogue, the contracting authority evaluates the bids on the basis of the 'best value for money' criterion and in accordance with the criteria set out in the contract notice or the descriptive document.

5. Innovation partnership

The contracting authority must indicate in the tender documentation that it needs to obtain an innovative product, service or work and the impossibility of satisfying this need through the offers available on the market. The documentation must also lay down the rules concerning intellectual property rights.

This procedure comprises two phases; in the first phase interested parties submit an application to participate in the procedure, in which they must

provide the information requested by the contracting authority concerning the absence of grounds for exclusion and compliance with the selection criteria. The application must be submitted within a minimum period of 30 days from the date of dispatch of the contract notice for publication. Only successful pre-selected candidates submitting their research and innovation bids are admitted to the second phase of the procedure. The contracting authority negotiates with the tenderers to improve the content of the initial and subsequent bids, with the exception of the final bids. In this procedure, the contracting authority evaluates bids only according to the ‘best value for money’ criterion.

6. Negotiated procedure without prior notice / negotiated procedure without prior call for bids / negotiated procedure without publication of a contract notice / direct negotiation

These procedures cannot be freely chosen by contracting authorities, and they apply in the presence of explicit and exhaustive grounds specified in the Act, as follows:

- in the case of public contracting authorities, the grounds under Article 79 of the Public Procurement Act;
- in the case of sectoral contracting entities, the grounds referred to in Article 1 of the Public Procurement Act;
- in the case of defence and security procurement, the grounds under Article 164 of the Public Procurement Act.

In carrying out the above procedures, the contracting authority invites one or more specified persons with whom it conducts oral negotiations, which will be binding, to determine the terms of the future contract.

7. Design Competition

The procedure applies only in cases where the contracting authority seeks to acquire a plan or design (*e.g., in the fields of urban and rural planning, architecture, engineering, etc.*) selected by an independent jury with or without awards. The terms and conditions for a design competition are set out in the RIPPA.

The PPA also provides for other specific procurement techniques and instruments, including the framework agreement, dynamic purchasing systems, electronic tendering, electronic catalogues and centralised procurement (*cf. Chapter Ten, Part Two of the Act*).

IV. PUBLICITY AND TRANSPARENCY

The transposition of Directive 2014/24/EU and Directive 2014/25/EU into the Public Procurement Act introduced an obligation for contracting authorities and participants to conduct and award public contracts fully electronically. The exchange of information is carried out solely electronically with some exceptions to this rule.

The sources of information on public procurement are: the Official Journal of the EU (OJEU), the Public Procurement Register and the contracting authority's buyer profile.

Publication in the OJEU is only mandatory for public contracts of the value referred to in Article 20(1) (*European procurement*). Various types of notices are published in the OJEU, but not decisions.

1. The Public Procurement Agency

The Public Procurement Agency (PPAg) is a legal entity with budgetary dependence and headquarters in Sofia. The activities, structure, organisation of work and staffing PPAg is determined by special regulations¹¹ (*in force as of 24.03.2017, adopted by Decree No. 53 of the Council of Ministers of 20.03.2017, most recent amendment SG 106 of 22 December 2023*).

The PPAg was established in 2004 by a decree of the Council of Ministers (*No. 56 of 12.03.2004*), issued on the basis of Article 54(2) of the Administration Act. It is an autonomous administrative structure attached to the Minister of Finance. It is headed and represented by an Executive Director, who is a secondary budget authoriser for the budget of the Ministry of Finance.

¹¹ See: <https://www2.aop.bg/aop/ustroistven-pravilnik/> [Accessed on 10 March 2023].

The Agency assists the Minister of Finance in the implementation of the state policy in the field of public procurement, with the powers of the Executive Director of PPAG being regulated in Article 1 of the Public Procurement Act.

The mission of the Public Procurement Agency is to protect public interest in the use of public funds through public procurement, and the Agency's role in implementing public policy in this area is primarily related to the development of the regulatory framework and the establishment of lawful practices, ensuring publicity and transparency, and promoting professionalisation.

2. Centralised Automated Electronic Procurement Information System

By Decree No. 108 of 19.02.2015, the Council of Ministers selected a centralised single-platform model for the development of e-procurement in the Republic of Bulgaria, which is implemented through the acquisition of a single electronic platform and the integration of existing e-procurement systems owned and used by central public procurement authorities.

The provision of Article 40 of the Public Procurement Act introduced the legal obligation of contracting authorities to carry out all activities in the public procurement process through a single national electronic web-based platform.

With the amendment of the Public Procurement Act (*SG No. 86/2018*), the provision of Article 40 PPA has been repealed and a new Article 39a was created, which provides for changes in the texts on the centralised electronic platform. It aims to provide conditions for a phased transition to fully electronic public procurement.

The centralised electronic platform is generally accessible and interoperable with the most common information and communication technology products on the market for wide use. In all cases of transmission, exchange and storage of information, the platform guarantees the protection of data integrity and the confidentiality of tender documents until the moment of their opening and examination, which must be after the deadline for their receipt.

Pursuant to Article 229(11) and (12) of the Public Procurement Act, the Executive Director of the Public Procurement Agency maintains and manages the platform under Article 1 PPA, but also develops and approves template documents and rules for its use.

By Decree No. 332 of 13 December 2019, the Council of Ministers adopted a schedule for implementation of the contracting authorities' obligation to use CAIS EPP under Article 1 of the Public Procurement Act from 01.01.2020. In connection with § 12 of the Transitional and Final Provisions of the Measures and Actions during State of Emergency Act, the Public Procurement Agency published a notice on its official website on 18 May 2020, informing that as of 14 June 2020 the CAIS EPP is mandatory for use by all contracting entities.

The introduction of CAIS EPP is a step towards easing the work of end-users, reducing administrative burden and standardising operation.

The system includes all the basic modules necessary for conducting e-procurement, as well as for meeting the requirements of European directives in the field (*Directive 2014/24/EU, Directive 2014/25/EU, Directive 2014/55/EU and Directive 2009/81/EC*).

In general, the benefits of implementing CAIS EPP include:

- 24/7 operation;
- providing a single point of access to all available information related to a specific procedure;
- increasing the level of publicity and transparency;
- saving time when preparing orders and offers;
- security of sensitive information;
- lower transaction costs;
- reduced administrative burden;
- improving access for businesses, including small and medium-sized enterprises, to public procurement markets, etc.

3. Public Procurement Register

The Public Procurement Register (PPR) is an electronic database – part of the CAIS EPP. The Public Procurement Register is public and access to its information is free and open. The PPR is a single national source of information on public procurement and publishes everything that is subject to publication under the provisions of the Public Procurement Act.

4. Public Procurement Portal

The Public Procurement Portal (PPP), which is maintained by CAIS EPP, provides access to information on all aspects of public procurement, organised into thematic areas and targeted to the specific interests of the main user groups.

5. Buyer Profile

The buyer profile is a separate section where all documents related to public procurement are published, which is maintained by CEIS EPP, previously by contracting authorities on their websites. The buyer profile is a mandatory tool for ensuring publicity in public procurement; it also ensures compliance with the basic principles and requirements of valid public procurement legislation, as well as unrestricted full, free and direct access to all documents of interested parties in procedures/public procurement.

V. FORECASTING PROCUREMENT NEEDS AND PLANNING THE CONDUCT OF PROCUREMENT

Forecasting and planning are the first two stages of the procurement management cycle. Public procuring entities, which are obliged under Article 244 of the Public Procurement Act¹² to develop and establish

¹² See: Article 244 (1) Public contracting authorities shall adopt internal rules for the management of the public procurement cycle when they dispose of an annual budget, including funds provided under various European funds and programmes, equal to or greater than BGN 5 million. (2) The minimum content of the rules referred to in para. (1) shall be determined by the implementing rules.

Internal Rules for the management of the procurement cycle, must provide specific arrangements for these processes, as required by Article 140(1) PPA, Article 1(1) and (2) of the RIPPA.¹³

All other contracting entities (*which are not bound by a commitment to have internal rules for the management of the procurement cycle*) are not exempted from the obligation under Article 1 of the Public Procurement Act.¹⁴

Without a doubt, the most underestimated part of the procurement management cycle is forecasting and planning. It follows that the omissions and errors made at these stages are at the root of many of the problems encountered by contracting authorities in the course of conducting and awarding public contracts.

1. Forecasting procurement needs

Article 5(1) of the current PPA provides for the first time that contracting authorities (*public and sectoral*) are responsible for correctly forecasting procurement needs. Article 25 RIPPA, in turn, requires that the forecasting exercise should establish the number and type of public contracts, according to expected needs, and the financial resources that the contracting authority envisages to provide.

The purpose of forecasting is to identify all potential needs/requirements for works, supplies and services that fall within the scope of the contracting authority's responsibility.

There are two features of forecasting that distinguish this process from planning. Firstly, in forecasting we do not yet talk of 'public procurement', but only of 'needs/requirements for works, supplies and services' (*some of which, under certain conditions and at a later stage, will become a public*

¹³ See: Article 140(1) The internal rules referred to in Article 1 of the Public Procurement Act shall determine at least the procedure for: 1. forecasting procurement needs, including for establishing the dates by which procurement contracts must be in force; 2. planning the conduct of procedures, taking into account the time for preparation, conduct of procedures and conclusion of contracts.

¹⁴ See: Article 5(1) Contracting authorities shall be responsible for the proper forecasting, planning, conduct, completion and reporting of procurement outcomes.

procurement). Second, forecasting reflects the current state of needs (*i.e., it indicates the willingness and intention for works, supplies and services*) and is not time-bound.

The end result of this stage (*forecasting*) is the identification of needs that will be the subject of procurement.

2. Procurement planning

According to Article 5(1) PPA, contracting authorities are also responsible for the proper planning of public procurement. Article 26 RIPPA¹⁵ requires that the result of the planning be reflected in a procurement schedule, taking into account the provisions of Article 26(1)(1) and (2) RIPPA.

The purpose of planning is to identify, on the basis of the results of the forecasting exercise, the specific procurements to be launched in the next 12 months, starting from the date of approval of the procurement schedule.

Unlike forecasting, which is not time-bound, planning is always for a fixed period. Practice indicates that the minimum planning period is 12 months. This period may not coincide with the calendar year. Planning refers to procurement for which the selection of a contractor will start in the next 12 months in the ways described above (*see Section II and Section III*).

At the planning stage, the timing (*deadlines*) of procurement is most often overlooked. This leads to an underestimation of the duration of the different stages and ultimately to inability to conclude the contract by the relevant date. As a result, interim awards are required, which in turn leads to splitting up of the contract and to unlawful action. Assuming that we

¹⁵ See: (1) In planning, the contracting authority shall draw up a timetable for the award of contracts, taking into account: 1. the procedure laid down for the award of each contract, including the type of procedure chosen, where applicable; 2. the time for preparation, including of the documentation; 3. the time for the conduct of the award, including the receipt of applications to participate or tenders, the work of the committee and the conclusion of the contract.

(2) (Suppl. – SG 17/2019, in force from 01.03.2019) When planning, the contracting authority shall take into account all statutory deadlines relevant to the subject matter of the contract, including those in appeal proceedings, control by the PPA, where applicable, as well as the starting point and the time limit for the performance of the contract.

have a contract with ongoing performance that expires on 31.12 and needs to be renewed on 01.01, the contracting authority should take into account the following milestones and deadlines:

- preparation of the procurement report;
- preparation of the tender documentation;
- preparation of the decision and the contract notice; preparation, submission, examination, evaluation and ranking of bids;
- appeal against the decision selecting the contractor;
- contract conclusion.

All that said, depending on the complexity of the contract, preparatory actions should commence no less than five or six months prior to expiry of the current contract, i.e., assuming 31.12 as the date on which the contract expires and the same is available by 01.01, preparatory activities should start by 01.07 so that the contracting authority is able to take all necessary measures to comply with statutory rules.

Article 26 RIPPA introduces the requirement for the procurement schedule as a mandatory document in planning. The same provision contains important reference points for the content of the schedule and the way in which information should be set out. The schedule should be drawn up in tabular form, making it easier to understand and follow.

VI. PROCEDURE/PROCUREMENT PREPARATION

In the launching of public procurement, it is essential that the decision and the public procurement notice comply with approved templates and contain the requisite elements set out in the Public Procurement Act, and that the procurement documents comply with Article 31 of the Public Procurement Act. In other words, when preparing the documentation, the contracting authority must precisely and clearly describe the subject-matter of the contract, the selection criteria, the relevant templates, as well as the instructions for their preparation, the technical specification, the methodology for determining the complex evaluation of the tender,

where applicable, the provisions of the draft contract, so as to enable it to achieve its objectives, namely to obtain the desired quality of works, goods or services at the most favourable price.

1. Decision to open a procedure under the Public Procurement Act

This type of decision marks the beginning of any type of procedure under Article 1 of the Public Procurement Act by approving a contract notice in the case of procedures requiring such a notice, or an invitation to participate in the case of negotiated procedures under Article 18(1), items 8 to 10 and 13 of the Public Procurement Act. The decision also approves the contract documents, where applicable.

By its legal nature the decision comprises an individual administrative act (*Article 22(9) PPA*) and is subject to appeal under a special procedure of the Public Procurement Act. The contracting authority is not entitled to allow provisional execution of issued decisions.

The decision must follow the relevant template (*Article 22(4) PPA*) and is published in the PPR as well as in the buyer profile of the respective contracting authority. In the case of procedures subject to publication in the OJEU (*pursuant to Article 20(1) PPA*), a decision launching the procedure must be issued but not sent for publication in the OJEU.

Decisions are applicable only in the case of procedures under the Public Procurement Act, but not in the case of procurements by invitation to tender, or invitation to certain persons, or in the case of direct award for contract values within the limits of Article 20(4) PPD.

2. Contract notice

The public contract notice is one of the main documents prepared in connection with the most frequently applied procedures under the Public Procurement Act. A contract notice must be completed in the procedures referred to in Article 18(1) PPA. Depending on the type of procedure, the notice is published in the OJEU and in the PPR (*in the case of procedures under Article 18(1)(1)–(6) PPA*) or only in the PPR (*in the case of public competition under Article 18(1)(12) PPA*).

The notice is a standardised document drawn up in accordance with an approved form. Its format is mandatory for all contracting authorities as it has been adopted by an EC Regulation. This means that regardless of which EU country a public contract is advertised in, it is described in the same way. With regard to the notice, EU member states are not free to arbitrarily amend or remove fields.

The different types of contracting authorities (public and sectoral) use different templates. In this respect, it is particularly important to use the correct model notice.

The contract notice is approved by the decision launching the procedure.

3. Procurement documentation

Article 31 PPA specifies the content of the procurement documents. The most essential and important documents are:

3.1. technical specifications

The contracting authority defines the technical specifications in accordance with the requirements of the applicable regulations in the relevant field. The technical specifications ensure equal access for the candidates or tenderers in the procurement procedure and does not create unjustified obstacles to the award of the contract in competitive conditions. Technical specifications must not contain a particular model, source or specific process that characterises the products or services offered by a particular potential contractor, nor a trademark, patent, type or specific origin or manufacture that would favour or eliminate certain persons or certain products. As an exception, where it is not possible to describe the subject-matter of the contract with sufficient precision and clarity, pursuant to Article 48(1)(a) PPA, such reference is allowed, with the mandatory addition of the words ‘or equivalent(s)’.

3.2. the methodology for determining the overall evaluation of the bid, where applicable

Pursuant to Article 70 PPA, public contracts are awarded on the basis of the most economically advantageous tender. The award criteria replace the bid evaluation criteria (*PPA (repealed)*). The award criteria for determining the most economically advantageous tender are:

- lowest price;
- cost level, taking into account cost-effectiveness, including life-cycle costs;
- optimum value for money, which is assessed on the basis of price or level of costs, as well as indicators including qualitative, environmental and/or social aspects related to the subject-matter of the procurement.

When preparing the documentation, the contracting authority is faced with the challenge of which award criterion to apply in order to obtain the most economically advantageous tender, depending on the objective to be achieved by the procurement.

The ‘lowest price’ criterion may be chosen by the contracting authority where the purpose of the contract is to negotiate the lowest price for the relevant works, supply or service, within the specified parameters.

The ‘cost level’ criterion is logical to use in cases where the contracting authority aims to achieve low operating costs covering the life cycle of the procurement subject. If a life-cycle costing method is mandatory under EU legislation, this criterion will be mandatory for contracting authorities to apply.

Use of the ‘optimal quality/price correlation’ criterion provides the greatest opportunity for selecting a proposal that combines price or cost level with indicators such as qualitative, environmental and/or social aspects.

Article 70(6) PPA requires contracting entities, when using more than one evaluation indicator, to declare the relative weight of each and, if this is not possible, to rank them in descending order. Contracting authorities

should set minimum and maximum values for the quantifiable evaluation indicators.

The contracting authority must specify in the contract documents the methodology for the complex evaluation and the method for determining the evaluation for each indicator. The method should:

- enable assessment of the level of performance proposed in each bid in accordance with the subject-matter of the procurement and the technical specifications;
- enable objective comparison and evaluation of the technical proposals contained in each bid;
- provide candidates and tenderers with sufficient information on the rules to be applied in determining the evaluation of each indicator, specifying: for quantifiable indicators, the relevant figure or percentage and the way these are calculated, and for non-quantifiable qualitative indicators – the way they are evaluated by the committee and assigned a specific value through expert evaluation.

The methodology for determining the comprehensive evaluation of bids is undoubtedly one of the most important documents in the award of public contracts. The objectivity of selected evaluation indicators should always be discussed.

The Act does not allow evaluation indicators such as payment timing or the amount or waiver of advance payments when an advance is to be granted.

3.3. templates and instructions for their preparation

The contracting authority must provide interested parties with templates of the documents to be contained in the bid and give instructions for their preparation. By submitting their bids, tenderers will be deemed to have accepted all the terms and conditions of the contracting authority, including the period of validity of bids and the draft contract.

Documents evidencing personal capacity and compliance with the selection criteria set by the contracting authority.

European and national legislation enshrines the general principle that the award of public contracts to persons who have been involved in criminal organisations or who have been found guilty of corruption or fraud detrimental to national financial interests as well as those of the European Communities, terrorist offences, money laundering or terrorist financing, non-payment of taxes and social security contributions should be avoided. This principle is regulated by the obligation to exclude (*debar*) from public procurement persons who are subject to such circumstances.¹⁶

European Commission Regulation No. 2016 of 05.01.2016¹⁷ establishes a standardised model of the European Single Procurement Document (ESPD). As stated by the EC in the introductory part of the Regulation, the aim is to replace the different and diverse national personal declarations with a single standard form applicable at European level.

Next, the ESPD has been singled out as a key element of the EC's efforts to ease the administrative burden in the public procurement process, with the aim of removing the need to submit a significant number of documents related to personal situation and compliance with selection criteria. Therefore, in addition to the statements of candidates/participants related to the grounds for exclusion (*personal situation Article 54(1) and Article 55(1) PPA*), the ESPD also includes those related to the selection criteria.

The European Single Procurement Document is an official personal declaration, drawn up in accordance with a model approved by an act of the European Commission, which provides prior information that the signatory is not subject to the relevant exclusion grounds, that the relevant selection criteria have been met and that the person will provide the relevant evidence, if any, requested by the contracting authority.

The European Single Procurement Document must be submitted by tenderers and candidates when submitting their applications or

¹⁶ The grounds for mandatory exclusion of participants or candidates from participation in a public procurement procedure are set out in Article 54 PPA. The grounds for non-mandatory exclusion of participants or candidates from participation in a procurement procedure are set out in Article 55 PPA.

¹⁷ See: <http://eur-lex.europa.eu/legal-content/BG/TXT/?uri=CELEX%3A32016R0007> [Accessed on 07 March 2023].

bids, providing the relevant information requested by the contracting authority and indicating the national databases containing the declared circumstances, or the competent authorities which, under the law of the country in which the tenderer or candidate is established, are required to provide information. The contracting authority retains the possibility to request a tenderer to provide the documents evidencing the information indicated in the ESPD.

Evidence of reliability measures taken, where applicable

In the event that a participant or candidate is subject to the circumstances for mandatory and optional exclusion set by the contracting authority and evidence of the reliability of the participant or candidate is provided, the contracting authority may not exclude the participant or candidate from participation. Such proof may be evidence that the tenderer has:

1. repaid its obligations under Article 54(1)(3) of the Public Procurement Act (*for taxes and social security contributions and such to the state and the municipality*), including accrued interest and/or fines, or that these have been deferred or secured;

2. paid or is in the process of paying any compensation due for any loss or damage resulting from the relevant offence or misconduct;

3. clarified the facts and circumstances exhaustively, actively cooperated with the competent authorities, and implemented specific prescriptions, technical, organisational and personnel measures to prevent further crimes or violations.

Pursuant to Article 37(4) RPPA, the contracting authority may require a candidate or a participant that is an association (which is not a legal entity), to submit a copy of a document establishing such association, as well as the following information in relation to the specific procurement:

1. the rights and obligations of the participants in the association;
2. the allocation of responsibility among the members of the association;
3. the activities to be carried out by each member of the association.

In the narrow sense, the word ‘bid’ should be understood as the submission of a technical and price proposal (*Article 39(3) RPPA*).

Contracting authorities should make specific templates for technical and price proposals in accordance with the subject-matter of the procurement, and give specific instructions to the tenderers for their completion.

The tenderer must attach a completed technical proposal in accordance with the specification and the requirements of the contracting authority.

The tenderer must include, in its bid, a price proposal in accordance with the requirements of the contracting authority, with the proposed price being consistent with the estimated value of the contract.

3.4. public procurement contract

By means of Order No. 1365 of 29.12.2016, the Minister of Finance approved, on the basis of Article 109(2) RIPPA, standardised draft contracts and standardised clauses to public procurement contracts.

These approved documents come in two variants:

- standardised draft contracts – for the supply of food products, vehicles and specialised medical equipment, a general service contract, and a service contract for the development, implementation and warranty support of specialised software products;
- standardised clauses to contracts – for security and construction supervision.

Pursuant to Article 69 RIPPA, the public procurement contract must contain at least:

- details of the parties, date and place of contract conclusion;
- subject;
- price, method and terms of payment;
- period or duration of contract performance and, in the case of phased performance, intermediate deadlines;
- rights and obligations of the parties, including the contractor's obligation to enter into a subcontracting agreement where it has declared the use of subcontractors in its bid;
- where applicable, the intended options and renewals, including volume and value, and the terms and conditions for exercising them;

- amount and conditions for the forfeiture and release of performance bonds, including phased release;
- procedure for acceptance of the works;
- conditions and procedure for termination.

A public procurement contract is a remunerative fixed-term contract, which means that the term is an essential element of its content. As a rule, it has a maximum duration of 5 years, except under certain conditions which allow a longer period. Public procurement contracts of unlimited duration are not allowed. In the absence of a time limit, the contract would be void for violating a mandatory statutory prohibition.

Contract under Condition. The Public Procurement Act also regulates the issue of contract conclusion in the absence of secured financing (*Article 114 PPA*). Where financing is not secured upon launch of the procedure, the contracting authority must indicate this circumstance in the notice or the invitation to confirm interest and must provide for a deferred performance clause in the draft contract. In such case, the contracting authority may conduct a procedure in which it must declare the lack of funding upon launching the procedure and conclude a contract, which may be terminated by either party without notice in the event that funding is not secured within 3 months.

Where financing has not been provided 10 months after contract conclusion, the contract will be considered terminated.

The Act also provides for a series of grounds for amending the public procurement contract,¹⁸ with any amendments being regulated by supplemental agreements between the parties. Contracting authorities may terminate a public procurement contract or framework agreement in the cases provided for by the Act, the contract or the agreement.

Contract documents are approved by the decision to launch the procedure.

¹⁸ The grounds for amending a public procurement contract are set out in Article 116 and Article 117a PPA.

4. Requirements to applicants and participants – selection criteria

The selection criteria comprise minimum eligibility requirements for candidates/participants which the contracting authority may lay down as part of the terms of the contract in order to verify performance capability. The use of the selection criteria is a right but not an obligation for the contracting authority.

In its assessment of selection criteria for a specific procedure/public procurement, the contracting authority is bound by the general rule of Article 59(2) of the Public Procurement Act, which states that the selection criteria must be related (*relevant*) to the subject, value, volume and complexity of the public procurement. Where the subject-matter of a public contract contains separate items, the selection criteria must be consistent with the above elements, but from the point of view of the specific item. Contracting authorities may only apply the selection criteria set out in the PPA as necessary to establish the tenderers' ability to perform the specific public contract.

Public procurements should be carried out in compliance with the principles set out in Article 2 of the Public Procurement Act.

personal standing

The grounds for compulsory exclusion of participants or candidates from participation in a public procurement procedure are detailed in Article 1 of the Public Procurement Act.

According to Article 55(2) of the Public Procurement Act the contracting authority must indicate the circumstances under Article 55(1) of the Public Procurement Act (*grounds for optional exclusion*) in the notice announcing the opening of the procedure. Therefore, in order for the contracting authority to have the right to exclude a tenderer for whom there is a ground for optional exclusion, that ground must be stated.

4.1. ability (capacity)

Where applicable, the contracting authority has the right to require candidates or participants to be registered with the commercial register and/or a relevant professional register, and for foreign entities – in similar registers in accordance with the legislation of the Member State in which they are established.

4.2. economic and financial standing

The requirements to economic and financial standing may be one or more of the following:

1. a minimum total turnover, including specialised turnover, calculated on the basis of annual turnover (*up to twice the estimated value, except where specifically justified by the nature of the contract*);
2. ‘professional indemnity’ insurance with cover amount appropriate to the scope and nature of the contract or arising from a statutory instrument;
3. positive ratio between certain assets and liabilities.

4.3. technical and professional capabilities

The contracting authority may set criteria to establish whether candidates or tenderers have the necessary human and technical resources and experience to perform the contract to an appropriate standard of quality. The contracting authority may require the candidate or tenderer:

1. to have carried out activities with a subject and volume identical or similar to those of the contract, usually for the last: 5 years from the date of submission of the application or bid – for construction; or 3 years from the date of submission of the application or bids – for supplies and services;
2. have the required number of technical persons and/or organisations;
3. have the necessary technical means and facilities for quality assurance;

4. have a delivery management and tracking system that it will apply during contract performance;
5. have staff and/or management with the specified professional competence for the performance of the contract, provided that the requirement is not used as an indicator for the evaluation of bids;
6. apply certain environmental protection measures in the performance of the contract;
7. provide information on the average annual number of staff and the number of members of the management staff for the last three years;
8. possess the tools, facilities and technical equipment necessary for contract performance;
9. have in place certification of the goods by accredited quality control bodies certifying their conformity to specified specifications or standards;
10. possess quality management systems, including those for access for people with disabilities;
11. apply environmental protection systems or standards.

On the basis of Article 59(3) of the Public Procurement Act, contracting authorities are not entitled to require from candidates or participants any other documents to prove compliance with the selection criteria, except those specified in the Act (*Article 62 PPA – documents to prove economic and financial standing and Article 64 PPA – documents to prove technical and professional capabilities*).

Pursuant to Article 65 PPA, candidates or tenderers may, for a specific procurement, use the capacities of third parties, irrespective of the legal relationship between them, to demonstrate compliance with the criteria relating to economic and financial standing, technical and professional capacities.

On the basis of Article 66 PPA, candidates and participants may also use subcontractors for the specific contract, indicating the share of the contract they will award to them. In this case, they must provide proof of the obligations assumed by the subcontractors.

4.4. Separate positions

As term ‘separate position’ was an element of the Public Procurement Act repealed in 2016. According to the legal definition of the term, this is such a part of the subject of the public procurement, which, although it may be an independent subject of the public procurement, is systematically related to the other items of the subject of the public procurement (*Article 29 of § 2 PPA*).

Where the contracting authority does not divide the contract into lots, it must state the reasons for this in the opening decision.

Starting from the applicable provisions indicating the rules and prohibitions in the award of a public contract with separate positions, as well as from the legal definition of the concept itself, and taking into account the diversity in the specificity of the different subjects, the interpretation of systematic coherence should be applied when proving the same, and not only on the argument of similarity in the name of the subject of the public contract.

5. Performance guarantee

Performance bonds for public procurement are regulated in Article 111 PPA.

There are two types of guarantees related to the procurement contract.

1. a performance bond;
2. a guarantee securing the advanced funds.

The performance security may not exceed 10% of the contract value (*according to § 1 of the Supplementary Provisions of PPA, this is the contract value excluding VAT*). If the contract does not have a final total value, the performance security must be set at the estimated value of the contract. The amount (*as a percentage of the value and not as an absolute value*) should be indicated in the contract notice. Where the contract is awarded to specialised undertakings or cooperatives of disabled persons, the performance guarantee may not exceed 2 % of the contract value.

The security securing the funds advanced may be up to the amount of the advance. The law does not set a minimum or maximum amount. The amount of the guarantee securing the funds advanced must also be specified in the contract notice. The security will be released within three days after the return or use of the advance.

The legislator has provided for three forms in which guarantees may be granted:

1. a sum of money;
2. bank guarantee;
3. a guarantee in the form of insurance that unconditionally and irrevocably secures performance by covering the contractor's liability.

A guarantee provided in the form of insurance may be provided only where the value of the funds advanced, respectively of the performance guarantee, is equal to or less than BGN 500 000.00.

A guarantee in the form of a cash or bank guarantee may be provided on behalf of the contractor or on behalf of a third-party guarantor.

6. Explanations of Procedure Conditions.

The right to request explanations and the right to provide such explanations are regulated in Article 33, Article 180 and Article 189 PPA, within the respective time limits.

Explanations may be requested after the publication of a specific procurement, i.e., after the publication of the decision to open a procedure or after the publication of a notice. Any person may request clarification of the terms of a public contract without having to prove his interest in participating in the award. Within the time limits laid down, the same person may repeatedly request explanations.

For a request for explanation to warrant a response, it must be made in writing and received by the contracting authority within the stipulated time limit. Where a written request for explanation is received within the relevant time limit, the contracting authority is under an obligation to provide a written explanation. Explanations must be made public only

through their publication on the contracting authority's buyer profile, on the electronic file of the procurement concerned and on the PPR.

It is important to bear in mind the operative word used to describe the scope of this right, which is 'explanations'. The word itself indicates that the purpose of a clarification is to explain a circumstance (*condition, requirement*) already disclosed *which is* unclear, not to make changes to the terms of the tender or to supplement omitted parts of the terms or content of the tender documentation. Actions for amendments to public procurement documents are possible in procedures under the PPA, but only once, within a certain deadline, by publishing a decision approving the notice of amendment and additional information (*Article 100(1) and (3) PPA*).

7. Commission for the selection, examination and evaluation of the offers

The contracting authority must appoint a commission to perform the selection, examination and evaluation of the offers and to conduct the negotiation and dialogue. The choice of the composition of such committee is entirely at the discretion of the contracting authority.

Under the current PPA, the requirements for the commission are reduced to the condition that it has an odd number of members. There must be no conflict of interest between the members of the commission and the candidates or participants.

Where the evaluation of a proposal of a tenderer is more than 20 per cent more favourable than the average of the proposals of the other tenderers, the contracting authority must require the submission, within 5 days, of a justification for the way in which such proposal was formed. This should be done when the proposal is more than 20 per cent more favourable than:

1. the average of the proposals of the other tenderers for the same evaluation criterion – where three or more tenders are evaluated;
2. the declared estimated value and, where this is not applicable, another appropriate and objective basis for comparison, determined in advance by the contracting authority and set out in the tender specification – where one or two tenders are evaluated.

Although the law requires the contracting authority to request a written justification, in practice this is done by the contracting authority's subsidiary body, namely the commission. The justification received must be assessed as to its completeness and objectivity as regards the circumstances referred to in Article 72(2) PPA, on which the tenderer relies. If necessary, the participant may be requested to provide additional information. The justification may not be accepted and the tenderer may be excluded only where the evidence provided is insufficient to justify the price or costs proposed.

The actions of the commission must be recorded and the results of its work reflected in a report to be submitted to the contracting authority for approval and decision. The time limit for approval of the commission's report is 15 days. The contracting authority may return the commission's report with written instructions where the information contained therein is not sufficient to take a decision on the closure of the procedure and/or it finds an irregularity in the commission's work which can be remedied without terminating the procedure. The contracting authority must, within 10 days of validation of the report, issue a decision awarding the contract or terminating the procedure.

VII. INTERNAL RULES FOR MANAGEMENT OF THE PUBLIC PROCUREMENT CYCLE

The Internal Rules for Management of the Public Procurement Cycle were introduced in the Public Procurement Act¹⁹ (*repealed*) with its amendment effective from 01.01.2009; this was the first legislative text in the field of public procurement, which obliged contracting authorities to prepare and approve Internal Rules for Management of the Public Procurement Cycle.

In the current version of the Act, the regulation of the internal rules is contained in Article 244 PPA. According to the provision, only public contracting authorities that have a budget of BGN 5 million, including funds granted under various European funds and programmes, are required

¹⁹ See: Article 8(7) PPA (*repealed*).

to have internal rules for the management of the procurement cycle. Thus, the circle of obliged entities is narrowed down, as ‘small’ public contracting entities and sectoral contracting entities do not need to have internal rules.

VIII. APPEAL

Any decision of the contracting authority may be subject to appeal, except for the specifically provided exceptions. Any act or omission of the contracting authority which impedes access or participation of persons in a procedure is also be subject to appeal. The opening decision, in so far as it concerns the justification why dividing the subject-matter of the contract into separate positions is not possible, is not subject to review.

The Competition Protection Commission (CPC) is the first instance and the Supreme Administrative Court of the Republic of Bulgaria is the cassation instance in the appeal; the decisions of the court are final.

The deadline for filing a complaint is 10 days. The complaint must be submitted to the CPC. An appeal may be submitted by any interested person, any interested applicant or participant, as well as professional associations and organisations in the relevant industry for the protection of the interests of their members (*the legal definitions of interested persons, participants and candidates are set out in the Supplementary Provisions of the Public Procurement Act – § 2, items 12–14*).

The decision of the Competition Protection Commission is subject to appeal before a three-member panel of the Supreme Administrative Court within 14 days of its notification to the parties. The Supreme Administrative Court rules within one month of receipt of the appeal and its decision is final.

Any interested person may claim compensation for damages, suffered as a result of irregularities, in the conduct of a procedure and the conclusion of a public procurement contract, under the conditions of Article 203, para. 1, Article 204 par. 1, 3 and 4 and Article 205 of the Administrative Procedure Code.

IX. CONTROL

1. Control by the Public Procurement Agency

The Public Procurement Agency exercises control by random selection over the procedures whose notices of opening are to be published in the PPR. The procedures to be subject to prior review are determined by random selection according to a methodology which takes into account risk levels. Control is carried out in two stages: prior to opening of the procedure, on the draft decision, notice and technical specification and, where applicable, on the draft evaluation methodology, and following opening of the procedure, on the approved documents.

The Public Procurement Agency controls contracting procedures launched by public and sector contracting authorities. Control is carried out after publication of the decision in the PPR and verifies compliance with the legal basis cited in the opening decision and the evidence submitted by the contracting authority.

The Public Procurement Agency controls the amendment of a public procurement contract. For the purposes of this control, the contracting authority must, before concluding a supplementary agreement, provide reasons, supported by evidence, as to why the contract needs to be amended.

2. Ex-post External Control

Ex-post external control on the implementation of the Public Procurement Act, including control over the implementation of public procurement contracts and framework agreements, is carried out by the National Audit Office and the Public Financial Inspection Agency.

The contracting authorities that fall under the scope of the National Audit Office Act are subject to control by the National Audit Office.

3. Administrative Penal Provisions

In case of violation of procurement rules, the guilty officials are subject to administrative penalties. The grounds related for administrative-penal liability are laid down in Articles 247–258 of the Public Procurement Act. The imposition of administrative penalties is strictly formal and any deviation from the provisions PPA leads to adverse consequences for contracting authorities.

Sanctions will also be imposed in cases of delegation of powers (*where the contracting authority designates an official to organise and/or award public contracts and, in the absence of the contracting authority, its powers relating to the award of public contracts are exercised by the person who replaces it in accordance with a normative, administrative or other act which determines the representation of the contracting authority*).

According to the provisions of the Public Procurement Act, all contracting authorities are subject to administrative penalties only in the form of fines. No property sanctions are stipulated as they can only be imposed on legal persons or sole traders, and there are no such persons among public procurers.

VIII. MANAGEMENT OF EU FUNDS UNDER SHARED MANAGEMENT ACT

1. Basic provisions

The Management of EU Funds under Shared Management Act (MEFSMA), formerly known as the Management of Resources from the European Structural and Investment Funds Act (MRESIFA), was promulgated in the State Gazette, issue 101 of 2015 (*last amended and supplemented, State Gazette, issue 102 of 23.12.2022*), in force from 26.12.2015. MEFSMA is not limited to a specific programming period, but aims to create a stable and predictable legal framework for the management of EU funds allocated to the Republic of Bulgaria.²⁰ The practice in

²⁰ See Михайлова-Големинова, С. Контрол за законност на управлението

other EU Member States is to have separate legislation for different programming periods. The Act does not have the character of a codifying law with regard to the management of all EU funds. It covers the European Funds under shared management (EFSM), namely: the European Regional Development Fund, the European Social Fund Plus, the Cohesion Fund, the Just Transition Fund, the funds for the financing of Community-led Local Development (CLLD) the European Agricultural Fund for Rural Development, the European Maritime, Fisheries and Aquaculture Fund, the Asylum, Migration and Integration Fund, the Internal Security Fund and the Instrument for Financial Support for Border Management and Visa Policy provided under programmes of the Republic of Bulgaria (Article 1(2) MEFSMA). EFSM funds are public funds intended to achieve public policies and objectives.

MEFSMA does not exhaustively regulate all issues related to the management of EFSM funds, but complies with the current legislation on the spending of public funds, applicable also to the implementation of EU-funded programmes and projects, including the Public Finance Act (PFA).

For certain issues related to the provision of grants and the implementation of projects financed with EFSM funds, MEFSMA refers to the provisions of the Public Procurement Act. By this reference, the circumstances for exclusion from participation in a public procurement procedure, i.e., the grounds for mandatory exclusion under Article 54 PPA and the grounds for optional exclusion under Article 55 PPA, also apply to two of the procedures provided for in MEFSMA, namely: in procedures for the award of a grant by selection and in procedures for the selection of a contractor by public invitation.

The provision of Article 5 MEFSMA provides for the establishment of a Fund of Funds,²¹ through which the financial instruments provided with EFSM funds will be implemented. The entity managing the Fund of Funds

на средствата от европейските структурни и инвестиционни фондове – 10 години по-късно. // Общество и право, 2018, № 2, 3–21; and **Mihaylova, Goleminova, S.** Rule of Law Infringements in the Field of European Structural and Investment Funds Management. – In: **Belov, M.** (ed.) Rule of Law at the Beginning of the Twenty-First Century. The Hague: Eleven publ., 2018, 329–339.

²¹ See: <https://www.fmfib.bg/> [Accessed on 15 March 2023].

was established by Decree No. 3 of 2015 of the Council of Ministers, as the single member joint-stock company with state participation named Fund Manager of Financial Instruments in Bulgaria EAD (*Joint-stock company*), represented by the Minister of Innovation and Growth. The Fund of Funds, as a ring-fenced financial resource formed from EFSM funds made available under the programmes, is managed on the basis of an agreement concluded between the heads of the managing authorities of the respective programmes and the Manager of the Fund of Funds.

1.1. Principles

According to Article 1 MEFSMA, funds from EFSM must be managed on the basis of compliance with the horizontal principles and legality, sound financial management, proportionality and transparency through partnership and multi-level governance with the aim of reducing the administrative burden for the beneficiary and ensuring visibility. Compliance with some of the principles has also been attributed to the beneficiaries of the grant; accordingly, their breach is stipulated to be a direct ground for financial correction (*Article 70(1)(1) and (3) MEFSMA*).

The by-norms of MEFSMA arise not through implementing regulations, but in separate regulations of the Council of Ministers and the Minister of Finance. More than 15 legal acts have been adopted (*cf. § 8, paragraph 1 of the Transitional and Final Provisions of MEFSMA*).

1.2. Special rules for the designation of a contractor by grant beneficiaries

MEFSMA allows that the beneficiaries of the grant can either directly implement the project financed by EFSM and outsource its implementation and/or management. Chapter 4 MEFSMA lays down the rules under which external contractors are to be appointed – through a procedure for the selection of a contractor by public call for bids when the amount of the grant is greater than 50% of the total amount of the approved project and the award is for works, services and/or supplies of goods above a certain estimated value.²²

²² See Article 50(2): ‘A selection procedure with a public call shall be carried out

A selection procedure by public invitation must be conducted in compliance with the principles of free and fair competition, equal treatment and non-discrimination.

The public call must contain the information referred to in Article 51 MEFSMA and must be published on the Single Information Portal on the European Structural and Investment Funds.

The appointment of the contractor must be carried out in compliance with the requirements for effectiveness, efficiency and economy in the use of funds from EFSM, and the beneficiaries must conclude a contract with the candidate contractor who has submitted the most economically advantageous tender.

The most economically advantageous tender is determined in accordance with the criteria set out in the invitation to tender, which may be:

- lowest price;
- cost level, taking into account cost-effectiveness, including life-cycle costs;
- optimal quality / price ratio.

In this part MEFSMA is not a special law in relation to the Public Procurement Act, because the procedure for selection by public invitation is only for beneficiaries who are not contracting authorities within the meaning of the Public Procurement Act (*Article 49(2), item 2 of the MEFSMA*). The procedure for selection by public call for bids laid down in MEFSMA is not intended to apply to the designation of a contractor by a beneficiary which is a contracting authority within the meaning of PPA. Beneficiaries which are contracting authorities within the meaning PPA are subject to the rules of that Act.

when the amount of the grant awarded is greater than 50 per cent of the total amount of the approved project and the estimated cost of:

1. construction, including co-financing by the beneficiary, excluding value added tax, is equal to or higher than BGN 50 000,00; 2. supplies or services, including co-financing by the beneficiary, excluding value added tax, is equal to or higher than BGN 30 000,00.'

2. Administering irregularities and introducing financial corrections.

Two separate legal institutes are included in the matter. The first one is the administration of irregularities (*Article 69 MEFSMA*) and the second one is the introduction of financial corrections (*Articles 70–77 MEFSMA*). A financial correction serves as grounds for closure of the irregularity procedure for the same infringement (*Article 71(5) MEFSMA*). The cases of irregularities referred to in *Article 70(1) MEFSMA* also constitute grounds for financial corrections.

The administration of irregularities is within the competence of the managing authority of the respective operational programme (*Article 69(1) MEFSMA*) and as a rule this procedure is initiated *ex officio* by the managing authority where sufficient evidence of an irregularity is in place.

The decision of the head of the managing authority to determine a financial correction for an irregularity must be formalised in an order issued by it, insofar as all heads of managing authorities within the meaning of *Article 9(4), second sentence, MEFSMA*, are single administrative authorities. As any individual administrative act within the meaning of *Article 21(1) of the Administrative Procedure Code*, an order for the determination of a financial correction may be challenged in court under the procedure laid down in the *Administrative Procedure Code*.

The art of lawful public procurement is in fact the art of making the right decisions based on sound knowledge of the law and its application. Top among the basic prerequisites for good procurement management is morality. There is no doubt that even the best law is useless if there is no public, managerial and institutional intolerance to its misapplication and no managerial will to confront questionable practices. No institution alone is capable of solving problems of this magnitude. Even the set of institutions that form the state apparatus would be powerless, because before we become experts directly involved in the contracting process, we are citizens and everything we achieve, we achieve as citizens.

CHAPTER 25:

BULGARIA'S ACCESSION TO THE EUROZONE

Magdalena Vlahova-Veleva

ABSTRACT

This chapter presents the key aspects of the Bulgarian path towards the eurozone. Article 140 of the c (TFEU), one of the two treaties establishing the constitutional basis of the European Union, sets out the convergence criteria to be met prior to euro adoption. The latter include the criterion for price stability, the criterion on a sustainable government financial position, criterion on exchange rate levels and criterion on long-term interest-rate levels. Moreover, the compatibility of national legislation with EU law, including the statutes of national central banks, also needs to be examined. The fulfilment of these conditions is assessed every two years or at a request of a member state, as the EC and the ECB issue convergence reports. The process of transition to the third stage of the economic and monetary union includes joining Exchange Rate Mechanism II, the attainment of the respective post-commitments, the establishment of a Coordination Council for preparation of Bulgaria for eurozone membership, the elaboration of a National Euro Changeover Plan, the drafting and adoption of an Act to regulate the adoption of the euro in the Republic of Bulgaria and other important activities related to the process of preparation for eurozone membership.

KEY WORDS

EU member state,
eurozone,
single currency,
euro adoption,
convergence criteria,
National Euro
Changeover Plan,
Euro Adoption Act

I. INTRODUCTION

EU traditions and values are the basic legal foundations on the way to *monetary and fiscal integration. The monetary system is part of the financial system of the Republic of Bulgaria and the EU (see Chapter 13)*.¹ The main statutory Acts pertaining to this matter in Bulgaria are the Currency Act, the Credit Institutions Act, the Measures against Money Laundering Act,² the Bulgarian National Bank Act, the Limitations of Cash Payments Act, the Customs Act, etc. The euro was introduced in 1999; currently there are 20-eurozone member states after Croatia joined the monetary union on 1 January 2023. In general, the eurozone is the union of European Union (EU) member states that have adopted the common currency – the euro. All EU member states have the obligation to become full-fledged participants in the EMU – Economic and Monetary Union once they fulfil the necessary conditions, except Denmark, as the country has an opt-out clause negotiated in a protocol annexed to the Treaty.

The Bulgarian path towards the eurozone started long ago, with the European Union Pre-accession Economic Programme of the Republic of Bulgaria (PEP)³ 2002-2005 and PEP 2004-2007. Therefore, as from the date of Bulgaria's accession to the European Union the country started on the path of joining the EMU, taking the irrevocable commitment to become a member state of the eurozone. The adoption of the European single currency – the euro, is the logical final phase of the European integration processes of Bulgaria within the Economic and Monetary Union. A currency board was introduced in Bulgaria on July 1, 1997, and the Bulgarian national currency was primarily pegged to the Deutsche mark (the German mark). From 1999 onwards the Bulgarian lev was pegged to the euro at a fixed rate of 1 € = BGN 1.95583.

¹ See: Jean Monnet Module for European Monetary Law and Faculty of Law University of Niš at: <http://monela.ni.ac.rs/en/about-jean-monnet-module.html> [Accessed on 15 October 2023].

² For more information on anti-money laundering regulation in the European Union and Bulgaria see Chapter 30.

³ Pre-accession economic programmes help candidate countries for EU membership prepare to participate in the EU's economic and monetary union. They aim to outline the appropriate medium-term financial policy framework needed for EU accession.

The accumulated legislation, legal acts and court decisions constituting the body of the European Union law since 1993 is known as the *acquis communautaire* or Community *acquis*. The French term *acquis* means ‘that which has been acquired or obtained’. For the purpose of negotiation between the European Union and candidate member states, during the process of enlargement of the Union, the *acquis* was divided into thirty-one chapters, each covering a specific policy area. Chapter 11 of the *acquis* was dedicated to the Economic and Monetary Union. A few years later the *acquis* was divided into thirty-five chapters, with the aim of achieving a better balance between chapters. These changes were introduced during the negotiation process with Croatia which joined the EU in 2013, as well as for candidate and future candidate countries such as Iceland, Turkey, Montenegro, Serbia, North Macedonia, Albania, Moldova, Ukraine and Bosnia and Herzegovina. Chapter 11 on the Economic and Monetary Union was transformed into Chapter 17 Economic and Monetary Policy. Thus, Bulgaria’s pledge to become a eurozone member state stems also from Chapter 11 Economic and Monetary Union of 2001. This obligation was confirmed in the Treaty of Accession of the Republic of Bulgaria and Romania to the European Union, published in the Official Journal of the European Union OJ L 157, 21 June 2005,⁴ with effect from 1 January 2007.

II. BASIC ISSUES

1. Maastricht criteria and convergence reports

According to the European Union Treaty, becoming part of the core of the European Union – the eurozone, is needed to achieve nominal and sustainable convergence. The latter is defined by the fulfilment of the so-called convergence criteria for joining the eurozone described in the Maastricht Treaty,⁵ signed on 7 February 1992 and effective as of 1 November 1993, namely:

⁴ Official Journal of the European Union, L 157, 21 June 2005. See: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ%3AL%3A2005%3A157%3ATOC> [Accessed on 15 March 2023]

⁵ The Maastricht convergence criteria are described in Art. 140 of the Treaty on the Functioning of the European Union and Protocol 13. See: <http://eur-lex.europa.eu/legal-content/BG/TXT/?uri=celex%3A12012E%2FTXT> [Accessed on 2 April 2023].

- **Criterion for price stability** – achieving a rate of inflation which is ‘close to that of, at most, the three best performing Member States in terms of price stability’. In other words, the average rate of inflation, measured on the basis of the Harmonised Index of Consumer Prices (HICP) over a 12-month reference period, should not exceed by more than 1.5 percentage points the average inflation rate in the three best performing member states in the field of price stability.
- **Criterion on government financial position** (fiscal developments)

Article 2 of the Protocol (No. 13) on the convergence criteria stipulates that: ‘The criterion on the government budgetary position referred to in the second indent of Article 140(1) of the said Treaty shall mean that at the time of the examination the Member State is not the subject of a Council decision under Article 126(6) of the said Treaty that an excessive deficit exists’.

Furthermore, in accordance with Article 126(2) and (3), the European Commission prepares a report if a member state does not fulfil the requirements for fiscal discipline, when:

‘1. the ratio of the planned or actual government deficit to GDP exceeds a reference value (defined in the Protocol on the EDP as 3% of GDP), unless either: (a) the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, (b) the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value;

2. the ratio of government debt to GDP exceeds a reference value (defined in the Protocol on the EDP as 60% of GDP), unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.’

- **Criterion on exchange rate developments**

The criterion is defined in Article 140(1): ‘the observance of the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System, for at least two years, without devaluing against the euro’, and Article 3 of the Protocol (No. 13): ‘The criterion on

participation in the Exchange Rate mechanism of the European Monetary System referred to in the third indent of Article 140(1) of the said Treaty shall mean that a Member State has respected the normal fluctuation margins provided for by the exchange-rate mechanism on the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State shall not have devalued its currency's bilateral central rate against the euro on its own initiative for the same period.'

▪ **Criterion on long-term interest-rate levels**

As stipulated in Article 140(1) of the Treaty: 'the durability of convergence achieved by the Member State with a derogation and of its participation in the exchange-rate mechanism being reflected in the long-term interest-rate levels' is an important criterion. Article 4 of the Protocol (No 13) also defines this convergence criterion: 'The criterion on the convergence of interest rates referred to in the fourth indent of Article 140(1) of the said Treaty shall mean that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than two percentage points that of, at most, the three best performing Member States in terms of price stability. Interest rates shall be measured based on long-term government bonds or comparable securities, considering differences in national definitions.'

*The concept of 'outlier' is applied occasionally in the assessment of the criteria. ECB's convergence report for 2022 clarifies that a 'member state is considered to be an 'outlier' if two conditions are fulfilled: first, its 12-month average inflation rate is significantly below the comparable rates in other member states; and, second, its price developments have been strongly affected by exceptional factors. The identification of outliers does not follow any mechanical approach. The approach used was introduced to deal appropriately with potential significant distortions in the inflation developments of individual countries.'

Bulgaria will access the eurozone once it fulfils the necessary conditions for membership. Until introducing the euro, the country participates in the

Economic and Monetary Union as a member state with a derogation.⁶ In this regard, as defined in Article 140 TFEU: ‘at least once every two years, or at the request of a Member State with a derogation, the Commission and the European Central Bank shall report to the Council on the progress made by the Member States with a derogation in fulfilling their obligations regarding the achievement of economic and monetary union. These reports shall include an examination of the compatibility between the national legislation of each of these Member States, including the statutes of its national central bank, and Articles 130 and 131 and the Statute of the ESCB and of the ECB. The reports shall also examine the achievement of a high degree of sustainable convergence by reference to the fulfilment by each Member State’ of the so-called Maastricht or convergence criteria.’

On 1 June 2022, the European Commission⁷ and the European Central Bank⁸ published their convergence reports encompassing the progress made by non-eurozone member states towards satisfying the necessary conditions for euro adoption, namely: Bulgaria, Czechia, Croatia, Hungary, Poland, Romania and Sweden. The ECB report included a more in-depth assessment of Croatia compared to the other EU member states, considering the intention of the country to introduce the European single currency as of 1 January 2023. In general, the reports concluded that, apart from Croatia, none of the other member states under assessment complies with all economic convergence criteria. For instance, in five of the seven countries under review, the inflation is above the reference value. Overall, the countries have made limited progress towards meeting the Maastricht criteria, except for Croatia, due to the challenging economic conditions. Most of them did not reduce their fiscal imbalances. Three out of the seven member states did not meet the long-term interest rate criterion.

On the other hand, EC’s convergence report concluded that:

⁶ A derogation is a provision in an EU legislative measure which allows for all or part of the legal measure to be applied differently, or not at all, to individuals, groups or organisations.

⁷ EC’s Convergence report 2022. See: https://ec.europa.eu/commission/presscorner/detail/en/ip_22_3312 [Accessed on 5 April 2023].

⁸ ECB’s Convergence report 2022. See: <https://www.ecb.europa.eu/pub/convergence/html/ecb.cr202206~e0fe4e1874.en.html> [Accessed on 5 April 2023].

- ‘Only Croatia and Sweden meet the price stability criterion.
- All Member States fulfil the criterion on public finances, except Romania which is the only Member State subject to an excessive deficit procedure.
- Bulgaria and Croatia are the two Member States fulfilling the exchange rate criterion.
- Bulgaria, Croatia, Czechia, and Sweden fulfil the long-term interest rate criterion.’

2. Preparation process for euro adoption in Bulgaria

A Coordination Council for the preparation of Bulgaria for eurozone membership was established in 2015 by Decree No. 168 of the Council of Ministers.⁹ The Coordination Council is responsible for the organisation, coordination and monitoring of the practical preparation process of adoption of the single European currency. In addition, the Council is accountable for the development, implementation, and potential update of the National Plan for the Introduction of the Euro in the Republic of Bulgaria. Its key tasks are to approve documents, activities and initiatives related to preparation for eurozone accession, along with regular reporting to the Council of Ministers on the progress of the process.

The Council is co-chaired by the Governor of the Bulgarian National Bank and the Minister of Finance, who is the national coordinator of the preparation of the Republic of Bulgaria for eurozone membership.

As described by the Ministry of Finance, in the ‘Questions and Answers on the Introduction of the Euro in Bulgaria’ section on their website:¹⁰ the members of the Council are:

- The heads of the working groups who support with their expertise the work of the Council and whose scope of activity is described in the Plan for the Introduction of the Euro in the Republic of

⁹ Decree No 168 of the Council of Ministers of the Republic of Bulgaria. See: <https://dv.parliament.bg/DVWeb/showMaterialDV.jsp;jsessionId=033DE2E96D-A329141C282EBF269C58CD?idMat=95722> [Accessed on 7 April 2023].

¹⁰ Questions and Answers on the Introduction of the Euro in Bulgaria, Bulgarian Ministry of Finance. See: <https://www.minfin.bg/en/1606> [Accessed on 7 April 2023].

Bulgaria, including a deputy minister of finance, a deputy minister of economy and industry, the deputy governors of the Bulgarian National Bank and a member of the FSC;

- The deputy prime minister responsible for European fund management.
- A deputy minister of foreign affairs.
- A deputy minister of justice.
- A deputy minister of e-government.
- A deputy minister of interior.
- The chairman of the State Agency for National Security.
- A deputy minister of transport and communications.

The activity of the Coordination Council resumed after the Bulgarian lev accessed to Exchange Rate Mechanism II. The Council is assisted by expert working groups, as well as subgroups in charge of the practical aspects of the preparation for euro adoption. Those working groups may involve representatives of social partners, business organisations, non-governmental organisations, and academia. The expert working groups as defined in the National changeover plan are:

▪ **Macroeconomic Analyses and Public Finance Working Group**

The leading institution is the Ministry of Finance and the key activities of the working group are: analysis of the degree of nominal and actual convergence of the economy of Bulgaria; preparing proposals for measures and policies that will maximize the benefits of the introduction of the euro at minimum cost; preparation in the field of public finances – budgeting, statistics, accounting, payments in euro from/to budget organisations, etc. (More information on contemporary financial law, budget law and budget process in the European Union, and legal foundations of sustainable finance is presented respectively in chapters 18, 20 and 21).

▪ **Communications Working Group**

This Group is headed by the Ministry of Finance and the Bulgarian National Bank. The aim of the Group is to develop and implement a Communication Strategy for the euro, a dedicated information campaign, surveys of public

support for the euro, information materials and others to raise public awareness of the various issues relating to Bulgaria's eurozone accession.

▪ **Public Administration Working Group**

Led by the administration of the Council of Ministers, this group aims to prepare the administration to operate with the euro by developing guidelines and training initiatives for the smooth transition from lev to euro.

▪ **Non-Financial Sector Working Group**

The leading institution is the Ministry of Economy and Industry, and the main responsibilities of the working group are related to the activities of the non-financial sector and the preparation of guidelines for: tax reporting and accounting, logistics, commodity and other systems, correct conversion of prices from lev to euro, etc.

▪ **Currency, Payment Infrastructure and Credit Institutions Working Group**

The responsible institution is the Bulgarian National Bank, and its activities are split in three subgroups, each of which is chaired by one of the Deputy Governors of the Bulgarian National Bank:

1. Credit and Other Financial Institutions Working subgroup.
2. Currency (banknotes and coins) Working subgroup.
3. Payment Systems and Payment Service Providers Working subgroup.

▪ **Non-Banking Financial Sector Working Group**

This working group is headed by the Financial Supervision Commission and its main duties are linked to the non-banking financial sector (i.e., the conversion of financial instruments from BGN to EUR), the adaptation of clearing systems and settlement of securities to the euro and the reorganisation of information systems, accounting, financial and non-financial information, etc.

▪ **Consumer Protection Working Group**

The leading institutions are the Ministry of Economy and Industry and the Consumer Protection Commission. The working group is charged with preparing and implementing measures to protect consumers; it monitors

the conversion of prices from lev to euro, initiating a campaign for ‘fair introduction of the euro’, etc.

▪ **Euro Adoption Act Working group**

The Ministry of Finance is the leading institution for the development of an Act on euro adoption in Bulgaria. The latter will be coordinated with the other working groups.

3. Bulgaria and Exchange Rate Mechanism II

On 29 June 2018, the Bulgarian Minister of Finance and the Governor of the Bulgarian National Bank sent a letter regarding Bulgaria’s path towards ERM II participation¹¹ to the Presidents of Eurogroup and Ecofin on. Bulgaria’s intentions, as stated in this letter, are to join ERM II with its existing currency board arrangement in place, i.e., to apply to the mechanism by July 2019 and ultimately the euro following the fulfilment of all convergence criteria in accordance with Article 140 TFEU. Furthermore, the country expressed its expectations to join simultaneously ERM II and the Banking Union. Bulgaria made several commitments before ERM II entry, namely:

- ‘1. Strengthening banking supervision by entering into close cooperation with the ECB and undertaking the necessary preparations in line with existing procedures. The application of the Bulgarian authorities to the ECB for establishing close cooperation with the Single Supervisory Mechanism will be sent to the ECB the working day following a positive note from the Eurogroup, Denmark and the ECB regarding our intention to join the ERM II by July 2019 as expressed in this letter, for which the necessary formal steps will fully respect the conditions specified in the ECB’s legal framework for close cooperation with the ECB.
2. developing the macroprudential framework by providing the legislative basis for borrower-based measures, in addition to

¹¹ Council of the European Union, Letter to the Presidents of the Eurogroup and the Ecofin sent by the Bulgarian Minister of Finance and the Governor of the Bulgarian National Bank. See: <https://www.consilium.europa.eu/media/36125/st11119-en18.pdf> [Accessed on 9 April 2023].

- the existing capital-based measures, as called upon by the ECB Governing Council for all eurozone countries.
3. enhancing the supervision of the non-banking financial sector by
 - i) implementing and reporting to EIOPA on the action plan for supervision of the non-banking financial sector (pension funds and insurance companies) adopted by the regulator in September 2017; ii) preparing and adopting guidelines for the valuation of assets and liabilities in the non-banking financial sector; and iii) designing and implementing a risk based supervisory system under Solvency II.
 4. identifying, in cooperation with the Structural Reform Support Service (SRSS), the existing gaps in the insolvency framework and preparing a roadmap listing the steps necessary to address these gaps with focus on i) introducing a system of reliable data collection on insolvency and restructuring proceedings, and ii) introducing measures to reinforce the judicial infrastructure.
 5. strengthening the anti-money laundering framework by addressing any issue potentially identified by the Commission in its assessment of the transposition into national legislation of the fourth anti-money laundering directive (AML4-Directive) and adopting a draft law transposing the fifth anti-money laundering directive (AML5-Directive) at the government level.
 6. Improving, with the assistance of the SRSS, the governance of state-owned enterprises by revising and aligning legislation with the OECD Guidelines on Corporate governance of SOEs.'

On 22 August 2018, the Bulgarian Authorities approved an Action Plan with measures in response to the country's intentions to join Exchange Rate Mechanism II and the Banking Union. From a legal perspective and as stated by Savina Mihaylova-Goleminova: 'This implies changes in fiscal legislation and in both the national banking system and non-banking systems. The legal doctrine should reflect on and present these changes in a new way. Preparations for a new valuation of bank assets, this time at the initiative of the European Central Bank (ECB), have already begun. The final deadline for disclosure of the results is July 2019... Our country is

committed to introducing reforms to strengthen the financial sector, improve the work of institutions and start preparing for close cooperation with the ECB (the only way non-eurozone countries can participate in the Banking Union). A large part of the measures in the plan are related precisely to the establishment of close cooperation with the European Central Bank (ECB). They envisage several changes in the legal framework that should be introduced by the end of this year.’¹²

Following the letter dated 29 June 2018, on 9 July 2020¹³ Bulgarian authorities, represented by the Minister of Finance and the Governor of the Bulgarian National Bank sent an application letter. In this letter they requested initiation of the ERM II Procedure with the intention of joining ERM II.

On 30 April 2020 Bulgaria officially submitted documents to the European Central Bank in application for participation in Exchange Rate Mechanism II, the first step toward introducing the euro. On 24 June 2020 the Governing Council of the European Central Bank adopted a decision establishing close cooperation with the Bulgarian National Bank effective as of 1 October 2020.

On 10 July 2020 in a Communiqué on Bulgaria,¹⁴ published by the European Central Bank, it was announced that: ‘at the request of the Bulgarian authorities, the finance ministers of the eurozone Member States of the European Union, the President of the European Central Bank, and the finance ministers and central bank governors of Denmark and Bulgaria have decided, by mutual agreement, to include the Bulgarian lev in the Exchange Rate Mechanism (ERM II). The Commission has been involved and the Economic and Financial Committee has been consulted.’ This moment marks the date on which Bulgaria officially joined the Exchange Rate Mechanism (ERM II).

¹² **Михайлова-Големинова, С.** Предизвикателства пред държавите членки и кандидатките за членство в Европейския съюз в областта на данъчното облагане и финансовото право. София, Сиела, 2019, 246–248.

¹³ European Central Bank, Letter to the President of the Eurogroup sent by the Bulgarian Minister of Finance and the Governor of the Bulgarian National Bank. See: https://www.ecb.europa.eu/pub/pdf/annex/ecb.pr200710_annex~29156bba37.bg.pdf [Accessed on 11 April 2023].

¹⁴ European Central Bank, Communiqué on Bulgaria, 10 July 2020. See: <https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200710~4aa5e3565a.bg.html> [Accessed on 11 April 2023].

The Ministry of Finance of Bulgaria has announced and published on its website an Action Plan¹⁵ with measures to address ERM II post-commitments and other relevant policies. Concerning the non-banking financial sector, the responsible institution on completing the activities is the financial supervision commission. These activities include:

- ‘Carrying out compliance checks of the technical provisions with the obligations under the Green Card. The Actions include conducting checks, including cross-checks, where necessary to establish the adequacy of the technical provisions in relation to obligations towards Green Card participants.
- Carrying out: off-site and on-site, including related to risk-based supervision.
- Carrying out targeted meetings with audit companies.
- Drafting of secondary legislation on the implementation of the Insurance Code in relation to the management system, including the application of the prudent person principle.
- Carrying out an analysis of the investment policies and portfolios of non-life insurers and taking action against insurers where necessary.
- Monitoring the financial stability of the National Bureau of Bulgarian Motor Insurers by receiving periodic reports on its financial status.
- Implementing a project under the Structural Reform Support Programme (SRSP) – EIOPA Pilot Insurance Training Programme and implementation of a new project under SRSP with the aim of strengthening the capacity of insurance and pension insurance supervision, including training.
- Completion of the legal procedure for appointing new members of the FSC by the National Assembly to ensure the efficient governance of the supervisory authority, including by timely filling of vacant positions in their governing boards.’

¹⁵ Bulgarian Ministry of finance. Action plan with measures to address the ERM II post-commitments. See: <https://www.minfin.bg/en/1464> [Accessed on 11 April 2023].

Several other topics are covered in the Action plan. The Public Enterprises and Control Agency is responsible for implementing the measures regarding state-owned enterprises (SOEs). The listed activities aim to ‘ensure the timely and effective implementation of the Public Enterprises Act and to strengthen the capacity of the Public Enterprises and Control Agency by implementing a project under the SRSP with the assistance of OECD’:

- Develop a state ownership policy.
- Within 12 months of entry into force of the Act, to bring the composition of the boards of public enterprises in compliance with the selection procedures set out in the Public Enterprises Act.
- Undertake an analysis of the activities of state-owned enterprises established by special laws and submit it to the Council of Ministers.
- Prepare and approve annual aggregate reporting on the performance of the state public enterprises.
- Draft Rules of Procedure of the Public Enterprises and Control Agency.

The Ministry of Justice is responsible for increasing ‘the efficiency of insolvency and restructuring procedures through implementation of legislative amendments to reform the organisation of the courts handling procedures, to strengthen the regulation of the profession of insolvency practitioners and to allow the use of electronic means throughout procedures.’ The activities identified within the Action Plan in implementation of the above-mentioned measure are: firstly, drafting of legislative amendments to the Commerce Act regarding the insolvency framework, including full transposition of Directive (EC) 2019/1023 in accordance with applicable deadlines. Secondly, an organisational change of the Ministry of Justice for the purpose of operationalising the new regime for the profession of insolvency practitioners; this could be done through a draft proposal for amendments to the organisational structure of the Ministry of Justice. Thirdly, training programs for insolvency practitioners and judges, to be initiated by means of:

- Drafting and approval of training methodology and specialised trainings for judges and court staff.

- Adopting a methodology for assessment of IPs Training Needs.
- Launching the CPD programme for IPs to complement existing training initiatives.

Initial technical feasibility assessment of IIS and initial functional requirements must be assessed. Draft detailed terms of reference are a way to accomplish the goal of introducing specialised electronic tools within insolvency and restructuring. Moreover, manuals, codes, templates, and guidelines must be developed and introduced:

- Draft proposal of a Procedural Manual for IPs in insolvency and stabilisation including reporting templates for IPs.
- Draft proposal of standardised templates for parties in insolvency and stabilisation proceedings.
- Draft proposal of a Code of Conduct and Professional Standards of IPs in Bulgaria.

A further action with regard to the insolvency framework will be the collection and publication of statistical data with the final result being updating of the Commercial Register (through draft functional requirements and technical specifications) and adoption of a methodology (draft proposal for a regulation and methodology for collection and verification of the quality of statistical data).

The next big topic covered by the Action Plan on ERM II post-commitments is the anti-money laundering framework. Several responsible institutions are identified, namely: the State Agency on National Security, the Bulgarian National Bank, the Financial Supervision Commission, the National Revenue Agency, etc. Several measures are identified: enhancing the capacity and capability of supervisory authorities to mitigate money laundering risks and enhancing application of the anti-money laundering framework by the relevant entities, including the following activities:

- Employing/transforming staff to perform tasks related to AML/CTF supervision.
- Reviewing internal procedures for effective supervision based on risk assessment of supervised sectors/entities.

- Developing a supervisory strategy (to allocate resources to each relevant entity in accordance with its risk-profile)
- Developing and enforcing a risk mitigation policy for the money laundering risks to which local institutions are exposed (including guidance on how to deal with politically exposed persons).
- Revising the supervisory procedures manual to ensure a consistent and effective approach to monitoring (for instance, record keeping of files and documents examined during on-site inspections) and follow-up (for instance, remedial actions) to ensure that the relevant entities comply with their anti-money laundering obligations.
- Increasing the awareness of relevant entities regarding their obligations under AML/CFT legislation.
- Developing and introducing a dissuasive sanctioning policy.

The second anti-money laundering measure is to enhance the capacity and analytical capabilities of the Financial Intelligence Unit to make better use of suspicious transaction reports and increase the use of financial intelligence by competent authorities. This will be achieved by increasing the staff of FIU through hiring highly skilled staff to engage in the processing of suspicious transaction reports and to carry out financial intelligence based on these reports, and developing or acquiring IT tools to process and analyse the suspicious transactions reports received by FIU. Further, an action plan must be drawn up for follow up on the risks identified in the national risk assessment; this will be achieved by implementing a project devoted to enhancing the capacity of the competent Bulgarian institutions to effectively mitigate the risks of money laundering and terrorist financing. Furthermore, in order to complement national risk assessment with an analysis of risks linked to virtual assets and general risks emanating from citizenship schemes, another project must be implemented, aimed at enhancing the capacity of Bulgarian institutions to effectively mitigate the risks of money laundering and terrorist financing.

The final part of the Action Plan comprises several activities intended to address the legal incompatibilities identified in the ECB and EC 2020 convergence reports; the responsible institution in this respect is the

Bulgarian National Bank. Thus, a number of amendments in the relevant Bulgarian legislative acts are listed:

- Amendments to the Bulgarian National Bank Act to strengthen the independence of the central bank, as follows: deletion of Article 3; Article 14 must provide explicitly for the right of the competent Bulgarian court to review decisions for dismissal of members of the BNB Governing Council other than the Governor; Article 13 should include reference to the content of the oath of central bank independence.
- Amendments in Article 80 of the Counter-Corruption and Unlawfully Acquired Assets Forfeiture Act to further ensure central bank independence as follows – to provide that, in case of ascertained conflict of interest, a member of the BNB's Governing Council will be dismissed in accordance with Article 14(1) of the BNB Act.
- Amendments to Article 56 and Article 56a of the Credit Institutions Act as follows – these must provide that the BNB will not be liable for information provided by obliged entities to the Central Credit Register and the Register of Bank Accounts and Safe Deposit Boxes. The amendments aim to ensure compliance with the monetary financing prohibition.
- Amendments to the Bulgarian National Bank Act with view of legal integration of BNB into the Eurosystem and ensuring further compliance with the monetary financing prohibition.

III. NATIONAL EURO CHANGEOVER PLAN

The Coordination Council for Preparation of the Republic of Bulgaria for Eurozone Membership adopted a draft national plan for euro adoption on 30 June 2021 with a target date of introducing the euro on 1 January 2024, reaffirming the country's commitment to adopt the euro on the target date.

The Coordination Council for Preparation of the Republic of Bulgaria for Eurozone Membership elaborated the **National Euro Changeover plan**. The plan comprises a strategic document which contains the

principles, main tasks and deadlines related to operational work for the replacement of the lev with the euro. The plan was adopted by the Council of Ministers on May 27, 2022, and reaffirms the commitment of joining the eurozone on 1 January 2024.

In the preparation process, public authorities must strictly adhere to several key principals: efficiency, responsibility, transparency, conversion from levs to euro (meaning that the full fixed exchange rate should be applied including all five numbers after the decimal point), consumer protection, prevention of harm to individuals and legal entities, consumer security, minimization of public spending associated with the adoption of the euro, special attention to the most vulnerable groups (students, ethnic minorities, pensioners, citizens living in remote areas, those suffering from physical, sensory or mental illnesses etc.), extension of existing contracts and automatic conversion of credit facilities, deposits and funds under accounts, loans, financial instruments and securities.

The third chapter of the National Changeover Plan presents the scenarios¹⁶ and time limits for adoption of the European single currency. In general, there are two possible scenarios for the changeover: the big bang scenario and the big bang scenario with phasing out. As defined in the plan: ‘the so-called ‘Big bang scenario’ is the scenario under which euro banknotes and coins become official means of payment as of the date of membership in the eurozone. Use of national currency in parallel with the euro is allowed for a period of up to 6 months after the changeover. The so-called ‘Big bang scenario with phasing-out’ is when the national currency can still be used in certain legal instruments and systems (such as IT systems) for a maximum period of one year from the date of euro introduction. This scenario takes advantage of the rapid euro introduction, as in the first scenario, combined with an extended withdrawal period, which could be useful for changing more complex administrative and technological systems.’ In the case of Bulgaria, the date of introducing the common currency coincides with the adoption of the euro as the official unit of payment, hence, the **big bang scenario** is chosen.

¹⁶ Regulation (EC) 2169/2005 amending Regulation (EC) 974/98 provides for the possibility for Member States to choose the scenario for the eurozone accession and the length of the transitional period.

A mandatory dual display of prices in both euro and lev would be required one month after the Council of the European Union takes the decision that Bulgaria meets the respective criteria for joining the eurozone. Moreover, both the lev and the euro will hold the status of legal tenders and will be simultaneously in circulation during the first month from the date of euro adoption; thereafter, only the euro will be the legal tender¹⁷ in the country. Banks and Bulgarian Posts EAD will exchange banknotes and coins from lev to euro free of charge during the first six months following the day of euro adoption; after that they may charge for the service. However, the Bulgarian National Bank will exchange lev and euro banknotes and coins free of charge indefinitely. A transition period will not apply for current accounts, deposit accounts, current budget accounts, savings accounts, payment accounts and others, and they will be converted on a one-off basis, free of charge and automatically from the day of euro adoption.

The National Changeover Plan also defines the time frames and responsible institutions for other important activities, such as the selection of a design for the national side of euro coins, their production, the preparation of starter kits with euro coins, the communication campaign, the supply of euro banknotes and coins to banks, as well as merchants, the preparation for conversion of financial instruments (registers, clearing and settlement systems, trading systems), etc.

One month after the Council of the European Union takes the decision that Bulgaria meets the required conditions for the adoption of the euro and confirms the fixed exchange rate for converting the lev to the euro, a requirement for mandatory dual display of prices in both currencies will come into force. This obligation will remain in force for 12 months from the date of euro introduction.

Special attention is given also to the schedule for the main activities in the field of banks and financial institutions, as they have to prepare their information systems, the conversion of bank payment and credit accounts, conversion also of reference interest rates, as well as for presentation of current reports for statistical, regulatory and public purposes in euro only.

¹⁷ Regulation (EC) 974/98 on the adoption of the euro governs the substitution of the euro for the national currency of the member state. This legal act provides for the right of the countries that have adopted the euro to issue coins that have the status of legal tender in all eurozone member states.

Regarding the non-banking financial sector, strict preparation is required for the conversion of financial instruments, liabilities, shares, balances on all accounts, for reports and statements.

The schedule for the main activities in the field of payment systems is also presented and includes some more specific tasks: ‘accession of the BNB, banks, payment systems and securities settlement systems to the new consolidated TARGET services platform; analysis, development and preparation of the necessary changes in the legal framework, payment and internal information systems of the BNB, BORICA AD and the banks, ensuring the transition of the lev interbank payments to settlement in euro on a consolidated TARGET services platform; analysis, development and preparation for migration of client payments, including budget ones, in BGN, to SEPA payments in EUR; analysis, development and preparation of the necessary changes in the information systems for government securities auctions, for information servicing of the state budget and in the systems servicing the Government Securities Depository. Legal and technical preparation for accession of the Government Securities Depository and Central Depository AD to TARGET2-Securities; analysis, development and preparation of the necessary technical and legal changes in statistical reporting and information systems in connection with the introduction of the euro; publication of the time series of statistical data, converted into euro and beginning of parallel publication of the current statistical data in BGN and in EUR; issuing methodological guidelines for statistical reporting in euro; implementation of data reporting under ECB Regulation 2016/867 of 18 May 2016 on the collection of granular credit and credit risk data (ECB / 2016/13) and BNB requirements; conducting tests of the changes in information systems.

A Decision by the 48th National Assembly was adopted on 27 October 2022¹⁸ which states that the Council of Ministers, in coordination with the Bulgarian National Bank, has to speed up the consultations and negotiations with the European Commission, the countries whose entire currency is the euro and the countries participating in the Exchange Rate Mechanism II, with a view to adopting the euro in the Republic of Bulgaria with a target date of January 1, 2024. In addition, the Council of Ministers,

¹⁸ Decision by the 48th National Assembly of the Republic of Bulgaria. See: <https://www.parliament.bg/bg/desision/ID/164380> [Accessed on 15 April 2023]

in coordination with the Bulgarian National Bank and other responsible committees, has to accelerate the process of technical preparation for the adoption of the euro according to the National Plan for the introduction of the euro in the Republic of Bulgaria; the exchange rate to be applied for converting the lev into euro was confirmed: BGN 1,95583 for EUR 1.

IV. ADOPTION OF THE EURO IN THE REPUBLIC OF BULGARIA ACT

Joining the eurozone will also require some changes in the Bulgarian legal framework in order to create conditions for a smooth transition to the euro and ensure legal certainty. In this regard, prior to introduction of the single currency, a special act regulating common issues related to this process needs to be adopted. The latter will be called the Adoption of the Euro in the Republic of Bulgaria Act (or Euro Adoption Act). Additionally, a number of laws and legislative instruments involving provisions related to the lev will have to be amended.

In the autumn of 2022, a concept for Adoption of the Euro in the Republic of Bulgaria Act¹⁹ was published. In general, the document aims to propose a concept for the scope and structure of a Euro Adoption Act. The Act will govern the principles, rules, and procedures for introducing the euro as the official currency in Bulgaria. Subsequently, a report of all proposals and opinions received in the course of public consultations on the concept, both those reflected in the concept and not, was also published. On that base, a full Euro Adoption Act was developed by the various institutions and working groups.

As of the date of writing this chapter, the **Adoption of the Euro in the Republic of Bulgaria Act** is not yet adopted; however, it is expected that this legal act will cover the subjects introduced by the National Euro Changeover Plan. There are ongoing discussions on specific articles of the draft act in a number of the working groups dedicated to the preparation process. In general, the Act will regulate the principles, rules, and

¹⁹ Bulgarian Ministry of finance, Concept of an Adoption of the Euro in the Republic of Bulgaria Act. See: <https://www.minfin.bg/bg/legislation1/415> [Accessed on 15 April 2023].

procedures for the introduction of the euro as the monetary unit of Bulgaria. Its purpose is to ensure the introduction of the euro in Bulgaria and to increase transparency and awareness of the entire process. The euro will be the official monetary unit of Bulgaria, as of the date of introduction of the euro in the country. In addition, the banknotes issued by the European Central Bank and the banknotes and coins issued by the national central banks of the member states whose currency is the euro, will be legal tender in Bulgaria, as of the date of introduction of the euro in the country. The Euro Adoption Act will also define the official exchange rate of the lev to the euro; this will be the irrevocably fixed exchange rate of the lev to the euro defined in Council Regulation (EC) No. 2866/98 of 31 December 1998 on the conversion rates between the euro and the currencies of the Member States adopting the euro (OJ, L 359/1 of December 31, 1998), which cannot be different from the central rate of BGN 1.95583 per 1 euro.

Moreover, the Act will define the rule for conversion from lev to euro: this will be carried out by dividing the numerical value in lev by the full numerical value of the official exchange rate with all five digits after the decimal point; an abbreviated form of the official exchange rate will not be allowed. Another key principle is determining the rounding rule – following revaluation according to the defined rule for conversion, the resulting amount will be rounded to the second decimal place based on the third decimal place according to mathematical rounding rules, with some specific exceptions only where this or another law or instrument of the European Union provides that rounding is to be carried out to a decimal point other than the specified.

Other topics subject to this Act are the rules for designation during the double coverage period, distribution and exchange of euro banknotes and coins, general rules for currency conversion (of goods and services, accounts, payment operations, the nominal values of units and shares in commercial companies, capital, debt securities, government securities, conversion in the commercial register, conversion related to the shares of supplementary pension insurance funds, interest rates on credit agreements, remunerations, cash benefits and pensions under the Social Security Code, social benefits etc.). A further topic is the adaptation of information systems for operation with the euro, registers, accounting and tax documents, declaration, obligations, official statistics. The law

incorporates also a section on control, enforcing, administrative measures and administrative penal liability.

In addition, in October 2023, the Ministry of Finance announced a logo and slogan contest for Bulgaria's accession to the Eurozone. The latter will be used in materials for all communication channels – printed, audio and video materials and messages in television, radio, Internet, and digital space, in the period before, during and after introduction of the single European currency in Bulgaria. In October, an updated Communication Strategy for Bulgaria's Accession to the Eurozone was also adopted. The new texts stipulate for a campaign which will acquaint citizens with the benefits and effects of eurozone membership. A detailed and extensive research on the benefits, risks, challenges and possible problem areas in participating in the final stage of the Economic and Monetary Union is the collective monograph entitled *Challenges to the Bulgarian economy on the way to membership in the Eurozone* prepared by distinguished professors and scientists from the Economics department of Sofia University St. Kliment Ohridski.²⁰ A goal has also been set for measures to counteract any misinformation that may mislead or instil unfounded concerns among citizens regarding the process. The strategy plans the phases of the campaign, considering the changed perspective for Bulgaria's membership for January 1, 2025, adding several new communication activities and changing those foreseen in the previous strategy.²¹

Furthermore, in November 2023 the Bulgarian National Bank presented the design of the national side of the euro coins of all denominations: 1-, 2-, 5-, 10-, 20- and 50-eurocents and 1 euro and 2 euro. Euro coins have a common side and a national side. The current design of Bulgarian exchange coins will be reproduced on the national side of Bulgarian euro coins: the Madara Horseman – on 1-, 2-, 5-, 10-, 20- and 50-eurocent coins; St. Ivan Rilski – on the 1-euro coin; Paisius of Hilendar – on the 2-euro coin; the reverse side will bear the inscription 'God protect Bulgaria'. In addition,

²⁰ 120 years Department of Economics: Collective Monograph Challenges to the Bulgarian economy on the way to membership in the Eurozone. See: https://www.uni-sofia.bg/index.php/universitet_t/fakulteti/stopanski_fakultet/novini_ot_fakulteta/120_godini_katedra_ikonomika_kolektivna_monografiya_predizvikatelstva_pred_b_lgarskata_ikonomika_po_p_tya_k_m_chlenstvo_v_evrozonata.

²¹ Ministry of finance, News. See: <https://www.minfin.bg/bg/news/12375> and <https://www.minfin.bg/bg/news/12370>.

the word ‘stotinki’ will also be retained in the graphic design of national euro coins. The national side will feature a circle of 12 stars, as on the flag of the European Union; also, the word ‘Bulgaria’ will be written in Cyrillic. The design of the common side of the coins is the work of Luc Luyx of the Royal Belgian Mint. They feature images of the European Union or Europe, which symbolize the unity of the EU.²² The artistic designs for the Bulgarian national side of the euro coins were adopted by the Coordination Council and meet the requirements for the main motifs and mandatory design features set out in Council Regulation (EU) No 729/2014 of June 24, 2014 on denominations and technical specifications of euro coins intended for circulation.

Additionally, at the end of November 2023 the Ministry of Finance announced for public discussion a new BNB Act as a first step towards the introduction of a completely different regime of monetary policy compared to the monetary board established in 1997. The new Act is intended to enter into force on the day designated by the Council of the European Union for adoption of the euro by the Republic of Bulgaria and will repeal the Currency Board Act.²³

To conclude, Bulgaria aims at becoming the 21st eurozone member state and is in the process of joining the eurozone. Nonetheless, the target date for euro adoption changed from 1 January 2024 to 1 January 2025 as a possible date if the country meets the necessary criteria. In this respect, two reasons were identified – Bulgaria did not meet the entry criteria on inflation and some legal issues had not been solved – the National Assembly failed to adopt changes to the Insurance code, the Commerce Act and to anti-money laundering acts. Thus, the country did not file for a convergence report in 2023; the upcoming regular report is expected in 2024.

²² Bulgarian National Bank, Design of the Bulgarian national side of the euro coins, 16 November 2023. See: https://www.bnb.bg/AboutUs/PressOffice/POAccessionToEuropeanFinancialInfrastructure/POAEFIPressReleasesAndStatements/PR_20231116_BG#.

²³ Ministry of Finance, Drafts of normative and other acts – Draft act on Amendments and Supplements to the Bulgarian National Bank Act. See: <https://www.minfin.bg/bg/legislation1/200>.

CHAPTER 26:

STRATEGIC DOCUMENTS IN THE FIELD OF CIRCULAR ECONOMY. FUNDING OPPORTUNITIES

Mario Milov

ABSTRACT	KEY WORDS
The circular economy is a sustainable alternative that aims at economic growth and environmental protection at the same time. Its model attempts to extend the life cycle of products. In practice, this means sharing, borrowing, reusing, repairing and recycling existing materials and products for as long as possible. When a product reaches the end of its life, the materials that make it up continue to have other uses. This can be repeated over and over again, thus minimising waste disposal. The increasing consumption of resources and the environmental consequences it causes require a change in the economic model. The concept of a circular economy is part of this change. Its notion is built in opposition to the traditional linear model, where raw materials are used to make things and products which are then consumed and the leftovers thrown away. This model relies on large quantities of cheap and available materials and energy sources.	circular economy, strategic documents, European strategic documents, national strategic documents, finance and investments, European Structural and Investment Funds, sources of financing for green investments.

I. INTRODUCTION

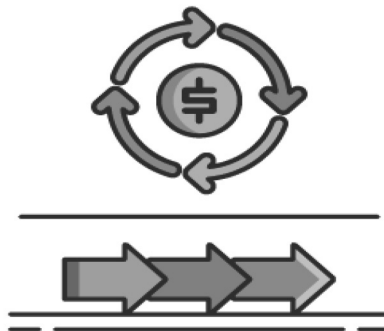
Knowledge, skills and information at national level related to establishing a framework for sustainable product policy and creating circular patterns for the benefit of people, regions and cities are inadequate. The difficulties of businesses in adapting environmental legislation to the

activities of a particular organisation arise for two reasons (See Chapters 8, 9, 21, 28). On the one hand, this is due to lack of knowledge of the business sector of the different national strategy documents, and on the other hand, to lack of information and knowledge in the field of environmentally friendly practices. This leads to lack of motivation and interest in business in implementing new technologies for sustainable production alternatives.

Conventional notions of the economy are based on a ‘linear’ model: natural resources are extracted and transformed into products. Products are used by consumers and discarded when they become unnecessary. The model does not take into account the high economic, environmental and social costs associated with the exploitation, processing and disposal of these resources and is unsustainable in the long term.

The circular economy offers an alternative model where the usefulness of products, materials and resources is extended as much as possible and waste is reduced or even eliminated. By ‘closing the loop’, the circular economy can develop within our limited material resources. The transition to such an economy involves a wide range of activities/sectors: mobility and transport, agriculture, land use and waste management, business development and consumer education, affecting almost all social strata and levels of government. However, this transition is not something that an institution or company can implement on its own. It requires interaction and collaboration between stakeholders and sectors.

Figure 1: Transition from a linear to a circular economy.



II. EUROPEAN SUSTAINABLE ECONOMIC ACTIVITIES

Today's economy is discarding more and more waste that is slow and difficult to break down, yet has a high residual value if managed properly. Serious environmental and economic problems follow. Mountains of rubbish on land and islands of rubbish in the oceans threaten our health. Furthermore, growth based on extracting finite natural resources and then disposing of them is inherently doomed.

'The circular economy is a concept in which growth and prosperity are decoupled from the consumption of natural resources and the decline of ecosystems. It is a strategy for securing natural resources so that all people on the planet can reach an acceptable level of prosperity without destroying the planet in the process,' says Nick Voulvoulis, Professor of Environmental Technology at Imperial College London.¹

The first use of the term 'circular economy' is most often associated with the name of Walter R. Stachel, a Swiss architect, currently head of the Product-Life Institute. In 1982, in a report to the European Commission, Walter Stachel and Genevieve Reday theorised a model of circular economy and explored its impact on job creation, economic competitiveness, resource savings and waste prevention.²

Recycling is therefore becoming an increasingly topical issue. The idea is to produce products in a way that allows them to be easily repaired or converted into other products later on (*so-called product transformation*), with companies taking responsibility for them after they have been sold. To complete the circle, each industry works with the others and uses their waste material (*so-called industrial symbiosis*).

Regardless of the formulation, the model and logic of the circular economy (*closing the loop*) offer a very clear and applicable vision for the overall structuring of socio-economic relations in such a way that economic activities do not pose a threat to nature and people, but become

¹ See: [<https://www.greenbiz.com/article/8-companies-watch-circular-economy>] [Accessed on 05 March 2022].

² See: Мишонова, Р. Икономическо развитие и климатични промени. // Платформа за знания „Климатека“, 2021.

an integral, positive element of the whole ecosystem, creating conditions for regenerative functioning and generating benefits for society, business and the environment. The circular economy is a model of production and consumption that minimises waste.

Every European consumes on average 14 tonnes of raw materials and leaves 5 tonnes of waste every year. But this waste, these products and materials, can be reused or recycled. This is the principle of the circular economy, supported by the European Parliament. The aim is to move away from the linear model that has dominated since the industrial revolution, namely *'take-make-use-dispose'*. Its place should be taken by circular economy, in which the life cycle of products is extended, the use of raw materials is reduced and only unusable waste is discarded.

The transition to a circular economy will reduce environmental pollution, alleviate raw material sourcing problems, and boost innovation and competitiveness. The change has the potential to add a further 0.5% to the EU's GDP and create 700,000 jobs in Europe by 2030, while giving consumers access to more sustainable and cost-effective products.

The circular economy is set as a strategic objective at European level. In 2015, the European Commission published a Circular Economy Action Plan,³ which proposes rethinking EU policy by introducing changes in product life cycle stages: design – production – consumption – waste management – recycling of secondary materials. The transition to a circular economy is also a key priority for the EU in order to achieve UN Sustainable Development Goals.⁴

The concept of circular economy is also enshrined in a number of EU and national strategic documents. However, for the circular economy to become a reality, long-term action is needed at all levels – from Member States, regions and cities to businesses and citizens.

³ See: http://europa.eu/rapid/press-release_IP-15-6203_en.htm;
<https://www.europarl.europa.eu/factsheets/bg/sheet/76/resource-efficiency-and-the-circular-economy> [Accessed on 12 March 2023].

⁴ See: <https://cor.europa.eu/bg/news/Pages/un-sustainable-development-goals-should-guide-the-european-recovery.aspx> [Accessed on 10 March 2022].

The transition towards a more circular economy, in which the value of goods, materials and resources is retained in the economy for as long as possible and waste generation is minimised, is a key contribution to the EU's efforts to build a sustainable, low-carbon, resource-efficient and competitive economy. The circular economy is expected to increase the competitiveness of EU economy, protect businesses from resource scarcity and help create new business opportunities for innovative and efficient ways of production and consumption. In parallel, the circular economy will help to save energy and prevent irreversible damage to climate, biodiversity and air, soil and water pollution caused by using resources at a rate that exceeds the earth's capacity to renew them. The transition is expected to have a positive impact on reducing carbon dioxide emissions. By promoting more sustainable activities in key sectors and new business opportunities, the conditions will be created to harness the potential of the circular economy to create growth and jobs. Action at EU level supports the circular economy along the entire value chain – from production to consumption, repair and remanufacturing, waste management and secondary raw materials re-used in the economy.

An essential part of the circular economy concept is the establishment of an effective monitoring framework at EU level containing a set of key indicators that reflect the essential elements of the circular economy.⁵

⁵ See: <http://ec.europa.eu/environment/circular-economy/pdf/monitoring-framework.pdf> [Accessed on 15 March 2022].

Figure 2: Elements of the circular economy.

One of the big challenges at the moment is how to break away from the growth-dominated model in order to meet the social needs of society, and how to replace the current predatory exploitation of natural resources with a new, more efficient, resource-efficient and environmentally responsible model.

Circular economy provides basic guidance on what needs to be done to significantly and permanently reduce the resource dependence of economy and move towards overcoming the scarcity of non-renewable natural resources. It proposes important solutions, especially for production skills and design, new business models, cycle-building skills, and cross-sectoral collaboration.

Circular economy is a closed loop covering each of the three areas: supply and responsible choice of producers, demand and consumer behaviour, and waste management.⁶

One of the EU's key policy priorities, aimed at helping Europe meet its commitments to the UN's Sustainable Development Goals, which

⁶ See Europesworld, 2014.

have risen to 17,⁷ is the transition to a circular economy based on three pillars:

- benefits to the environment by limiting environmental impacts and reducing resource use;
- cost savings from reduced natural resource needs;
- creating new markets providing additional economic benefits from circular practices.

The European Commission's Circular Economy Package includes revised legislative proposals on waste to drive Europe's transition towards a circular economy, which will boost global competitiveness, foster sustainable economic growth and generate new jobs.

The proposed actions will contribute to 'closing the loop' of product lifecycles by increasing recycling and reuse and will bring benefits for both the environment and the economy.

III. THE STRATEGIC PLANNING MODEL

The economic basis for achieving the common European objectives is the EU budget, which sets out the Union's total revenue and expenditure for the year, based on an agreed policy development strategy.⁸ In the EU, the Union's development strategy and its objectives for the relevant programming period are adopted first, followed by the multiannual financial framework, which secures the achievement of these objectives by the EU and the Member States, which also adopt strategies in line with EU strategies.⁹

⁷ See Sustainable Development Goals, <http://devedu.eu/worldinthesuitcase/цели-заустойчиво-development/> [Accessed on 24 March 2022].

⁸ For more information on European public finances, see the Fifth Edition of EU Public Finances: http://ec.europa.eu/budget/news/article_en.cfm?id=201501061636http://devedu.eu/worldinthesuitcase/цели-заустойчиво-development/ [Accessed on 26 March 2022].

⁹ For more information, see **Mihaylova, S.** Challenges Facing Member States and Candidate Countries of the European Union in the Field of Taxation. Sofia, Ciela, 2019, p. 364.

The process of developing strategies or updating existing programming documents is never formally linked to the budgetary procedure. Experience shows that there is insufficient integration and coordination of strategic development documents, which does not ensure optimal synergy and leads to inefficient and ineffective use of resources (*financial, human, natural, etc.*). These circumstances determine the low quality of the strategic planning and management process, and hence the negative attitudes of the direct actors in this process (*administration, political office, business and others*) and citizens (*voters and taxpayers*).

The current model for strategic development programming in Bulgaria declares¹⁰ that it seeks to enable a high degree of coherence between the objectives and measures envisaged in the different strategic documents and to achieve the so-called synergy effect in the implementation of government policies. The strategy papers themselves are an important instrument of the government for planning and implementing development policies. The development programming system introduced in 2010 is based on international best practices and is based on interlinked official documents (*programmes, strategies, plans*). These strategic documents are expected to define the long-term, medium-term and short-term objectives and measures for the economic and social development of Bulgaria.

There is no strategic planning procedure in our legislation. What we have are basic strategic documents adopted in accordance with the Methodology for Strategic Planning in the Republic of Bulgaria in its current model, which documents can be classified in the following ways:

a) According to reason for admission:

- internal documents on national economic and social development policies;
- European documents related to Bulgaria's membership of the European Union;

b) According to purpose:

- framework – setting the framework for development policies;

¹⁰ See Council for Administrative Reform (2010) Methodology for Strategic Planning in the Republic of Bulgaria, Council of Ministers, et al.

- operational – determining how development policies are implemented;

c) According to content:

- general – determining development policies in all sectors of government;
- sectoral – defining policies for the development of a particular sector of government.

d) According to territorial scope:

- for the whole country – national;
- for a certain territorial level – planning region, district, municipality.

e) According to the time frame:

- long-term – for a period exceeding 10 years;
- medium-term – for a period between 3 and 10 years;
- short-term – for up to 3 years.

These characteristics define both the types of strategic development programming documents and their interrelationships. The implementation of strategic documents is integrated into the structure of the relevant public organisation through budget and management, by objectives (*so-called target management*). In exercise of its constitutional powers under Articles 105–116 of the Constitution of the Republic of Bulgaria (CRB), the Council of Ministers exercises general direction, formulates, develops and implements public policy through the adoption of strategic documents by the relevant ministers. Article 20(3) of the Administration Act establishes that the Council of Ministers formulates, develops and implements state policy in accordance with its constitutional powers and the laws of the Republic of Bulgaria. The Council of Ministers adopts a programme of strategic objectives and priorities for the duration of its administration. Following analysis,¹¹ it is clear that there is insufficient

¹¹ In the public consultation portal, under the heading ‘strategic documents’: <http://www.strategy.bg/StrategicDocuments/List.aspx?lang=bg-BG&categoryId=1&typeConsultation=1&typeCategory=0&docType=1> [Accessed on 06 April 2022].

synergy in the preparation, implementation, monitoring and evaluation of the implementation of these strategic documents, in particular: there is no coordination of national strategies, plans and programmes with the horizontal policies of the National Development Programme of Bulgaria and the Partnership Agreement of the Republic of Bulgaria outlining the assistance from European Structural and Investment Funds (ESIF) for the period 2021-2027. There is insufficient coordination of national strategies, plans and programmes with the Government Programme for the relevant period, and the annual objectives of the administrations responsible for their implementation. Action plans and programme budgeting, including long-term programming of relevant strategic documents, are not in place. Most strategic documents provide for a monitoring mechanism, but only by prescription, i.e., there are no publicly available and disclosed monitoring reports from which to track defined strategic objectives. No *ex-ante* impact assessments of strategic documents are stipulated, i.e., the expected effect of achieving strategic objectives is not planned. There is no final evaluation of the strategy papers which have completed their period of operation (*the final evaluation determines continuity between papers for subsequent periods*). In terms of reporting on the implementation of strategies, plans and programmes, there are no publicly available reports on their implementation. It must be noted that coordination at national level of common European and national objectives and strategies should be achieved by individual Member States through policy area strategies, in accordance with the Partnership Agreement and other sectoral strategy papers, in line with the legal framework – European and national.

There are isolated provisions in most sectoral legislation regarding the adoption of strategies, but there is no clear legal framework. There is a need to establish one that emphasises the link between the adoption of strategies, their monitoring and reporting, programme budgeting and effective financial management, and control systems for budget and public sector organisations. *Ex-ante* and *ex-post* impact assessment of strategic documents, analogous to the Statutory Instruments Act, should also be included in this legal framework. Preventive measures, including sanctions, should be laid down and linked to the Public Finance Act

(PFA), the Financial Management and Control in the Public Sector Act, the Public Sector Internal Audit Act, the Public Financial Inspection Act, the Social Assistance Act, etc. The idea is to link the objectives of the strategies and the indicators for their achievement to their financing from state and municipal budgets, the EU budget, financial instruments, public-private partnerships or private investments. This will monitor and ensure compliance with the basic principles of sound financial management set out in the FMCPS Act (*effective, efficient and economic management*). Coordination must be achieved at all levels of management – internal and external, expertise and professionalism, programme budgeting.

IV. IDENTIFICATION OF STRATEGIC DOCUMENTS

In the preparation of this chapter, a total of 11 (eleven) strategic documents were identified in the area of policy to promote the implementation of the circular economy for the study period, including 4 (four) European and 7 (seven) national strategic documents relevant to the circular economy. There is no hierarchical definition in the legal framework regulating the strategic planning process in the country that would allow the definition of a ‘leading’ strategic document, hence no leading strategic document was identified on the basis of the analysis carried out.

1. Main European strategic documents in the field of circular economy

a) European Green Pact

The European Green Pact,¹² the so-called European Green Deal (*endorsed by the European Commission in 2019*) is a new growth strategy that aims to transform the EU into a fair and prosperous society with a modern, resource-efficient and competitive economy where there are no net greenhouse gas emissions and economic growth is not dependent on resource use in 2050.

¹² See: https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_bg; http://europa.eu/rapid/press-release_IP-15-6203_en.htm [Accessed on 22 March 2022].

The Green Transition is among the EU's key ambitions to tackle the global challenge of limiting the adverse effects of climate change. The European Green Deal aims to make Europe the first climate neutral continent by 2050. The resources of the EU Next Generation Programme provide an opportunity to target investments towards greening economies.

The European Green Pact aims to make the EU economy sustainable by turning climate and environmental challenges into opportunities in all policy areas, ensuring that the transition is fair and inclusive for all. The European Green Deal focuses on taking action to ensure that environmental and climate issues are addressed, thereby ensuring a sustainable future for generations to come. Achieving climate neutrality by 2050 is the top priority. By moving towards a circular economy, which is one of the focuses of the pact, the aim is to strengthen the competitiveness of the economy and increase the Community's GDP by 0.5% by 2030.

In April 2020, an Advisory Council was established in our country in relation to the European Green Deal. Among the Council's main roles is to advise and assist the Council of Ministers in balancing and reconciling national priorities in the areas of energy security, accelerated economic development, social justice and environmental protection.

(b) Action Plan for Sustainable Consumption and Production and Sustainable Industrial Policy

In 2008, the Council of the European Union endorsed the Action Plan on Sustainable Consumption and Production and Sustainable Industrial Policy.¹³ The Plan includes a number of proposals for sustainable consumption and production to help improve the environmental performance of products and support demand for more sustainable goods and production technologies. At the same time, the industry is encouraged to take advantage of innovation to meet the challenge. A key element of the Action Plan is the development of a dynamic framework to improve

¹³ See: <https://www.europarl.europa.eu/factsheets/bg/sheet/77/%D1%83%D1%81%D1%82%D0%BE%D0%B8%D1%87%D0%B8%D0%B2%D0%BE-%D0%BF%D0%BE%D1%82%D1%80%D0%B5%D0%B1%D0%BB%D0%B5%D0%BD%D0%B8%D0%B5-%D0%B8-%D0%BF%D1%80%D0%BE%D0%B8%D0%B7%D0%B2%D0%BE%D0%B4%D1%81%D1%82%D0%B2%D0%BE> [Accessed on 19 March 2022].

the energy and environmental performance of products and promote their uptake by consumers. The challenge is to create an environmentally friendly product cycle by: improving the overall environmental performance of products throughout their life cycle, encouraging and stimulating demand for better products and production technologies, and supporting consumers to make better choices through consistent and simple labelling.

c) A new roadmap to a circular economy

As part of the European Green Deal, in March 2020 the European Commission published a New Action Plan towards a Circular Economy¹⁴ with measures to accelerate the transition to a sustainable model and the recovery of natural resources, thereby reducing the impact on environment and society. The new Action Plan aims to:

- establish a sustainable product policy framework;
- introduce key value chains in the product area;
- create a more effective waste policy aimed at prevention, re-use and recovery;
- create circular models to benefit people, regions and cities.

The plan aims to create a well-functioning market for secondary raw materials. Secondary raw materials are subject to a number of challenges stemming from their competition with primary raw materials, aspects of which cover both the safety of raw materials and their efficiency, availability and cost.

By promoting more sustainable activities in key sectors and new business opportunities, the plan will help unlock the growth and job creation potential of the circular economy.

d) A European Strategy for Plastics in a Circular Economy

In January 2018, the European Union endorsed a European Strategy for Plastics in a Circular Economy,¹⁵ which aims to protect the environment

¹⁴ See: https://ec.europa.eu/commission/presscorner/detail/bg/ip_20_420 [Accessed on 20 March 2022].

¹⁵ See: <https://eur-lex.europa.eu/legal-content/BG/ALL/?uri=CELEX:52018DC0028> [Accessed on 25 March 2022].

from plastic pollution while promoting innovation in the sector. As fundamental measures to meet the above objectives, the European Union wants to reduce the consumption of single-use plastics, limit the use of plastic microparticles and make all plastic packaging recyclable by 2030.

2. Main national strategic documents in the field of environment

(a) National Recovery and Resilience Plan

One of the four pillars in the National Recovery and Resilience Plan¹⁶ is Green Bulgaria with a focus on sustainable management of natural resources to meet the current needs of economy and society, while maintaining environmental sustainability so that these needs can continue to be met in the long term; the programme is allocated 41.90% of the plan's resources.

The Green Transition takes the lead in the National Recovery and Resilience Plan, concentrating 53.66% of total projected expenditure, against the Regulation (EU) 2020/852 minimum of 37.00%. In this way, Bulgaria contributes to EU-wide targets for progressive decarbonisation. In doing so, efforts are focused on three main areas:

- creating conditions for accelerated deployment of renewable energy and hydrogen;
- increased action to improve the energy efficiency of the economy;
- sustainable mobility.

b) Partnership Agreement between the Republic of Bulgaria and the European Commission for the 2021–2027 programming period

The Partnership Agreement is the national strategic document outlining the framework for the management of EU funds in Bulgaria in the 2021–2027 programming period.¹⁷ The Partnership Agreement for the 2021–2027 programming period sets out Bulgaria's strategy and priorities for implementation of the EU Cohesion Policy (*and the Common Fisheries*

16 See: <https://www.nextgeneration.bg/14> [Accessed on 06 July 2022].

17 See: <https://www.eufunds.bg/bg/node/9630> [Accessed on 27 March 2022].

Policy). Based on analysis of the socio-economic development of Bulgaria in the 2007-2017 period, the Partnership Agreement identifies the main areas of investment with EU co-financing. In order to ensure coherence with the programmes co-financed by the European Structural Funds, the Partnership Agreement provides for complementarity with interventions under the Recovery and Resilience Facility.

c) National Strategy for Small and Medium Enterprises (SMEs) for the 2021-2027 period

The National SME Strategy sets out six priorities, one of which is 'Environment'.¹⁸ Measures under this priority include: support for improved energy and resource efficiency of SMEs and increased use of renewable energy sources; certification of SMEs for environmental management; enhancing the capacity of SMEs to transition to a circular economy; and promotion of environmentally friendly products through the EU Ecolabel. In terms of the circular economy measure, the SME Strategy aims at better inclusion of SMEs in circular economy, better recycling practices in the largest waste generating SMEs; more effective extended producer responsibility schemes covering more waste streams, increased use of secondary materials by Bulgarian SMEs, including through industrial symbiosis.

d) Operational Programme 'Innovation and Competitiveness' for the 2021-2027 period

The programme was developed in response to the European Green Deal. Circular Economy¹⁹ is among the three main priorities of the programme. The measures to be supported under this priority include: investment in the use of alternative raw materials, the use of recycled materials as raw materials and the reuse of materials; improving waste management in enterprises, including the introduction of zero-waste technologies; the production of 'green products', including eco-design; the

¹⁸ See: <https://www.mi.government.bg/bg/themes/nacionalna-strategiya-za-mal-ki-i-sredni-predpriyatiya-msp-v-balgariya-2021-2027-g-2194-285.html> [Accessed on 26 March 2022].

¹⁹ See: <https://opik.bg/opik/nov-programen-period-2021-2027-g> [Accessed on 25 March 2022].

shift of production from disposable to reusable products and the upgrading of products to extend their life; more sustainable production processes with minimal use of chemicals and harmful substances.

e) National Waste Management Plan for the 2021-2028 period

The National Plan sets out the following principles for waste management in the period up to 2028:²⁰ waste as a vital resource and need for the country – a priority of state and local government policy; application of scientific and technical advances in waste management; application of economic regulators to achieve sustainable waste management and use of recycled materials/products resulting from waste treatment; prevention or reduction of harmful waste.

f) Operational Programme ‘Environment’ for the 2021-2027 period

One of the specific objectives of the programme is to ‘promote the transition to a circular economy’.²¹ In order to achieve this, the programme foresees the support of measures related to prevention of municipal waste, the establishment of preparation centres for reuse and repair, the recycling of waste, the development of a separate waste collection system and awareness-raising on sustainable consumption practices and behaviour in the context of circular economy and waste monitoring. Measures will also be supported to develop infrastructure related to municipal waste management at regional level to achieve the 2030 targets for recycling and landfilling.

g) National Development Programme Bulgaria 2030

The National Development Programme ‘Bulgaria 2030’²² is a strategic framework document of the highest order in the hierarchy of national programming documents, determining the vision and the general objectives of development policies in all sectors of public administration, including their territorial dimensions. Bulgaria sets the circular economy as

²⁰ See: https://www.moew.government.bg/static/media/ups/tiny/%D0%A3%D0%9E%D0%9E%D0%9F/%D0%9D%D0%9F%D0%A3%D0%9E-2021-2028/NPUO_2021-2028.pdf [Accessed on 20 March 2022].

²¹ See: <https://www.eufunds.bg/bg/opos/node/8738> [Accessed on 29 March 2022].

²² See: <https://www.minfin.bg/bg/1394> [Accessed on 29 March 2022].

a long-term priority of its development policy. The National Development Programme ‘Bulgaria 2030’ highlights as Priority 4 ‘Circular and Low Carbon Economy’, which aims to transform the country’s linear economy into a circular one.

The European Union’s common policy on circular economy is in development and our country should be aware of the challenges ahead as well as the time span of such transformation of societal attitudes, economic processes and institutional priorities. The transition to a circular economy will ensure economic growth and a better environment in the country. To this end, the necessary institutional, financial and human resources should be mobilised.

V. ‘GREEN’ FINANCE AND INVESTMENTS TO ENSURE A JUST TRANSITION

In preparation of this section on sources of financing for policies promoting the implementation of circular economy, a total of 16 (sixteen) alternative sources providing green financing and investment opportunities were identified for the study period.

At the moment, there is no coordination mechanism in place to link the institutional framework for implementation of strategic policies and the mechanism of their financing, which implies the application of subjective (*and often unquantified*) approaches to the financing of policies by political cabinets. The lack of such a link reflects both on the quality of the process of developing strategic documents and on their implementation in practice (*strategic documents often remain only ‘on paper’ and national strategic governance is reduced to the formulation of a wish list*).

To stabilise the euro area, euro area governments concluded an intergovernmental Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. It has been in force since January 2013. Bulgaria has also ratified the treaty (*known as the ‘fiscal compact’*).²³ This

²³ See Стойнев, И. Новата архитектура за финансова и икономическа стабилност в Европа. – В: Новият европейския пакт от март 2012 г. София, УИ „Св. Климент Охридски“, 2012, 66–94.

‘fiscal compact’ imposes requirements on eurozone countries regarding their budgetary policies.

a) European Structural and Investment Funds

Cohesion policy addresses different development needs in all EU regions and cities. Their budget is €351.8 billion – almost a third of the total EU budget. The ESFs are: the European Regional Development Fund (ERDF) and the Cohesion Fund – for the development and structural adjustment of regional economies, economic change, increasing competitiveness and territorial cooperation; the European Social Fund (ESF) – for employment, social inclusion and education; the European Agricultural Fund for Rural Development (EAFRD) – for agricultural competitiveness, sustainable management of natural resources and territorial development of rural communities; and the European Maritime and Fisheries Fund.²⁴

b) European Fund for Strategic Investments

The European Fund for Strategic Investments²⁵ is one of the three pillars of the Investment Plan for Europe and aims to address the current investment gap in the EU by mobilising private finance for strategic investments. It consists of a €21 billion budget from the European Commission and the European Investment Bank.

c) Urban Innovative Actions

The Urban Innovative Actions initiative provides urban areas across Europe with resources to test new and unproven solutions to urban challenges.²⁶ The total budget of the initiative for the period 2021 to 2027 is €371 million.

d) InvestEU Programme

The InvestEU programme runs from 2021 to 2027 and is the EU’s main instrument to support investment and access to finance in the EU²⁷. InvestEU

²⁴ See: https://ec.europa.eu/regional_policy/bg/funding/ [Accessed on 31 March 2022].

²⁵ See: <https://www.consilium.europa.eu/bg/policies/investment-plan/strategic-investments-fund/> [Accessed on 30 March 2022].

²⁶ See: https://ec.europa.eu/info/eu-regional-and-urban-development/topics/cities-and-urban-development/funding-cities_bg [Accessed on 05 April 2022].

²⁷ See: https://investeu.europa.eu/index_bg [Accessed on 04 April 2022].

succeeds the European Fund for Strategic Investments (EFSI) – the ‘Juncker Plan’, building on the experience gained, while proposing improvements including an integrated management and implementation structure for all centralised financial instruments and the EFSI. The aim is to bring together under one roof the multitude of EU financial instruments currently supporting investment in the EU, making the financing of investment projects in Europe simpler, more efficient and more flexible.

InvestEU is part of NextGenerationEU,²⁸ in addition to the Recovery and Resilience Facility, and aims to help European economies recover from the crisis.

e) Manager of Financial Instruments in Bulgaria Fund

The Fund was established by a decree of the Council of Ministers of 22 July 2015 for the purpose of managing the funds earmarked for financial instruments under operational and other programmes co-financed by the European Structural and Investment Funds (ESIF).²⁹

The MFIBF performs the functions of the Fund of Funds (FfF) – it allocates targeted public funds from European programmes and national co-financing through specialised funding schemes (financial instruments). The main activities of the MFIBF are related to:

- conducting market consultations to prepare a preliminary assessment of the demand and supply of financial products in the relevant area and among selected target groups;
- structuring debt and (quasi-) equity financial instruments and preparing technical specifications for them;
- conducting an open and transparent selection of financial intermediaries that will provide the necessary co-financing and deliver financial products to final beneficiaries;
- entering into operational agreements with financial intermediaries;

²⁸ NextGenerationEU is a new instrument, created on the proposal of the European Commission and aiming at a sustainable, coherent and fair recovery of EU Member States from the crisis caused by the COVID-19 pandemic, with a budget of more than €806.9 billion. The EU is helping to make Europe healthier, greener and more digital.

²⁹ See: <https://www.fmfib.bg/> [Accessed on 01 April 2022].

- monitoring, risk management, operational and financial reporting of financial instruments with a view to meeting the objectives set out in the relevant European programme providing the relevant public resource.

The fund manages BGN 1.2 billion for investments for sustainable economic growth, with:

- 5 venture capital funds
- 3 urban development funds
- 9 partner banks
- 2 micro-finance institutions
- 2 development banks (MDBs, EBRD).

f) URBACT Programme – A funding programme to improve the exchange of experience between European cities.

URBACT is a European exchange and training programme that promotes sustainable urban development and helps cities work together to develop pragmatic solutions to the challenges they face.³⁰ URBACT is co-financed by the European Regional Development Fund in all EU countries, Norway and Switzerland. The URBACT III programme, which runs from 2021 to 2027, will have a budget of €96.3 million.

g) Horizon 2030

Horizon 2030 is the EU's largest research and innovation programme, with a budget of over €95 billion for the period 2021 to 2027.³¹ The EU research programme will support and underpin green and digital transition. The main objectives are to strengthen science and technology, improve the competitiveness of industry and achieve the Sustainable Development Goals.

The full range of instruments available under Horizon Europe will support the necessary research and innovation efforts. Four 'Green Pact

³⁰ See: <https://urbact.eu/urbact-in-bulgaria> [Accessed on 02 April 2022].

³¹ See: https://ec.europa.eu/info/sites/default/files/research_and_innovation/strategy_on_research_and_innovation/presentations/horizon_europe_bg_investirame_z_a_da_oformim_nasheto_bdesheche.pdf [Accessed on 06 April 2022].

missions' will help deliver large-scale change in areas such as climate change adaptation, oceans, cities and soils. The missions will bring together a wide range of stakeholders, including regions and citizens. Partnerships with industry and Member States will support research and innovation in transport, including batteries, clean hydrogen, low carbon steel making, circular bio-based sectors and the built environment. The Knowledge and Innovation Communities under the auspices of the European Institute of Innovation and Technology will continue to foster collaboration between universities, research organisations and businesses on climate change, sustainable energy, food for the future and smart, green and integrated urban transport. The European Innovation Council will provide finance, capital investment and business acceleration services to high potential start-ups and SMEs to enable them to deliver breakthrough Green Pact innovations that reach global markets quickly.

h) the European Social Fund Plus for the 2021-2027 period

The budget of the European Social Fund Plus is 101 billion euros and a further 200 million euros are foreseen for increasing employment, raising quality, education and social welfare.³²

Active retraining and upskilling are necessary to reap the benefits of the ecological transition. The European Social Fund Plus will play an important role in helping Europe's workers to acquire the skills they need to move from declining sectors to growing sectors and to adapt to new processes to increase employability in the green economy.

Another objective of the European Social Fund Plus will be to boost education and training. Schools, training institutions and universities should be able to engage students, parents and the wider community with the changes needed for a successful transition. The Fund will support the development and assessment of knowledge, skills and attitudes in relation to climate change and sustainable development. It will also provide support materials and facilitate the exchange of good practice across EU networks on teacher training programmes.

³² See: <https://ec.europa.eu/social/main.jsp?catId=325&langId=bg> [Accessed on 06 April 2022].

i) LIFE Programme

The LIFE programme is the EU's financial instrument to support projects in the field of environment, nature conservation and climate action.³³ LIFE is the only programme at European level dedicated entirely to nature conservation and action against climate change. LIFE responds to challenges facing cities, such as air quality, noise, energy and waste. The total budget of projects to be funded between 2021 and 2027 is €3.5 billion for environment and €1.9 billion for climate action. The programme is part of the European Commission's Green Pact proposals.

j) European Investment Advisory Hub (EIAH)

The European Investment Advisory Hub was set up in 2015, alongside the European Fund for Strategic Investments, as part of the Investment Plan for Europe, which aims to revive investment after the economic crisis.³⁴ The role of the Hub is to promote investment in the real economy by providing advisory services to project promoters, in addition to the services already offered by other EU programmes.

EIAH provides targeted support for the identification, preparation and development of investment projects in the EU. The Advisory Hub draws on the expertise of the European Commission, the European Investment Bank Group, national incentive banks and institutions and the managing authorities in Member States.

k) Joint Assistance for Support to Projects in European Regions (JASPERS).

JASPERS³⁵ provides advice to cities and regions on strategic planning in a wide range of sectors. It supports the preparation of projects in areas that receive EU funding to meet all necessary standards.

JASPERS is a free tool for city authorities and project promoters to advise cities and regions on strategic planning in a wide range of sectors. It helps prepare projects in areas that benefit from EU funding to meet all the necessary standards.

³³ See: <http://www.life-bulgaria.bg/> [Accessed on 06 April 2022].

³⁴ See: <https://www.consilium.europa.eu/bg/policies/investment-plan/investment-advisory-hub/> [Accessed on 02 April 2022].

³⁵ See: <https://jaspers.eib.org/> [Accessed on 03 April 2022].

l) Programmes financed by the European Structural and Investment Funds.

These programmes will be a major source of funding for environmental activities. The following programmes have been identified as sources of funding:³⁶ Environment Programme, Enterprise Competitiveness and Innovation Programme, Regional Development Programme, Strategic Plan for Agricultural and Rural Development, Technical Assistance Programme, Education Programme, Human Resources Development Programme, Research, Innovation and Digitalisation for Smart Transformation Programme.

m) National Recovery and Resilience Plan

The responsible structures at national level for the organisation and coordination of the participation of the Republic of Bulgaria in the EU Recovery and Resilience Facility are defined by Decision of the Council of Ministers (DCM) No. 568 effective from 02.08.2021. The financial resources foreseen for the Green Bulgaria pillar amount to more than BGN 5.5 billion, allocated to the following components:³⁷

- Low Carbon Economy: the indicative cost estimates to implement the objectives of this component total BGN 7,553 million, of which BGN 5,109.6 million is allocated to the Recovery and Resilience Facility and BGN 2,443.4 million to national co-financing.
- Biodiversity: the indicative cost estimates to implement the objectives of this component total BGN 104.5 million, of which BGN 92.9 million is allocated to the Recovery and Resilience Facility and BGN 11.6 million to national co-financing.
- Sustainable agriculture: the indicative cost estimates to implement the objectives of this component total BGN 986.1 million (BGN 457.3 million to the account of the Recovery and Resilience Facility and BGN 528.8 million to national co-financing, including BGN 437.4 million private co-financing).

³⁶ See: https://ec.europa.eu/info/funding-tenders/funding-opportunities/funding-programmes/overview-funding-programmes/european-structural-and-investment-funds_bg [Accessed on 05 April 2022].

³⁷ See: <https://www.nextgeneration.bg/14> [Accessed on 06 July 2022].

The ultimate beneficiaries of the plan are responsible for implementing investments and supervising their contractors and counterparties to ensure timely and quality performance. All measures included – investments and reforms – must comply with the ‘do no significant harm’ principle as defined in Article 17 of Regulation (EU) 2020/852.

n) Business

Businesses should play a leading role in recycling waste as well as the recovery of construction and demolition waste and agricultural solid waste.³⁸ Recycling organisations should fund new, more efficient methods of separate collection as well as the introduction of new technologies for the treatment, recycling and recovery of bulky waste. In cooperation with municipalities, they should build additional recycling facilities for certain categories of waste. In addition, businesses should be responsible for the development of infrastructure for the treatment and recycling of construction and demolition waste and for the construction of recycling and recovery facilities for biomass of agricultural origin. Businesses should also lead the way in the responsible extraction of critical raw materials.

o) Municipal Budget

Municipalities will be able to finance activities within the framework of revenues from municipal waste tax and through the funds stipulated in their waste management programmes and landfill levies. They will lead the construction of municipal waste transfer sites, the implementation of separate collection systems for bulky waste aimed at reuse, the introduction of mandatory separate collection of bio-waste and hazardous waste generated by households and the organisation of information campaigns.

n) State budget

Funding from the state budget can be used to prepare sectoral analyses, analyse legislation and adopt new regulations, design programmes, identify investment needs, set up mechanisms, provide statistical information, improve control over individual activities and raise awareness among users.

The national budget plays a key role in the transition. Greater use of green budgeting instruments will help to redirect public investment,

³⁸ See: <http://www.moew.government.bg> [Accessed on 04 July 2022].

consumption and taxation towards environmental priorities and the removal of harmful subsidies. Well-designed tax reforms can boost economic growth and resilience to climate shocks and contribute to a fairer society and just transition. These reforms play a direct role by sending the right price signals and providing the right incentives for sustainable behaviour on behalf of manufacturers, users and consumers. The review will also be an opportunity to remove market barriers to the introduction of clean products.

p) Other sources of financing for green investments

Financial support for the circular economy can take various forms, including bank financing – loans, financial instruments, mixed financing (*in the form of a grant or financial instrument*), tax breaks, investment guarantees – either directly provided by public authorities or through intermediaries such as business associations; for example waste recovery organisations can finance new, more efficient methods of separate collection, as well as the introduction of new treatment technologies and recycling.

Financial support for the circular economy can be achieved through landfill tax by funding measures to support the prevention, reuse, separate collection, recycling and recovery of municipal waste.

Financial support for circular economy can also be achieved by prohibiting the spending of municipal waste revenues on other municipal activities.

Strategic documents undoubtedly play a key role in the success of institutions and businesses. In addition to a strong desire, a strategy document requires discipline, foresight, accountability, monitoring, etc. However, even the best strategy document faces a number of challenges that need to be accounted for so that the document can be successfully implemented.

In order to build and be successful, a strategy document should avoid the following factors:

i) developing a strategy document for the sole purpose of having one:

In many cases practice follows momentum, the general public and European attitudes that there should be a strategic document. However, the usefulness of such a document derives not from the fact that it exists, but from its content. Therefore, if an institution devotes resources to developing a strategy document, it should be meaningful and not fictitious. Otherwise, the expectation that something positive will arise from its existence is completely unrealistic.

ii) not understanding the external environment or focusing on results:

Planning should not ignore changes in the external environment – business conditions, macroeconomic conditions, social processes, changes in consumer expectations and public attitudes, etc. The strategy document must reflect expectations about the dynamics of the external environment. On this basis, adequate and meaningful priorities should be identified and formulated so that activities will be focused on achieving realistic results that are desirable for institutions.

iii) partial commitment:

Businesses, senior management, executives, etc., must be fully committed to and fully understand the strategic planning process. If they do not share the view that the strategy document can improve the situation, lead to better financial results and increase competitiveness, then their commitment to the implementation of the strategy document will be questionable.

iv) not having the right people involved:

Involving the right experts in the strategic planning process is an important prerequisite for a successful outcome. The employees who are expected to execute the strategy should be involved in the planning process from the onset. On the other hand, the strategic programming and planning team itself should be involved in the implementation process.

v) relegating the strategy document to the shelf:

If this is done, the consequences will be similar to those of writing a strategy document for the sole purpose of having one. Even if it is not written for its own sake, a strategy document should be an effective management tool – it should be used, monitored, evaluated for its implementation and periodically updated. Forbes Magazine³⁹ notes that a strategic plan is not a fine wine and does not have a good shelf life.

vi) unwillingness or inability to change the strategy document:

The strategy document must allow updating and modification it as a result of the changing external environment. To this end, the management and implementation team must have adequate skills, knowledge and attitude to allow for revision of activities and priorities and their synchronisation with new external conditions.

vii) putting the wrong people in leadership positions:

For a strategy document to be successful, senior management must be willing to make tough decisions, assign and reassign tasks and responsibilities so that every team member is in the right position. The right leaders, not the positioned ones, will champion the strategy document and do everything in their power to get the best results.

viii) ignoring marketplace reality, real data and market assumptions:

One of the most important skills in strategic planning and strategy document execution is the ability to clearly understand and see market realities. Ignoring signals from real data and not being aware of assumptions about the market (*which are invariably accepted in practice and theory*) leads to inability to foresee potential problems.

ix) lack of accountability and monitoring system:

A key task is to allocate responsibilities and reporting mechanisms for performance to the different levels of institutions. Accordingly, clear consequences of failure to implement individual tasks and of failure of the strategy as a whole should be articulated at the outset of implementing

³⁹ See Ten Reasons Why Strategic Plans Fail. // Forbes/Entrepreneurs, 2011.

the strategy document. To this end, a clear system of accountability and monitoring of the implementation process needs to be in place.

x) setting unrealistic goals or lack of focus and resources:

Strategic goals must be defined adequately, professionally, on the basis of accurate forecasting of the external environment and the expected impact of planned actions, as well as on the basis of a clear preliminary idea of available financial resources that will be allocated to the relevant actions. The strategy document should be focused and include a manageable number of objectives, objects and programmes. Fewer and more focused objectives is in most cases the better option than numerous and vague priorities. Last but not least, the strategy document should be based on available resources, which should be clearly allocated when activities are described. This ensures consistency between objectives and resources.

To successfully meet the EU's resource efficiency targets by 2030, the transition to a circular economy model should become a government priority. It is not enough to increase energy efficiency or reduce emissions, although these are also significant steps. The concept needs to be extended not only to waste reduction and recycling, but also to consumer awareness, extending product life cycles, breaking the dependency between economic growth and waste production. In turn, consumers also need to play an active role by gradually changing consumption patterns from 'consumer' to 'user' and from 'owner' to 'sharer'. Creating greater demand for services of this type will stimulate a change in attitudes and business. Traditional consumer habits can be a barrier to the development of new products and services. If prices do not reflect the real costs to society of resource use, and where policy fails to provide strong and coherent signals for the transition to a circular economy, such barriers could slow down the process.

The production-consumption-waste model as a linear model is already exhausted. However, the transition to a circular economy model is slow. The transformation is still in its infancy and the process is slow and cumbersome. The main obstacles include: insufficient awareness of managers and entrepreneurs; conservatism of some businesses (*fear of the new, the unknown, willingness to rely on what appears safe*); lack of willingness for radical change; insufficient resources for technological renewal and implementation

of new environmentally friendly and resource-saving technologies; insufficient motivation; lack of staff; lack of confidence in data security, lack of preparation for systems integration, etc. The existing infrastructure, business models and technologies, the lack of real and achievable strategic goals, the lack of information, together with the established behaviour, keep the economy 'attached' to the linear model. Companies lack the information, confidence and capacity to move towards circular economy solutions. The financial system often fails to deliver investment in efficiency improvements or in innovative business models that are seen as riskier and more complex, deterring many traditional investors. For businesses, moving to a circular model is attractive because of economic and job benefits, but this is not enough to make the transition happen.

Application of the circular economy model will contribute to a radical change in production and consumption behaviour patterns, and introduction of new concepts of territorial and regional development.

This would allow:

- reducing energy consumption, both by businesses and households;
- creating sustainable cities;
- dramatically reducing waste production and further increasing recycling and reuse opportunities;
- creating new green jobs in environmentally related industries.

The shift towards a sustainable circular economy must combine ambitious environmental goals with robust social requirements by creating a coherent strategic and legal framework for sustainable production and consumption.

The formulation and implementation of strategic documents in Bulgaria reveals that there is a significant difference in the requirements to mechanisms for the management of European policies and purely national strategies. Among the most revealing differences are the requirements for use of a management information system and budgeting rules.

Strategy papers for implementation of the circular economy will only be as successful and effective as their implementation.

CHAPTER 27

SHARED MANAGEMENT OF EU-BACKED FINANCIAL INSTRUMENTS IN COHESION POLICY.

COMBINATION OF SUPPORT: GRANTS AND FINANCIAL INSTRUMENTS – A STEP BACKWARD OR A WATERSHED MOMENT FOR COHESION POLICY FINANCIAL INSTRUMENTS?

Iva Petkova

ABSTRACT

This chapter examines the growing role of the Cohesion policy of the European Union and its evolvement from a redistribution mechanism in the 1980's to the main investment policy of the Union 20 years later. Special attention is paid to its ability to cope with multiple crises and to the dynamics in its delivery mechanisms in a shared management context – the change in the rationale from alternative use between grants and financial instruments (FI) to their combination. The main focus of the chapter is the proposed combination of financial instruments (FI) with grants, allowed under Article 58(5) of the Common Provisions Regulation 2021/1060, and its potential implications for the 2021–27 programming period. Is this a step backward or a breakthrough moment for the deployment of FI under the Cohesion policy, having in mind its new digital and green dimensions?

KEY WORDS

Cohesion Policy, financial instruments, shared management, combination of support, grants

I. INTRODUCTION

Cohesion policy, comprising a third of the total European Union (EU) budget (€ 392 bn for 2021–2027), is a major EU investment policy aimed at reducing disparities between Member states and their regions, fostering business competitiveness, job creation, economic growth, sustainable development, and improving citizens' quality of life. It has a unique model of multilevel-governance involving national governments, local authorities and communities under so-called 'shared management' with the European Commission. Moreover, the projects financed in the regions and cities should contribute to the goals of Commission priorities, including green and digital transition.

Cohesion Policy is delivered through specific funds (European Regional Development Fund (ERDF), Cohesion Fund (CF), European Social Fund Plus (ESF+)) **and through different delivery mechanisms, the most popular of which are grants and financial instruments (FI). While grants are a well-known investment tool, the surge for achieving more tangible results with fewer resources has led to the introduction of financial instruments with a stronger focus on return on investment and improved sustainability of interventions.**

Financial instruments have been promoted by the European Commission as they are considered cost-effective, market-oriented and able to leverage additional private financing. Though FIs seem to have a high profile in Cohesion policy in the 2007–13 and 2014–20 programming periods, they remain a relatively limited policy tool. Still, the need to 'do more with less'¹ forces the European Commission to offer improvements in its regulatory framework for simplifying and expanding the use of combination of FI and grants.²

¹ **Dąbrowski, M.** 'Doing more with less' or 'doing less with less'? Assessing EU cohesion policy's financial instruments for urban development. // *Regional Studies, Regional Science*, 2015, No. 1, 73–96.

See also: **Bachtler, J., Carlos Mendez.** Cohesion policy: doing more with less. – In: Wallace, H., Mark Pollack, Christilla Roederer-Rynning, Alasdair Young (Eds.). *Policy-Making in the European Union*. Oxford University Press. 2020, 232–253.

² See also **Михайлова-Големинова, С., Сашо Пенев, Юрий Кучев, Атанас Симеонов, Калин Славов, Ирена Георгиева.** Проучване на практиката по финансо-

II. ORIGIN AND DEVELOPMENT OF EU COHESION POLICY

In the 1950s, the six founding Member States (MS) established the European Coal and Steel Community (the 1951 Treaty), the European Economic Community (the 1957 EEC Treaty/Rome Treaty) and the European Atomic Energy Community (the 1957 Euratom Treaty) with separate legal identities, governance arrangements and respective budgets.

Given the great regional imbalances characterising member states in the 1950s, the Preamble of the Treaty of Rome declared that the signatory states were determined to lay the foundations of an ever-closer union, ensuring the harmonious development of economies of MS by reducing the differences existing between the various regions.³ However, the Rome Treaty did not set the stage for a fully-fledged European Cohesion policy, since it was considered politically divisive, unnecessary and too ambitious at that time. Still, the European Investment Bank (EIB), whose task was to grant loans and supply guarantees for the financing of projects in developing and restructuring regions was established under Article 129 and Article 130 of the Treaty of Rome to address regional imbalances.

At the beginning of the 1970s, with the oil crisis and the enlargement with the United Kingdom (UK), Denmark and Ireland, regional disparities exacerbated and the need for coordinated actions to cope with regional disparities became obvious. In May 1973, the European Commission published the Report on the Regional Problems in the Enlarged Community (CEC 1973), known as the Thomson Report. In July 1973, the European Commission drafted a legislative proposal concerning the creation of the European Regional Development Fund (ERDF).

воту управление и контрол на средствата от ЕС. – В: Предизвикателства пред финансово управление и контрол на средствата от Европейския съюз. Доклади от международна научно-приложна конференция, проведена през ноември 2016 г. в гр. София. София, УИ „Св. Кл. Охридски“, 2016; **Михайлова-Големинова, С.** Финансови правни отношения в системата на публичните средства от европейските структурни и инвестиционни фондове. София, Сиела, 2017, с. 276; **Михайлова-Големинова, С.** Контрол за законност на управлението на средствата от европейските структурни и инвестиционни фондове - 10 години по-късно. // Общество и право, 2018, № 2, 3–21.

³ Preamble of the Treaty of Rome, European Economic Community, 25 March 1957.

It was not until the adoption of the Single European Act in 1986 and the enlargement with Greece (1981), Spain and Portugal (1986), that the Structural Funds were integrated into an overarching Cohesion policy, introducing key principles focusing on the poorest and most backward regions, multi-annual programming, strategic orientation of investments, involvement of regional and local partners. The allocation of Cohesion funds is based on the ‘Berlin method/formula’, adopted in 1999, which entails different calculation for the three different categories of regions (less developed, transition and more developed regions based on regional statistics at NUTS II level and a reference period taking economic data average of three years).

In the 1990s the deepening of economic integration led to the creation of the Cohesion Fund in support of infrastructure development as economic and social cohesion became a core objective in the Maastricht Treaty (1993). The enlargement with Central and Eastern European countries required redirection of Cohesion policy financing from Southern Europe to the ‘new’ and poorer Member States. The ‘Lisbon Strategy’ (2000) shifted the EU’s and Cohesion priorities towards growth, jobs and innovation.

The insufficient alignment between Cohesion policy and the Lisbon strategy, led, in 2009, to the preparation of an independent report by Fabrizio Barca, the former Director-General of Italy’s Ministry of the Economy, assigned by Commissioner Danuta Hubner. The Barca Report⁴ aims to assess the role of the EU’s Cohesion policy and to submit proposals for reform for the post-2013 period. The main concept of the report is that there should be *‘a clear and explicit distinction between policy interventions aimed at increasing income and growth and those aimed at reducing inequalities, not least in order to be able to monitor and evaluate the results’*. The Report points out that the very purpose of the Cohesion policy could not be limited to financial redistribution between MS but is to *‘trigger institutional change and to break inefficiencies and social exclusion traps through the provision of public goods and services.’* The Barca’s arguments for a place-based approach and for creating adequate incentives to link financing to verifiable results, were further developed

⁴ **Barca, F.** An agenda for a reformed Cohesion policy – a place-based approach to meeting European Union challenges and expectations. Independent Report prepared at the request of Danuta Hübner, Commissioner for Regional Policy, 2009.

the following years, especially after the effects of the 2008–2010 financial crisis become evident in MS.

In addition, the financial crisis led to increased use of financial engineering instruments, when EIB was actively involved in structuring instruments that would effectively use public resources, attract private capital and recycle the resources into new projects.

In response to criticisms for its administrative complexity, in 2013 reforms were introduced in the Cohesion policy aiming at maximum impact on growth and jobs in the 2014–20 programming period. The legislative package for the 2014–2020 period, approved in December 2013, was focused on making the Cohesion policy more performance-based and result-oriented. Key elements of the reform were linked to adapting the level of support to the levels of development of regions, fixing clear, transparent, measurable aims and targets for accountability and results, cutting red tape and simplifying the use of EU investments as well as introducing simpler accounting rules, more targeted reporting demands and increased use of digital technology. Cohesion policy was expected to contribute to Country-Specific Recommendations in the European Semester process through the investment priorities of programmes.

Last but not least, the urban dimension of the Cohesion policy has been enhanced by earmarking a minimum number of resources under the ERDF to be spent for integrated projects in cities, thus paving the way to the JESSICA financial instrument.⁵ The wider use of financial instruments (loans, equity, guarantees) as a whole was encouraged to create revolving funds, reduce the dependency on grants and leverage other sources of public and private finance. Thus, the financial crisis (2008–2010), which led to contraction of national public investments, acted as a stimulus for a more ambitious and flexible Cohesion Policy and for introduction of new mechanisms for delivery of policy objectives. Financial management and control (see also Chapters 18, 20, 22, 23, 24) of EU funds in the form of shared management is part of the Financial Law legal doctrine.⁶

⁵ European Commission, Refocusing EU Cohesion Policy for Maximum Impact on Growth and Jobs: The Reform in 10 points, 19 November 2013.

⁶ See **Михайлова-Големинова, С.** Финансови правни отношения в системата на публичните средства от европейските структурни и инвестиционни фондове. София, Сиела, 2017, с. 276.

III. FINANCIAL INSTRUMENTS AS AN ALTERNATIVE TO GRANTS IN COHESION POLICY

The growing interest in the deployment of FIs at the EU level was initially based on the identified investment gaps linked both with the Eastern enlargement and with the budgetary constraints as a result of the financial crisis. FIs may take the form of very diverse financial products – loans, guarantees, equity and quasi-equity – targeting different sectors and implemented in different ways, but following the same principle that, unlike grants, the financing is repayable.

Figure 1: types of ESIF-backed financial instruments

LOAN	GUARANTEE
<i>'Agreement which obliges the lender to make available to the borrower an agreed sum of money for an agreed period of time and under which the borrower is obliged to repay that amount within the agreed time*'. Under a FI, a loan can help where banks are unwilling to lend on terms acceptable to the borrower. They can offer lower interest rates, longer repayment periods or have lower collateral requirements.</i>	<i>'Written commitment to assume responsibility for all or part of a third party's debt or obligation or for the successful performance by that third party of its obligations if an event occurs which triggers such guarantee, such as a loan default*'. Guarantees normally cover financial operations such as loans.</i>
EQUITY	QUASI-EQUITY
<i>'Provision of capital to a firm, invested directly or indirectly in return for total or partial ownership of that firm and where the equity investor may assume some management control of the firm and may share the firm's profits*'. The financial return depends on the growth and profitability of the business. It is earned through dividends and on the sale of the shares to another investor ('exit'), or through an initial public offering (IPO).</i>	<i>'A type of financing that ranks between equity and debt, having a higher risk than senior debt and a lower risk than common equity. Quasi-equity investments can be structured as debt, typically unsecured and subordinated and in some cases convertible into equity, or as preferred equity*'. The risk-return profile typically falls between debt and equity in a company's capital structure.</i>

* Source: European Commission (2015). Guidance for Member States on Financial Instruments Glossary.

The main rationale for public intervention in economic development policy is the market failure as described by Joseph Stiglitz⁷ and the need to support activities that the market will not undertake alone or at all. In that context, financial instruments using public funds to leverage private finance and to address market failures are a limited policy tool, suitable for a limited range of projects and policy objectives.

Financial instruments were initially established as an alternative delivery mechanism to grants.⁸ Their introduction is justified where the investment is income-generating or cost-saving, enabling the initial support to be repaid.⁹ There are **numerous advantages of FIs compared to grants**, but those most often highlighted by the European Commission, experts and practitioners are the following:

- FIs are regarded as a more sustainable delivery mode as the funds are repaid and can be used for financing of new investments (revolving effect);
- FIs lead to improvement of project quality as the repayment obligation gives beneficiaries a strong incentive to implement successful projects that deliver results, improving the effectiveness of EU support;
- FIs ability to leverage private sector financing make more cost-effective use of public funds, especially in times of crisis, which affect both public and private spending;
- FIs allow pooling of public and private expertise, collaboration between regional and local authorities and building new kinds of partnerships in support of Cohesion policy objectives.

⁷ **Stiglitz, J.** The Role of the State in Financial Markets. // The World Bank Economic Review, Volume 7, Issue suppl_1, 1993, 19–52.9.

⁸ See Special Report 06/2021: Financial instruments in cohesion policy at closure of the 2007–2013 period: verification work yielded good results overall, but some errors remained. European Court of Auditors <https://www.eca.europa.eu/en/publications?did=58289> [Accessed 12 January 2024].

⁹ See also **Михайлова-Големинова, С.** Участието на финансовите и кредитните институции в системата за управление, наблюдение, контрол, координация и усвояване на средствата от Европейския съюз по линия на Структурните и Кохезионния фондове от Европейския съюз през програмния период 2007–2013 г. // Общество и право, 2012, № 9, 3–18; № 10, 53–70.

Financial instruments are defined in Article 2 of the Financial Regulation (No 966/2012) as *‘Union measures of financial support provided on a complimentary basis from the budget in order to address one or more specific policy objectives of the Union. Such instruments may take the form of equity or quasi-equity investments, loans or guarantees, or other risk-sharing instruments, and may, where appropriate, be combined with grants.’* A general definition of intervention with financial instruments was given in the revised version of the Financial Regulation. According to Article 208 of Regulation 2018/1046:¹⁰ *‘Where it proves to be the most appropriate way to achieve policy objectives of the Union, the Union may establish financial instruments...’*

Their main aims as described in Article 209 are:

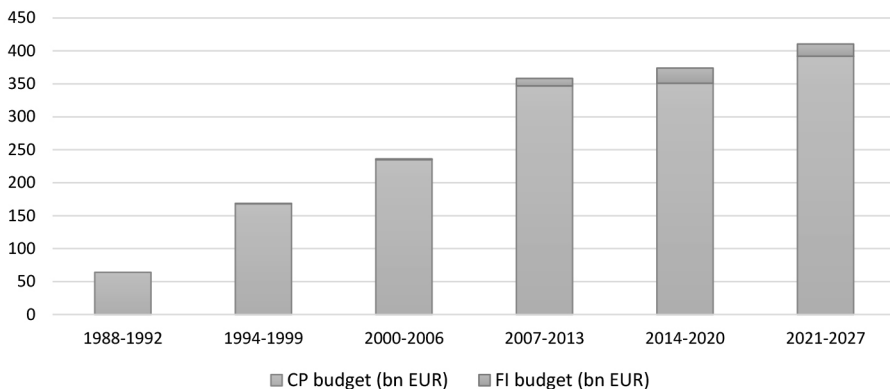
- To address market failures or sub-optimal investment situations and provide support, in a proportionate manner, only to final recipients that are deemed economically viable;
- To achieve additionality by preventing the replacement of potential support and investment from other public or private sources;
- To be consistent with State aid rules and not to distort internal market competition;
- To achieve a leverage and a multiplier effect by mobilising investment exceeding the size of the Union contribution;
- To ensure achieving of EU policy objectives;

It should be underlined that despite their numerous advantages, **FIs could not replace grant support in general.** They proved to be an alternative to grants for sectors and final recipients that are either not eligible for grants, or where the respective projects generate revenues and could not achieve 100% public support. Their share in the Cohesion Policy budget has substantially grown but still, the allocation for 21–27 represents

¹⁰ Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012.

around 6% of the total resources of ERDF, CF and ESF+.¹¹ Some of the weaknesses of FI's deployment are linked with their complexity (eligibility, state aid, procurement requirements), high levels of management costs and fees, low capacity of local authorities to deal with them, significant risks if they lack adequate planning and delivery mechanisms.

Figure 2: Cohesion Policy budget and FI share



Source: Cohesion Open Data, #EURegion Data Stories, Cohesion Policy support through financial instruments

In 1994–99, Cohesion Policy allocation for financial instruments was estimated at around EUR 0.57 billion, rising to some EUR 1.2 billion in 2000–06.¹² For the 2007–13 programming period FI allocation reached over EUR 12 billion. The Commission encouraged Member States to double the use of financial instruments with regard to 2007–13 and for 2014–20 FIs reached EUR 23 bn.¹³

¹¹ <https://cohesiondata.ec.europa.eu/stories/s/Financial-instruments-under-cohesion-policy-2021-2/tkqa-xd2d/> [Accessed 12 January 2024].

¹² Summary of data on the progress made in financing and implementing financial engineering instruments reported by managing authorities in accordance with Article 67(2)(j) of Council Regulation (EC) No 1083/2006, 2007–2013 Programming period. Situation as at 31 March 2017 (at closure).

¹³ Summaries of data on the progress made in financing and implementing financial instruments for the 2014–2020 programming period in accordance with Article 46 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council. Situation as at 31 December 2021.

FI allocations for 2014–20 rose also due to the increase in SME support linked to the COVID response measures. The summary of 2021 data shows that the leverage rate of FI is 3.7, which amounts to EUR 50 billion private co-financing contributing to the policy objectives of the European Union. From a total of 965 specific funds, managing Fis, EUR 12.5 billion was committed to FIs providing loans, EUR 7.2 to FIs providing guarantees and EUR 4.6 billion was committed to FIs providing equity.

IV. COHESION POLICY AND THE CRISES IN 2020's. THE RECOVERY AND RESILIENCE FACILITY (RRF)

In the 2018–2022 period the Cohesion policy was unexpectedly at the forefront of three crises for the EU, namely: 1) Brexit; 2) the COVID-19 pandemic; 3) the Russian invasion of Ukraine.

Brexit is regarded as a political issue, but it had its implications on the EU's budget and on the Cohesion Policy.¹⁴ As a member of the EU, the UK was a net contributor to the EU budget, though receiving a rebate after 1985. With the UK exit, the need for budgetary restraint on the size of the Multiannual Financial Framework (MFF) has become more prominent, though the Commission's proposal was to maintain spending in the 2021–27 period at a similar level to the 2014–20 period on behalf of other net payers (The Netherlands, Sweden, Denmark).

The COVID-19 pandemic posed an even bigger challenge on the EU in terms of both health policy and economic resilience.¹⁵ During the pandemic the Cohesion policy proved able to respond quickly to crises, first with the Coronavirus Response Investment Initiative packages (CRII and CRII+) to redirect existing funding, followed by the Recovery Assistance for Cohesion and the Territories of Europe (REACT-EU).

The introduction of a new policy instrument – **the Recovery and Resilience Facility (RRF)** based on the Recovery Plan for Europe, presented

¹⁴ **Bachtler, J., Iain Begg.** Cohesion policy after Brexit: the economic, social and institutional challenges. // Journal of Social Policy, 2017.

¹⁵ **Bachtler, J., Carlos Mendez, Fiona Wislade.** Will Cohesion Policy recover from COVID? An Initial Assessment. European Regional Policy Research Consortium Paper 20/3, European Policies Research Centre, Glasgow and Delft, 2020.

by the European Commission on 27 May 2020, enabled the Commission for the first time to raise funds by borrowing on the capital markets (issuing bonds on behalf of the EU) to partly fund NextGenerationEU (NGEU). NGEU is the EU's plan to emerge stronger and more resilient from the COVID crisis. The RRF envelope is €723 billion (€338 billion in grants and €385 billion in loans).¹⁶ Though Cohesion policy and the RRF have some common aims, both providing investment funding, they have **some major differences**,¹⁷ namely:

- Unlike the Cohesion Policy, RRF is a special temporary instrument with a broader scope by design. RRF finances reforms and investments in EU Member States from the start of the pandemic in February 2020 until 31 December 2026.
- RRF is meant to be 'performance based'¹⁸ and governments may request payment only upon completion of the agreed milestones and targets. Still, Article 2 of Regulation (EU) 2021/241 defines 'milestones and targets' as 'measures of progress towards the achievement of a reform or an investment' – i.e., stressing more on the process and outputs, but not on the achievement of tangible results.
- Though social and economic cohesion is one of the six pillars of the RRF, there is weak emphasis on regional level and dealing with local disparities;
- RRF is implemented under a unique form of direct management, with Member States preparing national recovery and resilience plans in consultation with the European Commission.

The main issue with the implementation both of RRF and the Cohesion Policy is linked with the capacity of member states to, firstly, provide a pipeline of mature projects, and secondly – to absorb the allocated funds and deliver reforms. The shorter implementation timeframe of RRF and REACT-EU led to delays in the programming of the 2021–2027 period.

¹⁶ Recovery and Resilience Facility (europa.eu) [Accessed 12 January 2024].

¹⁷ **Koopman, G.** Cohesion policy and the Recovery and Resilience Facility: not just two sides of the same coin, European Court of Auditors, ECA Journal, 2022, No. 1.

¹⁸ Preamble of the RRF (Regulation (EU) 2021/241).

Moreover, NextGenerationEU provided support of €10.87 billion for the Just Transition Fund (JTF), which is formally not part of Cohesion policy, but falls under the same framework and is integrated into its programmes.

The Russia-Ukraine war presented new demands for Cohesion policy in two directions: 1) provision of emergency support to refugees and their integration into labour markets (the Cohesion's Action for Refugees in Europe (CARE) and 2) support for the reorientation of energy supplies – REPowerEU. Reducing imports of Russian gas for some EU member states that were heavily dependent on Russia in 2022 lead to a substantial rise in energy prices.

In order to provide direct support for increased energy costs to consumers and SMEs, the European Commission proposed to MS redirection of unspent funds under the 2014–2020 Cohesion Policy allocation to SAFE (Supporting Affordable Energy) measures. In addition, given that the Recovery and Resilience Facility (RRF) is at the heart of the funding of the REPowerEU plan, MS are allowed to use up to 12.5% of Cohesion funds to expand renewables, strengthen grids, and electrify heating and industry.

As a whole, the Cohesion policy proved to adapt effectively and rapidly to the crisis, providing MS, regions and cities flexible financing to address problems. Still, the weak coordination between National Recovery and Resilience Plans (NRRP) and Cohesion Policy poses a high risk of competition for projects and lack of exploitation of synergies. The obvious shift from shared management to centrally managed policies provides the Commission with more influence over EU spending, but without a territorial dimension, multilevel governance and place-based approach the effectiveness of public spending is once again put at the forefront.

As highlighted by John Bachtler and Carlos Mendez (2023)¹⁹, an even more fundamental issue is whether the Cohesion Policy response to the crisis is blurring its purpose and long terms goals. Undoubtedly, the need for administrative flexibility for tackling economic and financial

¹⁹ **Bachtler, J., Carlos Mendez.** Navigating stormy waters: crises and Cohesion Policy beyond 2027. EoRPA Report 23/3, European Policies Research Centre, University of Strathclyde, Glasgow and EPRC Delft, 2023

consequences is important, but not for the sake of long-term structural and policy objectives.

The Eighth Cohesion Report,²⁰ published in 2022, shows that cohesion has improved, but gaps remain. According to the report, economic models indicate that GDP per head will be 2.6% higher in less developed regions in 2023, due to support from the Cohesion policy in 2014–2020. Eastern EU regions especially have been catching up substantially as they rely on infrastructure investment, but it is expected that *‘their low cost-advantages and returns on infrastructure investment may shrink over time.’* In order to avoid a development trap, in which a lot of the transition regions have been stuck, less developed regions should boost education and training and increase investments in research and innovation.

V. COHESION POLICY IN THE 2021–2027 PERIOD. COMBINATION OF SUPPORT – GRANTS AND FINANCIAL INSTRUMENTS

On 17–21 July 2020 the Special European Council (EUCO) reached agreement both on the European recovery plan and on the 2021–2027 MFF with the aim of facilitating a ‘sustainable and resilient recovery’²¹ while supporting the twin (green and digital) transition. The overall amount for commitments to MFF is EUR 1,074.3 billion in 2018 prices. Together with the RRF, it allows the EU to provide an unprecedented EUR 1.8 trillion²² of funding over the coming years. The allocation for Cohesion policy is of EUR 350 billion, topped with EUR 19 billion under the Just Transition Fund, which is still less than 2014–2020 allocation of EUR 404 billion.²³

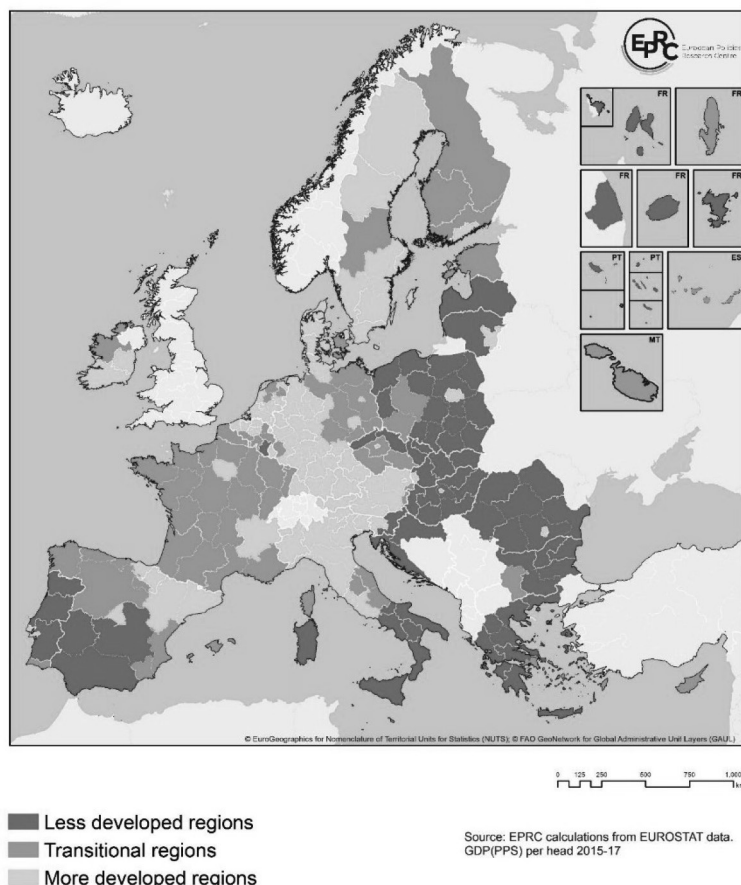
²⁰ Eighth Report on economic, social and territorial cohesion

²¹ European Council conclusions, 17–21 July 2020.

²² Multiannual financial framework for 2021–2027 adopted (press release, 17 December 2020).

²³ Cohesion Open Data Platform, https://cohesiondata.ec.europa.eu/cohesion_overview/14–20.

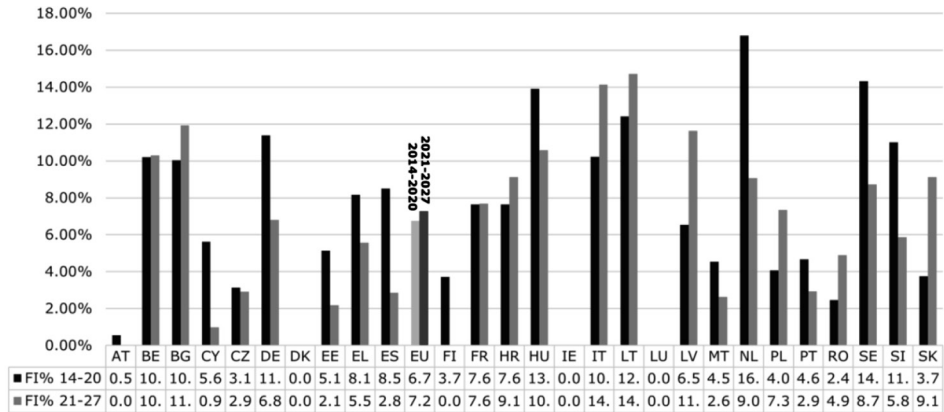
Map 1: Cohesion Policy status 2021–27 (EU27) by types of regions



The work on RRF and NRRPs and the delays in agreeing the new Cohesion legislation have in turn led to delays at the start of the 2021–2027 programming period. The adoption of the 2021–27 Partnership Agreements and programmes was largely completed during 2022.

For 2021–2027, almost EUR 18.5 bn (constant prices) from the EU budget is allocated under the Cohesion Policy to financial instruments, which represents a slight reduction in the share of allocated funds compared to the previous period. This contraction may be explained by the unexpected growth of FIs during the 2014–20 cycle as part of the COVID-response, as well as by the availability of alternative funding options.

Figure 3: Share of ERDF/CF allocated to financial instruments in 2014–20 and 2021–27



Source: Cohesion Open Data, #EURegion Data Stories, Cohesion Policy support through financial instruments

Lessons from the crisis have been drawn by the Commission, which proposed simplifications in the delivery mechanisms of Cohesion policy for 2021–2027. On 24 June 2021, the European Parliament and the Council agreed on the Common Provisions Regulation (CPR/Regulation 2021/1060) setting out the rules for 2021–2027.

A major shift in the rationale from alternative use between grants and FIs to combination of the two forms of Cohesion support is laid down in Article 58(5) of the CPR. In addition to technical support, guarantee fee and interest rate subsidies, which were allowed in the 2014–2020 programming period, bodies implementing financial instruments can be entrusted to provide grants that are necessary and directly linked to financial instruments, to meet part of the investment costs. This may take the form of an up-front capital grant or a capital rebate upon achievement of results.

The combination of FI and grant in one operation under financial instruments rules is meant to incentivize a policy effect, including to help reducing the reliance on 100% grant financing. The combination allows financing of riskier and not fully financially viable projects. (e.g. energy

efficiency investments,²⁴ etc.). The ‘embedded’ grant aims to trigger investments in targeted EU policy areas, mainly linked to the **European Green Deal**.

The European Commission introduced the European Green Deal at the end of 2019 – *‘a new growth strategy that aims to transform the EU into a fair and prosperous society, with a modern, resource-efficient and competitive economy where there are no net emissions of greenhouse gases in 2050 and where economic growth is decoupled from resource use’*.²⁵ As its launch in late 2019 coincided with the beginning of the COVID crises and afterwards with Russia’s aggression in Ukraine, progress was uneven with a bigger focus on drafting new regulations on the European Green Deal and less on their implementation. Both communication of the benefits of the Green Deal, as well as demonstrating tangible results in certain policy areas with greater progress (e.g., Climate and Energy policy), are considered crucial for its future deployment.

In 2022 the EIB and the European Commission Directorate for Regional and Urban policy launched two new model financial instruments in support of the REPowerEU and the New European Bauhaus initiatives.²⁶ While REPowerEU²⁷ was directly linked with reducing dependency on Russian fossil fuels, as well as energy consumption as a whole, the New European Bauhaus was announced by President von der Leyen in October 2020 as the ‘soul’ of the European Green Deal, adding a cultural dimension by incorporating values of aesthetics, sustainability, and inclusion, while accelerating the green transition.

²⁴ Fi-compass Library, European Commission, European Investment Bank. The potential for investment in energy efficiency through financial instruments in the European Union (2020)

²⁵ The European Green Deal Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, Brussels, 11.12.2019 COM(2019) 640 final

²⁶ <https://www.eib.org/en/press/all/2022-281-greener-housing-and-sustainable-living-spaces-the-european-commission-and-eib-launch-blueprints-for-financing-more-energy-efficiency-and-territorial-development-investments> [Accessed 12 January 2024].

²⁷ https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/repowereu-affordable-secure-and-sustainable-energy-europe_en [Accessed 12 January 2024].

Both models provide options on how to combine EU grants together with loans on favourable terms, based on simplifications in the Article 58(5) CPR, in support of energy efficiency and territorial development investments, showing the areas where the combination with grants is most suitable – boosting investments for building renovation to reduce greenhouse emissions, improve quality of life, and fight energy poverty.

This combination in one operation has the following main characteristics, according to the CPR:

- The rules applicable to financial instruments will apply to that single financial instrument operation;
- The grant support will be directly linked and necessary for the financial instrument and will not exceed the value of the investments supported by the financial product;
- Provision of the combination should be within a single funding agreement, where both distinct forms of support will be provided by the body implementing the financial instrument.

The application of a single set of rules is recognised as an important flexibility that may provide the respective MS and Managing authority with the opportunity to use the grant in a much more targeted and dynamic way, harnessing the added value that FIs bring to secure their programme objectives.²⁸

The practical application of this combination in a single operation will be seen in the following years, as the set-up of the financial instruments for 2021–2027 has been delayed and only a few fund managers have started their activity in 2023. Its success or failure will contribute to the overall discussion on the future of Cohesion policy post 2027 period.

²⁸ fi-compass Knowledge Hub (2023) Implementation of grants and financial instruments combined in a single operation

VI. DEBATE ON THE FUTURE OF COHESION POLICY POST-2027

Both green and digital transition are expected to fundamentally change the economies of European regions, bringing new opportunities, but also requiring structural changes and reforms that are likely to increase existing and to create new regional disparities. The need to complement structural policies with place-based approach should be reinforced, which means strengthening the role of Cohesion policy in unlocking public and private investment in the green, digital and demographic transitions.

The context for post-2027 Cohesion Policy is even more complex, dealing not only with the abovementioned challenges, but also with the potential next EU enlargement, as most regions from the accession countries are categorized as Less Developed Regions, imposing substantial pressures on the EU budget and on current MS. There are currently eight candidate countries and two potential candidate countries at various stages of the accession process.

The performance of EU's Recovery and Resilience Facility, especially in relation to progress with climate action and digital transition, is also a major corner stone for the future Cohesion policy. The RRF with its centralized and performance-based implementation approach is a preferred mechanism by the Commission. The low priority given to Cohesion policy is reflected in its absence from the recent State of the Union 2023 address by the Commission President, who made no mention of regional disparities.

Still, the debate on Cohesion Policy reform has intensified in 2023 and is expected to continue in the coming years in view of the publication of legislative proposals in 2025. It may take the form of a more radical reform of EU finances and of a thorough rethinking of the rationale and role of Cohesion Policy in the future EU.

In the last 50 years Cohesion policy of the European Union has evolved from a redistribution mechanism to the main long-term investment policy of the EU budget. The need for the EU to deal with multiple crises has led to the progressive weakening of Cohesion goals and their substitution with a wider set of objectives, including re-direction of cohesion funds to crisis

measures. Though the launch of the RRF confirmed a strong commitment by the EU to economic recovery from the COVID pandemic, the main concern from a Cohesion Policy perspective is the weak emphasis on regional and local disparities. Its simplified delivery mechanism, promoting centralised and performance-based implementation approach jeopardises the grounds of Cohesion policy and the deployment of place-based and multi-level approach.

Financial instruments, as the most flexible part of Cohesion policy investments, have also their evolution in the last three programming periods, rising to 6% of Cohesion resources. The novelty for the 2021–2027 period is the combination of grants and financial instruments in one operation, following financial instrument rules, allowing financing of riskier and not fully financially viable projects that contribute to the green and digital transition. The practical implementation of simplifications in the Article 58(5) of the CPR will test the delivery system of the Cohesion Policy and show where improvements are needed post-2027.

CHAPTER 28:

GREEN CLAIMS AND GREENWASHING BY FINANCIAL AND NON-FINANCIAL UNDERTAKINGS. SUSTAINABLE CONSTRUCTIONS.

Yuliya Jarova

ABSTRACT	KEY WORDS
This chapter examines the legal phenomenon of ‘green claims’, ‘sustainability-related claims’ and greenwashing as phenomena emerging in the transition to a sustainable economy. The analysis identifies the key role of sustainable finance in the green transition in the context of greenwashing risks. The chapter also reviews the Taxonomy-alignment assessment. It examines the legal framework regulating green claims, ‘sustainability-related claims’, ‘sustainability-related disclosures’ and greenwashing, as well as legislative initiatives. It also provides a high-level review of the criteria for sustainable financing in the real estate sector which is among the sectors that is responsible for a significant share of greenhouse gas emissions.	green claims, sustainability-related claims, sustainability-related disclosures, greenwashing, ESG, financial greenwashing, Taxonomy-aligned, Taxonomy-eligible, Taxonomy compliant, green construction.

I. GENERAL CONCEPT

The phenomenon of environmental claims, known also as green claims (‘**green claims**’ or ‘**environmental claims**’ or ‘**sustainability-related claims**’) emerged in the process of transitioning to a climate-neutral and sustainable circular economy.

The claim that a product or service reduces carbon footprint and has a positive effect on the environment (i.e., the green claim) is used by companies as a statement that they recognise and acknowledge the ‘*concept of shared value*’, which implies the dual utility of companies – simultaneously

creating economic value for society and at the same time – addressing its needs and challenges.¹ Through this concept, companies seek to create economic benefits by creating social value and announce it to the public (see Chapter [9]). In a rapidly warming and polluting environment, more and more companies are seeking to change their business models to build a sustainable future – one that protects people and the planet on the one hand, and ensures capital and profits on the other.² Lawmakers are rethinking the existing legislative framework to create fair conditions for the transition to a sustainable economy. Obviously, this change cannot take place **without the active participation of consumers**, who, through their participation in the **capital cycle**, give a clear signal of their customer preferences. The use of sustainable eco-credentials is becoming an advertising tool, with environmentally friendly products seeing a greater increase in sales than standard products.³ In the context of a sustainable transition, people, especially the younger generation, are increasingly paying attention to environmental issues and therefore **green claims as a marketing tool is increasingly used as a competitive advantage**. Businesses acknowledge that young people, educated from an early age in an environmental culture, will soon become the next generation of consumers, with their specific preferences and awareness of social responsibility, and strive to be relevant to their expectations.

The financial system, through its public, private, banking and non-banking actors⁴ (see Chapter 18), has a key role to play in implementing and supporting the green transition (the so-called sustainable finance), as these actors help to channel capital towards low-carbon activities or discriminate against high-carbon projects.⁵

¹ **Стефанова, М.** Отчитане на устойчивостта на предприятията. София, УИ „Св. Кл. Охридски, 2022, с. 19.

² **McAteer, P.** Sustainability is the new advantage. London, Anthem Press, 2021, 44–56.

³ eur-lex.europa.eu/legal-content/BG/TXT/PDF/?uri=CONSIL:ST_7777_2023_INIT&qid=1689518693672 [accessed on 29.08.2023].

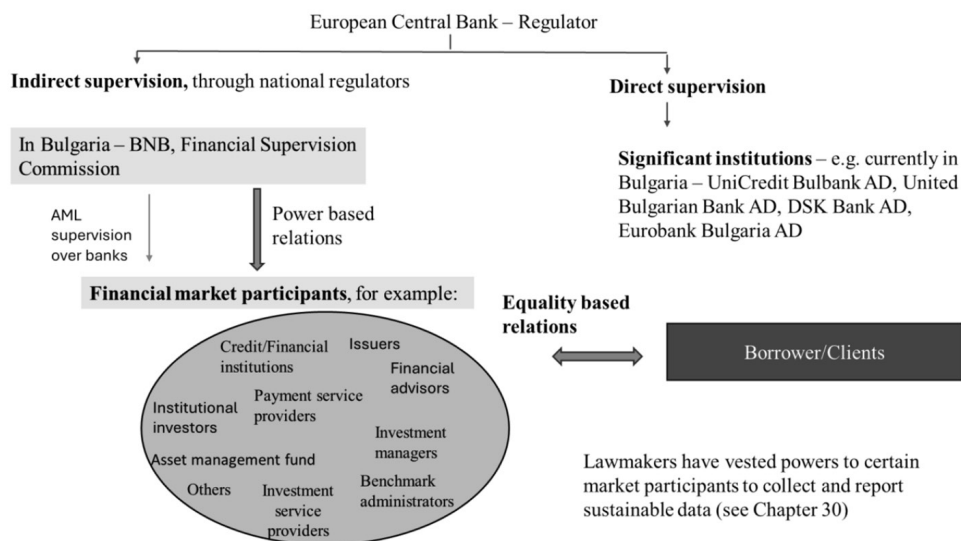
⁴ **Mihaylova-Goleminova, S.** Financial Control, Community and Law. // Financial Law Review, 2018, No. 4, 39–50.

⁵ <https://documents1.worldbank.org/curated/en/099548409142222955/pdf/IDU0881e4d02027f504e120898502121116e2eb7.pdf> [Accessed on 20.08.2023]

The financial system is an area that is strongly regulated by the framework of financial law (see Chapters 17 and 18) and as such is closely related to the application of the doctrine of administrative law. The relationship between financial players and supervisory authorities is of an administrative-legal and financial-legal nature, sanctioned by state coercion. Supervisory authorities are entitled by virtue of law (i.e., the Administrative Violations and Sanctions Act in Bulgaria) to impose administrative sanctions and measures illustrating the state coercion principle.

Figure 1 shows the hierarchy and interaction between the financial market participants and financial supervision authorities:

EU financial market participants and supervision



Along with the traditional business of financing, lending institutions also manage the risks that may arise in different economic sectors because of climate change. For example, climate deviations may alter the normal growth process for farmers (drought may cause a longer growing season for some crops),⁶ leading to changes in the financing structure, requirements for appropriate credit buffers, etc.

⁶ <https://nca2018.globalchange.gov/chapter/10/> [accessed on 30.08.2023].

Lending institutions with an integrated sustainability strategy may limit access to financial resources to clients that are unsustainable or are in relationships with unsustainable partners in their supply chain. This, in addition to lowering the credit rating of non-compliant companies, will also affect their market sustainability rating—known as the Environmental, Social and Governance (ESG)⁷ rating. This rating determines the ESG eligibility of a company, which, given the recent and forthcoming amendments in the legislative landscape, will be a guarantee for competitive participation in the commercial turnover, especially through participation in the supply chain of partners. Put simply, companies with good environmental/sustainable performance will face lower costs of debt financing in comparison to those that do not contribute to the green transition. Lending institutions set a standard for behaviour by introducing best practices on sustainable issues, educating their employees and partners on environmental awareness and encouraging them to behave sustainably.⁸ An example of such practice is the UBB Agri-Carbon Calculator,⁹ which calculates the carbon footprint of agricultural activities and is free to use.

Financial market participants are increasingly recognizing social debt as interlinked with their capitalisation efforts, and therefore these participants, in particular banks, are (and will increasingly) analyse the sustainability beliefs of their customers, **the quality of their data related to sustainability disclosures**, including **through their supply chain**, and environmental behaviour.

This introduction of the genesis of the green claim serves as a bridge to the next paragraph, which reviews the legal concept of green claims and their regulation.

⁷ Historically, the term ESG was first introduced in the UN's **Who Cares Win** report, entitled 'Principles for Responsible Investment' in 2006, which launched the requirement for ESG criteria to be part of companies' financial statements.

⁸ UBB's Report to Society is a good example of current green initiatives, innovations and efforts towards a sustainable future: https://www.ubb.bg/files/csr-vas-2023-en.pdf?_gl=1*10ne0nz*_ga*MjA1Mzg4NjMxOS4xNzA5MjAxMzk4*_ga_SVGK02M3Y5*MTcxNzQwMjAxMC40LjAuMTcxNzQwMjAxMC42MC4wLjA [accessed on 5 June 2024].

⁹ <https://www.ubb.bg/business-clients/agro-emission-calculator> [accessed on 30.08.2023].

By its legal nature, the classic **environmental claim** represents *any message or representation which is not mandatory under Union or national law, in any form, including text, pictorial, graphic or symbolic representation, such as labels, brand names, company names or product names, in the context of a commercial communication, and which states or implies that a product, product category, brand or trader has a positive or zero impact on the environment or is less damaging to the environment than other products, product categories, brands or traders, or has improved its impact over time*.¹⁰ Examples of such claims are: ‘environmentally friendly’, ‘eco’, ‘green’, ‘nature friendly’, ‘ecological’, ‘natural’, ‘animal friendly’, ‘cruelty free’, ‘sustainable’ ‘environmentally friendly’, ‘climate friendly’, ‘deforestation free’,¹¹ ‘biodegradable’, ‘zero emission’, ‘carbon neutral’, etc.¹² Green claims also focus on the sustainability of products or elements of products, such as their **durability, recyclability, repairability**, use of natural materials whose qualities have been found to reduce the negative environmental footprint or carbon footprint. **Ecological labels** are a subset of the environmental claim.

II. TYPES OF GREEN CLAIMS

Green claims vary depending on the object they address. Thus, they can be **product green claims** (including where the product is a financial instrument), **service green claims** and **entity green claims** (i.e., an environmental claim made by the enterprise for itself).

The **type of performance** of green claims distinguishes them as **overt** or **covert green claims**. The overt green claims may take all

¹⁰ This is the legal definition under **Directive (EU) 2024/825** of the European Parliament and of the Council of 28 February 2024 amending Directives 2005/29/EC and 2011/83/EU as regards empowering consumers for the green transition through better protection against unfair practices and through better information, OJ L, 2024/825, 6.3.2024.

¹¹ See **Regulation (EU) 2023/1115** of the European Parliament and of the Council of 31 May 2023 on the making available on the Union market and the export from the Union of certain commodities and products associated with deforestation and forest degradation and repealing Regulation (EU) No 995/2010.

¹² See Paragraph (9) of **Directive (EU) 2024/825**.

forms of commercial practices¹³ which have the direct-indirect effect of encouraging consumers to select the advertised object, or, through various types of overt action, to demonstrate environmentally friendly behaviour and awareness. Overt green claims may take the form of a sustainable label or logo. Covert green claims can include **the use of images** (trees, animals) and **colours** (e.g., a green background) that are associated with environmental sustainability.

The type of relationships involved distinguishes green claims as **classic** and **sectoral**. Classic green claims are consumer or business-to business oriented and, given the fact that they mainly relate to a product and a service, their legal regulation is found in the rules of traditional consumer and competition law (in Bulgaria: the Competition Protection Act and the Consumer Protection Act are the key pieces of relevant legislation in that area).

Green claims regulated by sectoral legislation, such as sustainability-related claims in the financial services sector, the sustainable investments, investment services, asset management and pension funds sectors, which are not directly targeted at consumers, and have a specific subject matter (such as trading with financial instruments) are **sectoral green claims**. Although these claims emphasize on the positive environmental performance of a product, instrument or trader as an incentive for funding, these claims are not classic green claims, but rather sectoral rules for due sustainable conduct (sustainable behaviour) which, for terminology clarification purposes, may be referred to as **sustainability-related claims**.¹⁴

For example, the sustainable behaviour of investment service providers obliges them to consider the sustainability preferences of the investor (in practice this is done through accurate questionnaires filled in by the client); the manager of investee companies is obliged to give correct sustainable statements about the investment (using comparable, traceable, fair and unambiguous data).

The designation of ‘ESG’ or ‘green’ funds, as a type of sectoral sustainability-related claim, should match the investment portfolio

¹³ Under the definition set out in § 13, item 23 of the SP of the Consumer Protection Act.

¹⁴ As mentioned in ESMA Final Report on Greenwashing ESMA36-287652198-2699 Final Report on Greenwashing (europa.eu) [accessed on 5 June 2024].

(requiring at least 80% of investments qualify for sustainable and commitment to sustainable investments), as these can influence investors' decisions.¹⁵

Issuers of the so called 'European Green Bond ('EuGB') must ensure that bond proceeds are allocated to economic activities¹⁶ that are in line with Regulation (EU) 2020/852¹⁷ (the '**Taxonomy Regulation**') establishing a framework to facilitate sustainable investments which [The Taxonomy Regulation] also applies to **sustainability-related disclosures** in the financial services sector regulated by Regulation (EU) 2019/2088¹⁸ (the '**SFDR**').

III. TAXONOMY REGULATION

The **Taxonomy Regulation** introduces a benchmark frame of reference when assessing and reporting on sustainability. The Regulation sets out **science-based unified criteria** that determine whether an activity qualifies as sustainable or not. These so-called **technical screening criteria** are elaborated in the **EU Taxonomy Delegated Acts**.¹⁹ The **Taxonomy Regulation** is also a transparency tool that

¹⁵ See latest guidelines of the European Securities and Markets Authority (ESMA), on funds' names using ESG or sustainability-related terms: https://www.esma.europa.eu/sites/default/files/2024-05/ESMA34-472-440_Final_Report_Guidelines_on_funds_names.pdf [accessed on 30 May 2024].

¹⁶ For an exact definition, see Regulation (EU) 2023/2631 of the European Parliament and of the Council of 22 November 2023 on European Green Bonds and optional disclosures for bonds marketed as environmentally sustainable and for sustainability-linked bonds.

¹⁷ Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

¹⁸ Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

¹⁹ **Commission Delegated Regulation (EU) 2021/2139** of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant

introduces mandatory **sustainability-related disclosure obligations** on some financial and non-financial undertakings, requiring them to disclose their share of Taxonomy-aligned activities²⁰ (see Figure 3). In-scope entities have different key performance indicators (**KPIs**) and forms of disclosure depending on whether they are a **financial** (an asset manager, a credit institution, an investment firm, an insurance or reinsurance undertaking) or **non-financial undertaking**, and depending on the type of financial undertaking.²¹ The **Taxonomy Regulation** is used to evaluate the climate performance of a specific investment, the sustainable profile of a company or a portfolio of assets. The evaluation is carried out in a harmonised and unified way for all activities, **which enables banks, partners and stakeholders to easily and objectively compare the quality of sustainable achievements between similar market players**.

harm to any of the other environmental objectives – as amended by Delegated Commission Regulation (EU) 2023/2485 of 27 June 2023 (two annexes) – in force from 01.01.2024;

Delegated Regulation (EU) 2021/2178 as of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation;

Commission Delegated Regulation (EU) 2023/2485 of 27 June 2023 amending Delegated Regulation (EU) 2021/2139 establishing additional technical screening criteria for determining the conditions under which certain economic activities qualify as contributing substantially to climate change mitigation or climate change adaptation and for determining whether those activities cause no significant harm to any of the other environmental objectives;

Commission Delegated Regulation (EU) 2023/2486 of 27 June 2023 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to the sustainable use and protection of water and marine resources, to the transition to a circular economy, to pollution prevention and control, or to the protection and restoration of biodiversity and ecosystems and for determining whether that economic activity causes no significant harm to any of the other environmental objectives and amending Commission Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities.

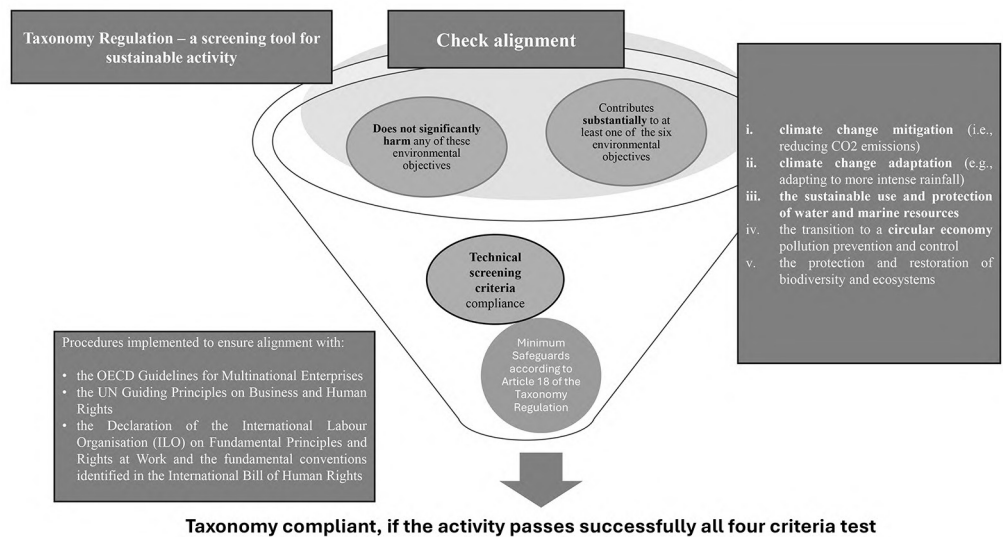
²⁰ https://finance.ec.europa.eu/document/download/a3c5fc94-6bc8-4c65-bc6c-de37cf3848b0_en [Accessed on 03.06.2024].

²¹ https://finance.ec.europa.eu/system/files/2021-12/sustainable-finance-taxonomy-eligibility-reporting-voluntary-information_en.pdf [07.06.2024]

The **Taxonomy Regulation** qualifies as an activity ‘**environmentally sustainable**’ by applying a **four-step** test, testing whether the activity:

- contributes **substantially** to one or more of six environmental objectives;
- **does not significantly harm** any of these environmental objectives;
- is carried out in compliance with **minimum safeguards**;
- complies with the **technical screening criteria**.

Figure 2 shows the Taxonomy-alignment test:



Therefore, it is of essence that the client is in a position to provide the credit institution or the person that needs to evaluate the fairness of the investment information with substantiated, reliable, and where required – official documents and data to satisfy all of the above criteria. Estimates and proxies **are not allowed** to be used for the mandatory reporting under Article 8 of the **Taxonomy Regulation**.²² Data must be

²² https://finance.ec.europa.eu/system/files/2021-12/sustainable-finance-taxonomy-eligibility-reporting-voluntary-information_en.pdf [accessed on 07.06.2024].

provided in a machine-readable and digital way, and where applicable, in a standardised way, to enable easy supervision by advanced digital tools (**SupTech tools**).²³ In practice, clients undertake to comply with the minimum safeguards by way of contractual commitments set out in the loan arrangement.

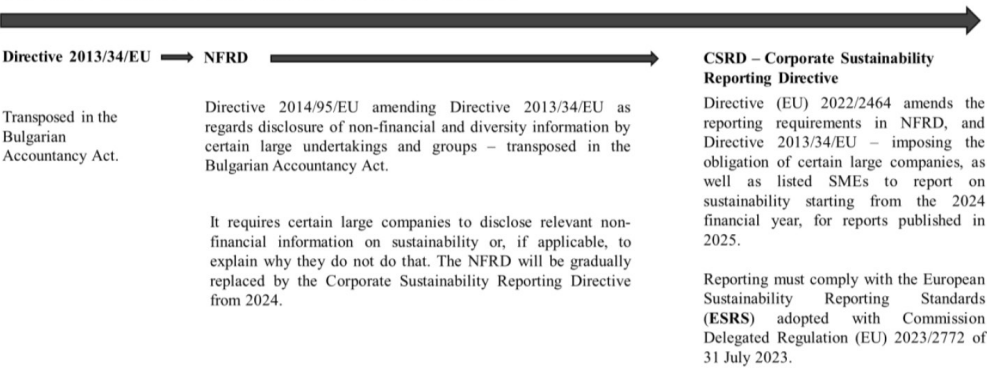
Non-financial sustainability reporting (see Chapter [9]) aims at informing the public and stakeholders about the sustainability performance of certain companies; however, these reporting obligations should not be treated as a classic green claim because reporting is not carried out to directly induce the addressee into entering in a transaction and for some companies it is not of a voluntary nature.²⁴ Non-financial sustainability reporting, also referred to as **sustainability-related disclosures**, is deemed to serve as an incentive for market actors to shift business models to enable timely transition to climate neutral and sustainable economy.

²³ The regulators are recommended to invest in SupTech tools to be able to verify sustainable related disclosures – ESMA Final Report on Greenwashing ESMA36-287652198-2699 Final Report on Greenwashing (europa.eu) [accessed on 5 June 2024].

²⁴ Article 5 of **Directive (EU) 2022/2464** provides the timeline and list of companies that are subject to mandatory non-financial reporting for sustainability – initially large undertakings which are public-interest entities (that includes certain banks) with more than 500 employees or if these companies are parent undertakings of a large group exceeding on its balance sheet dates, on a consolidated basis, the average number of 500 employees, subsequently all other large undertakings and all other parent undertakings of a large group, small and medium-sized enterprises whose transferable securities are admitted to trading on a regulated market in a Member State [and which are not micro-enterprises], etc.

Figure 3 shows the key legislative acts that relate to non-financial sustainability-related disclosures.

Key sources for non-financial disclosures on sustainability



Assessment of data is carried out according to the Taxonomy Regulation (linked to Corporate Sustainability Reporting Directive) and Technical Screening Criteria.

IV. GREENWASHING

Greenwashing represents the practice to use environmental claims that are misleading and untrue as to the environmental benefit of a product, service, or business, and as such can mislead individuals and commercial actors.²⁵

²⁵ Washing is a general term to present something in a misleading way. To this end, in the ESG landscape there are different kind of washing – e.g. social washing is used in cases where the company represents its itself as a socially responsible entity and the truth shows the opposite.

1. The concept of greenwashing

Figure 4 shows the multiple drivers for greenwashing.



Source: ESMA Final Report on Greenwashing, p. 7

In different economic sectors, greenwashing is demonstrated in a different, sector-specific form, and depending on its manifestation, may fall within the scope of consumer and competition law (i.e., – classic greenwashing); or violate the legal imperatives of sectoral rules regarding due sustainable conduct (i.e., – sectoral greenwashing). The term has become a catch-all for any act that misleads the addressees about the environmental performance of an entity, service or product (in consumer and competition relations), including any act that misleads stakeholders by misrepresenting sustainability information in transition plans and non-financial sustainability-related disclosures.

Classic greenwashing represents false green claims that fulfil the elements of a **misleading commercial practice**, and can be encountered in the stages of advertising, buying, and using products/services. Sectoral

greenwashing is manifested by false sectoral green claims or sustainable misconduct.

2. Forms of greenwashing

Greenwashing takes various forms, the most common being the following: false or misleading advertising;²⁶ selective promotion of environmentally friendly initiatives and deliberate withholding of information on the contribution of these companies to unsustainability; promises of environmental benefit without a mechanism provided to prove the positive environmental footprint and without an independent monitoring system; misuse of trademarks, certificates or logos associated with environmental standards or organisations; use of unreliable and opaque sustainability labels that are not validated by a credited certification scheme or public body; advertising emphasis on consumer benefits that are considered to be common practice in the relevant market or where all products in the relevant product category on the EU market are required to meet the advertised environmental performance; exaggeration of sustainability performance; reference to a trust mark,²⁷ a quality label or its equivalent without the trader having subscribed to certain rules of conduct or having obtained the necessary authorisation; comparative advertising for environmental friendliness without the possibility to provide information on the method of comparison; generic environmental claims directed at consumers in marketing where the environmental excellence of the product or trader cannot be demonstrated;²⁸ product-wide environmental claims where environmental excellence relates only to a particular aspect of the product; false claims relating to compliance with environmental

²⁶ **Варадинов, О.** Нелоялни търговски практики в отношенията търговец – потребител. София, Сиби, 2014. In addition, the U.S. Federal Trade Commission has issued guidelines for environmental marketing that outline the principles advertisers should follow when making environmental claims. Similar guidelines exist in other countries. In Bulgaria, these are the National Ethical Rules for Advertising and Commercial Communication, established by the National Council for Self-Regulation in 2009.

²⁷ <https://kzp.bg/data/content/u/9/upload/Buletini/%20%E2%84%96%203.pdf> [Accessed on 20.08.2023].

²⁸ In accordance with Regulation (EC) No 66/2010 of the European Parliament and the Council of 25 November 2009 on the EU Ecolabel.

legislation – e.g., where environmental standards are claimed to be met when this is not true. **Greenwashing is banned by rule of law** as some of these unfair market practices are included in the **blacklist of deceptive market practices** by Directive (EU) 2024/825.²⁹

Depending on the attitude in the statement, greenwashing can be **intentional** or **unintentional**. The relevance of this subjective element will depend on the facts of each case. Intention is irrelevant when the supervisory authority enforces an order to cease greenwashing as an unlawful practice. If, however, damages are claimed to arise from unfair competition, then negligence or intent is often relevant³⁰ – i.e., the attitude behind the act may influence the amount of awarded damages.

Some companies prefer to hide their environmental beliefs, sustainability strategy and willingness to participate in the green transition to avoid sanctions and reputational damage. This behaviour, a counterpoint to the sustainable and ecological behaviour, is known as ‘**greenhushing**’ and may have a negative effect on the green transition, as, on the one hand consumers are deprived of access to information that would allow them to consume sustainably, and on the other – there is a lack of motivation for sustainable innovation.

3. Greenwashing in banking

The regime of green claims and greenwashing has and will have an increasingly significant impact on credit institutions. Banks are doubly exposed to the risk of greenwashing, on the one hand because of their own green claims, sustainable behaviour and non-financial reporting, and on the other hand because of the green claims and behaviour of their clients and partners, which reflects on the bank’s sustainability image.

²⁹ Annex I to **Directive 2005/29/EC** of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council (**‘Unfair Commercial Practices Directive’**).

³⁰ ESMA22-106-4551 SMSG additional report on greenwashing (europa.eu) [accessed on 20.08.2023]; and **ESMA Final Report on greenwashing**.

Greenwashing on the financial market is a practice in which **sustainability-related statements, declarations, actions or communications do not clearly and fairly reflect the sustainability profile of an entity, financial product or financial service.**³¹ This practice can be misleading to consumers, investors, and stakeholders. **Sustainability-related statements** can occur and be disseminated **intentionally or unintentionally** and in connection with **entities, products, and services**. The number of greenwashing breaches in the banking sector has increased in all sectors, including EU banks, although the risk is still perceived as low.³² The breaches are most often on environmental issues and mostly at company level. Currently, **greenwashing has the greatest impact on reputational risk, followed by operational risk for banks and investment firms**. Operational risk relates to the regulatory and administrative sanctions that may be imposed on a credit institution because of greenwashing (by a supervisor or consumer/competition authority), as well as damages awarded in court proceedings (e.g., from a competitor). Currently, there is no evidence of regulatory sanctions imposed by supervisors on banks in the EU, although there is evidence of investigations into allegations of greenwashing and time will show how the competent authorities will sanction them. This trend is expected to change with the unification of the legal framework through ongoing legislative initiatives, as well as the establishment of judicial and administrative precedents.

The credit institution is exposed to greenwashing both **at entity level** and **at product level**. At entity level – the bank can greenwash its activities through advertising while at the same time participating in practices that could contradict the sustainability goals and the image it is creating – e.g., contradicting the targets set out in the sustainability report. At product level, the bank can implement greenwashing across the entire spectrum of banking activities – retail banking, corporate banking, investment services, payment services and proprietary funds management.

³¹ The analysis of greenwashing in the banking sector is based on the results of the EBA Progress Report on Greenwashing Monitoring and Supervision at https://www.eba.europa.eu/sites/default/files/document_library/Publications/Reports/2023/1055934/EBA%20progress%20report%20on%20greenwashing.pdf ('EBA Progress Report on Greenwashing') [Visited 05.06.2023].

³² EBA Progress Report on Greenwashing and ESMA Final Report on greenwashing.

Banks are required to disclose their Green Asset Ratio ('GAR') as part of their non-financial disclosures (e.g. this is a kind of KPI for the sustainability profile of the bank). Generally, GAR is the simple ratio between the Taxonomy-aligned assets of the bank such as: loans, investments in debt instruments, including green bonds, in equity securities, in acquired collateral and other assets in Taxonomy-compliant economic activities and the total value of all bank assets.

Figure 5 shows the GAR calculation formula:

Taxonomy-aligned assets of the bank (to include: the loans and advances, debt securities, equities and repossessed collaterals, financing Taxonomy-aligned economic activities based on turnover KPI and CapEx KPI of underlying assets)

GAR =

All taxonomy and non-taxonomy eligible or aligned assets
(to include: total loans and advances, total debt securities, total equities and total repossessed collaterals and all other covered on-balance sheet assets.)

Due to many limitations of the type of the assets that may achieve a higher GAR (you may not calculate in the nominator of the formula the exposure to non-taxonomy aligned activities; out-of-scope NFRD entities which are not obliged to make non-financing disclosures, etc.), it may not be considered as a key metric to show contribution to the climate neutral economy. However, incorrect disclosure of GAR will qualify for greenwashing. The GAR, which has not been disclosed by most banks to date, is expected to increase the appetite for more sustainably-linked loans.

Sustainably-linked loans incentivize borrowers to achieve predefined sustainability goals, where the use of funds is not restricted to specific green or social projects and funds are not required to be spent on such projects.³³ The financing may be given as project finance, acquisition finance or even working capital credit. **Sustainably-linked loans** must have:

- Sustainability **Indicators** ('KPIs') defined in advance between the bank and the borrower relevant to the specific business. The KPIs need to be ambitious, yet measurable, realistic, and achievable;

³³ The Loan Market Association has provided useful guidelines to the drafts and terms of sustainability loans.

- **Financial Incentives** for achieving the targets – the borrower may be incentivized with a lower interest premium or penalized with a higher one; and
- **Sustainability Coordinator** – i.e., experts appointed to assess the KPIs and subsequent verification of target achievements.

Classifying sustainably-linked loans as Taxonomy-aligned without clear KPIs, performance/targets, without checking the methodology and without adjustment of the interest in case of non-performance of the KPIs (e.g., a low interest rate is provided in return for an obligation to reforest a certain area of land, but the agreement does not provide for a penalty or increase in the premium for non-performance), may lead to greenwashing in two aspects. On the one hand, by presenting an incorrect **GAR** calculation, which will qualify as sectoral greenwashing and, as such may be subject to administrative sanctions by the regulator;³⁴ on the other hand – as classic greenwashing if a bank markets a product labelled as a sustainable-link loan without having the structure, capacity and industry experts with sufficient knowledge to achieve the KPIs of the loan arrangement and, as such, may be subject to fines imposed by competition authorities (e.g., Commission for protection of Competition in Bulgaria).³⁵

Greenwashing in the banking sector may manifest itself in **three main types**:

- Integrating the concept of sustainability at entity level – i.e., in the sustainability report to society that shares the bank's (ESG) strategy.
- Focusing on the sustainable performance of a product/service;
- Making future sustainability commitments.

³⁴ As yet, there is no precedent.

³⁵ As yet, there is no precedent.

Figure 6 shows the main examples of greenwashing in retail and corporate banking:

Greenwashing made by Credit institutions - Retail banking/ Corporate finance.	Misleading statements in non-financial reporting - under the Taxonomy Regulation, e.g. inaccurate data of the Green Asset Ratio that banks are required to disclose under the Non-Financial Reporting Directive 2014/95/EU;
	Misleading statements about the nature of the green loans and mortgages which in fact are used for 'non-green purposes' - e.g. providing credit for the purchase of a near-zero energy property without checking the validity of the energy performance certificates and Taxonomy compliance tests.
	Linking credit card purchases to sustainability-related benefits that cannot be proven, such as "for every amount spent on your credit card, a tree will be planted", without a methodology in place to control this process/ claims that a green loan/investment will allow the customer to reduce domestic energy without clear evidence or tools on how this will happen;
	Marketing a green savings product without a clear commitment on how the funds will be spent to finance sustainable projects;
	Financing business for reduction emissions per company/portfolio (e.g. mortgages, car loans), without a sufficient level of credibility under the proposed transition plan; making a green claim for financing of an environmentally sustainable airport project despite its negative impact on biodiversity and greenhouse gas emissions;
	Commitments to reduce emissions and/or achieve zero net emissions of exposures to the energy sector, but with an unreliable transition plan.
	Provision of sustainable – linked loans without clear sustainable key performance indicators, performance/targets checking methodology and without adjustment of the interest in case of non-performance of the key sustainability indicators - e.g. a low interest rate is provided in return for an obligation to reforest a certain area of land, but the agreement does not provide for a penalty or increase in the premium for non-performance.

Figure 7 shows the main examples of greenwashing in investment services:

Greenwashing in investment services	Misleading statements about the sustainability qualities and performance of financial products, funds, portfolio, under Article 8 and Article 9 of Regulation (EU) 2019/2088 on sustainability disclosures in the financial services sector; false or inaccurate advice about the extent to which the investment service takes into account clients' sustainability preferences;
	An investment fund representing itself as sustainable without providing substantiated and sufficient information about its sustainability or having this present in its strategy;
	An investment fund representing itself as sustainable while directly or indirectly financing questionable activities or countries;
	Representing a syndicate of sustainable bonds while omitting the more material syndication activity of securities from companies that use fossil fuels;
	A fund that claims to invest in sustainable companies but has no information on how it will measure this positive impact, or that invests in companies that are not "green" but slightly better than others – the sustainable impact shall be always substantial ; misuse of the term "impact investing";
	Public commitments to reduce emissions and/or achieve zero net emissions by funds/assets under management but with an unreliable transition plan in place.

Figure 8 shows the main examples of greenwashing in payment services:

Greenwashing in payment services	A misleading commitment by a payment service provider that it will offset carbon emissions produced by a crypto asset by purchasing carbon offsets;
	A public statement by a crypto asset provider that it will transition to more environmentally friendly settlement methods, which will require less energy consumption, without adequate technology in place to ensure this transition

Figure 9 shows the main examples of greenwashing at entity level

Greenwashing in own funds and liquidity	Sale of sustainable/green bonds without providing a guarantee that the funds raised will be used for sustainable purposes, and the collateral provided on them is not sustainable in nature;
	Sale of bonds with negligible green value; sale of bonds misleading purchasers that the funds raised will be used for environmental purposes by the issuer, while the proceeds are used to refinance existing "non-green" assets;
	Misleading statements about how environmental goals are integrated into the company's capital expenditure plans, and how proceeds from sustainable instruments will be spent according to the company's transition plans

V. EXISTING LEGAL FRAMEWORK

1. European Union Legal Framework³⁶

Although green claims and greenwashing are viewed as new phenomena, they are, and have been subject to regulation under existing Community law.³⁷ Given the similarity to the traditional scheme of consumer relations, on one hand, and unfair competition, on the other hand, classic green claims and greenwashing fall within the scope of consumer and competition law. The terms and conditions on how to directly address a green claim to a consumer are laid down in consumer law rules. Business-to-business relationships related to green claims

³⁶ Regarding the principles of EU law vis-vis domestic framework, see **Семов, А.** Принципи на прилагане на правото на Европейския съюз. София, Институт за публична администрация и европейска интеграция, 2007.

³⁷ Regarding European Community law as an independent legal order, see **Христов, Х.** Право на Европейския Съюз. Наказателноправни въпроси. София, Сиела, 2012.

fall within the ambit of Directive 2006/114/EO concerning misleading and comparative advertising. Green claims practice that is contrary to fair commercial practice and harms or is likely to harm the interests of competitors constitutes unfair competition and, as such, will fall within the scope of competition law.

Classic green claims addressed at consumers are generally regulated by the **Unfair Commercial Practices Directive**, as amended by the **Empowering Consumers Directive**.³⁸ These Directives, as transposed in local law,³⁹ apply to all traders (including credit institutions providing retail financial services) in the EU, regardless of legal form, turnover and scale, which must comply with the provisions of this legislation. The **Unfair Commercial Practices Directive** requires that any green claim must be true, presented in a clear, specific, unambiguous and precise manner. This directive has a framework character and acts as a ‘safety net’ to bridge legislative gaps not covered by sectoral legislation.

The newly adopted **Empowering Consumers Directive** introduces the legal definition of ‘an environmental claim’ and sets out **which practices will be considered greenwashing** (i.e., which green claims will be treated as unfair commercial practices), by adding them to the so-called ‘**black list**’,⁴⁰ such as:

- Displaying a sustainability label that is not based on a certification scheme or not established by public authorities;
- Making a **generic environmental claim** for which the trader is not able to demonstrate recognised excellent environmental performance relevant to the claim;

³⁸ **Unfair Commercial Practices Directive** and **Directive (EU) 2024/825** of the European Parliament and of the Council of 28 February 2024 amending Directives 2005/29/EC and 2011/83/EU as regards empowering consumers for the green transition through better protection against unfair practices and through better information (**Empowering Consumers Directive**).

³⁹ Regarding the vertical direct effect of the Directive after the transposition deadline, see **Семов, Ат.** Система на източниците на правото на Европейския съюз. София, УИ „Св. Климент Охридски, 2009.

⁴⁰ Annex 1 to **Unfair Commercial Practices Directive**.

- Making an environmental claim about the entire product or the trader's entire business when it concerns only **a certain aspect** of the product or a specific activity of the trader's business;
- Claiming, based on the **offsetting of greenhouse gas emissions**, that a product has a neutral, reduced or positive impact on the environment in terms of greenhouse gas emissions;
- Presenting **requirements imposed by law** on all products within the relevant product category on the Union market as a distinctive feature;
- **Withholding information from the consumer** about the fact that a software update will negatively impact the functioning of goods with digital elements or the use of digital content or digital services;
- Presenting **a software update as necessary** when it only enhances functionality features;
- Any commercial communication in relation to a good containing a feature introduced to limit its **durability** despite information on the feature and its effects on the durability of the good being available to the trader;
- Falsely claiming that under normal conditions of use a good has a certain **durability** in terms of usage time or intensity;
- Presenting a good as **allowing repair when it does not**; Inducing the consumer to replace or replenish the consumables of a good earlier than necessary for technical reasons.
- Withholding information concerning the impairment of the functionality of a good when consumables, spare parts or accessories not supplied by the original producer are used, or falsely claiming that such impairment will happen.
- Presenting requirements imposed by law on all products within the relevant product category on the Union market as a distinctive feature of the trader's offer.

Other key legislative act that impact green claims matters are **Directive 2011/83/EU on consumer rights⁴¹** and **Directive (EU)**

⁴¹ Directive 2011/83/EU of the European Parliament and of the Council of 25 October 2011 on consumer rights, amending Council Directive 93/13/EEC and Directive

2020/1828 on representative actions,⁴² the last one having the capacity to serve as catalyst for greenwashing claims after it is transposed in local law⁴³ because it enables the national customer regulator (in Bulgaria – the Commission for Consumer Protection) and qualified associations **to bring collective actions for compensation** and to initiate a similar procedure in relation to classic greenwashing, including those on the financial market, a legal option currently unavailable as a procedural tool.

Table 1 shows sector legislation violations which may give rise to greenwashing (an illustration rather than an exhaustive list of all applicable legislation).

EU Law	Transposition in BG Law	Local Supervision
SFDR (Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector)	Markets in Financial Instruments Act <i>Collective Investment Schemes and Other Undertakings for Collective Investments Act</i> Financial Supervision Commission Act	Financial Supervision Commission
AIFMD (Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010)	<i>Collective Investment Schemes and Other Undertakings for Collective Investments Act</i> Public Offering of Securities Act Markets in Financial Instruments Act	Financial Supervision Commission
MIFID II (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)	Public Offering of Securities Act Markets in Financial Instruments Act	Financial Supervision Commission
MCITS (Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009)	<i>Collective Investment Schemes and Other Undertakings for Collective Investments Act</i>	Financial Supervision Commission

1999/44/EC of the European Parliament and of the Council and repealing Council Directive 85/577/EEC and Directive 97/7/EC of the European Parliament and of the Council.

⁴² Directive (EU) 2020/1828 of the European Parliament and of the Council of 25 November 2020 on representative actions for the protection of the collective interests of consumers and repealing Directive 2009/22/EC.

⁴³ Regarding the vertical direct effect of the Directive after the transposition deadline, see **Семов, Ат.** Система на източниците на правото на Европейския съюз. София, УИ „Св. Климент Охридски, 2009.

EU Law	Transposition in BG Law	Local Supervision
MIFIR Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012)	<i>Collective Investment Schemes and Other Undertakings for Collective Investments Act</i>	Financial Supervision Commission
PRIIPs (Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products)	Markets in Financial Instruments Act <i>Collective Investment Schemes and Other Undertakings for Collective Investments Act</i>	Financial Supervision Commission
Prospectus Regulation	Special Pledges Act Credit Institutions Act Special Investment Purpose Companies and Securitization Companies Act Markets in Financial Instruments Act <i>Collective Investment Schemes and Other Undertakings for Collective Investments Act</i> Public Offering of Securities Act	Bulgarian National Bank Bulgarian National Bank/ECB (for significant banks) Financial Supervision Commission As above

The new **Corporate Sustainability Due Diligence Directive (EU) 2024/1760 (CSDDD)**⁴⁴ is expected to have a significant impact on corporate behaviour, drive a shift towards more sustainable business models and prevent greenwashing. The **CSDDD** is a **mandatory due diligence piece of legislation** that requires certain large companies (inc. certain non-European companies)⁴⁵ to identify and address human rights and environmental risks in their operations, subsidiaries and global value chains. Companies in scope must conduct due diligence to identify and assess actual and potential adverse human rights and environmental impacts, manage risks, report findings, and prepare climate transition plans. The Directive aims to promote sustainable business practices, thus, to address climate changes and prevent abuses of human rights. Breach of the core obligations in **CSDDD** may engage the administrative and civil liability of the company. The **CSDDD**'s provisions regarding administrative

⁴⁴ Directive (EU) 2024/1760 of the European Parliament and of the Council of 13 June 2024 on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859.

⁴⁵ Article 2 of Directive (EU) 2024/1760.

and civil liability, including sanctions and compensation, emphasize the directive's role as a mechanism for promoting substantive compliance rather than creating a formal checkbox compliance, this is why **CSDD** foresees external/supervisory authorities to verify compliance. **CSDDD** shall be transposed in local law until 26 July 2026.

2. Bulgarian Legal Framework

Green claims fall within the legal definition of commercial practice under §13, item 23 of the Bulgarian Consumer Protection Act, which transposes the **Unfair Commercial Practices Directive**. Greenwashing is banned as a misleading commercial practice towards consumers,⁴⁶ and in cases where greenwashing harms competition, the damaged party may have recourse to the protection granted⁴⁷ by the Competition Protection Act. Sector-specific greenwashing is governed by the rules of the applicable sector-specific regulations, transposed into local law (see **Table 1**).

Greenwashing may simultaneously constitute unfair competition under the Consumer Protection Act and an unfair trade practice under the Competition Protection Act, thus the offender may be subject to a **double sanction**.⁴⁸

Legislative initiatives at EU level: The European legislative landscape is developing to prevent greenwashing. The main example in this context is the proposal for adoption of the new Directive on the substantiation and communication of explicit environmental claims⁴⁹ (the ‘**Green Claim Directive**’). Once adopted and promulgated in Official Gazette this new legislative act will establish a **clear regime on how to formulate classic green claims, including eco-labels**.⁵⁰ The **Green**

⁴⁶ Article 68–68g of the Consumer Protection Act.

⁴⁷ Article 29–Article 35 of the Competition Protection Act.

⁴⁸ **Варадинов, О.** Цит. съч.

⁴⁹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2023%3A0166%3AFIN> [Accessed on 15.02.2024]

⁵⁰ The new proposals should also be considered in relation to the EC proposal for common rules to promote the repair of goods, the Ecodesign and Sustainable Products Regulation, and Directive (EU) 2020/1828 on representative actions for the protection of consumers’ collective interests and repealing Directive 2009/22/EC, which legislative initiatives also aim to form a legal framework to contribute to sustainable consumption.

Claim Directive will also apply to environmental claims in eco-design. The proposed requirements will apply to most operating companies in the EU, but not to sectors where rules on green claims exist or could be introduced, such as financial services.

The **Green Claims Directive** will establish the rules under which a classic green claim should be made⁵¹ (i.e., which methodologies companies should use to substantiate and communicate their green claims), while the Empowering Consumers Directive aims at determining **which practices will qualify as greenwashing** (i.e., which green claims will be considered unfair commercial practices).

Businesses established outside the EU but making green claims to consumers in the EU will also have to comply with the proposed new requirements. This will ensure that not only European companies, but also all traders who trade within the internal market will be able to participate in the green transition.

VI. SUSTAINABLE FINANCE IN REAL ESTATE SECTOR

Sustainable legislation aims at incentivizing financing in the real estate sector to achieve mainly energy efficiency and renovation of building stock. The **Taxonomy Regulation** and the ‘**Fit for 55**’ policy package⁵² contribute to the green transformation in all economic sectors (see Figure 9). The ‘**Fit for 55**’ package of legislation makes all sectors of the EU’s economy fit to reduce net greenhouse gas emissions by at least 55% by 2030 and reach the targets set out in the **Paris Agreement**. Part of the legislative acts relevant for the real estate sectors are set out in Figure 9.

⁵¹ The new thing is the introduction of an obligation for companies to only communicate green claims if they are audited in advance by a third independent accredited company (currently there is no such mandatory audit requirement). For the justification, primary product data is required to establish verification of the environmental impact of products throughout their life cycle. This also requires verification of the entire value chain.

⁵² https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal/delivering-european-green-deal_en [accessed on 06.06.2024]

- Large or listed companies that generate profit through construction, renovation, acquisition, rental, sale of buildings.
- Financial institutions with real estate related-assets, including repossessed real estate collateral.
- Financial institutions financing the construction, renovation, or acquisition of buildings.
- Non-financial institutions, financing specific real estate projects through green bonds issuance.

Currently, the Taxonomy distinguishes between **seven** (7) types of real estate-related activity:

- Construction of new buildings – for residential and non-residential buildings;
- Renovation of existing buildings (construction and civil engineering works or preparation thereof);
- Individual renovation measures consisting in installation, maintenance and repair of energy efficiency equipment;
- Installation, maintenance and repair of charging stations for electric vehicles in buildings (and parking spaces attached to buildings);
- Installation, maintenance and repair of instruments and devices for measuring, regulation and controlling energy performance of buildings;
- Installation, maintenance and repair of renewable energy technologies;
- Acquisition and ownership of buildings (buying real estate and exercising ownership of that real estate).

As a practical example, if we want to evaluate whether a building may be classified as Taxonomy-aligned we need to carry out a Taxonomy assessment by cross-checking available data against technical screening criteria.⁵⁴

⁵⁴ Sections 7.2, 7.3, 7.4, 7.5, 7.6 and 7.7 of Annex I to Commission Delegated Regulation (EU) 2021/2139 and Section 3 in Annex II of Regulation (EU) 2023/2486 of 27 June 2023.

Thus, **a new construction** can be Taxonomy-aligned if, *amongst others*,⁵⁵ it has at least 10 per cent lower primary energy demand than nearly zero energy building requirements in national measures. Therefore, the energy certificate of the new building must indicate the how the primary energy demand compares to the nearly zero energy reference value at local level. Following completion, new buildings exceeding 5 000 m² need to be tested for air-tightness and thermal integrity, and any deviation from initial design plans must be disclosed to investors and clients.

Existing buildings can be Taxonomy-aligned if they have the technical screening criteria energy efficient status referenced in the Taxonomy on the date of filing of the complete application for issuance of a building permit (before or after 31 December 2020), etc.

The Taxonomy technical screening criteria will allow financial undertakings to prepare ‘**a requirements list**’ and standard reporting forms (e.g., as per the template introduced by the delegated acts to the Taxonomy Regulation) when developing a financial product for each of the seven areas. The requirements should be aligned with the technical verification criteria. Loan arrangements must include contractual clauses obliging the client to maintain the Taxonomy nature of the project and provide the required information on a continuing basis.

Given the Taxonomy environment, the ‘**Fit for 55**’ policy and the **strong appetite for sustainable financing in the real estate sector**, key players on this market must be aware that:

- **Taxonomy-aligned constructions** are essentially **different** from those that comply with the highest local regulatory standards for energy efficiency; therefore, the highest energy class certificate would not be enough for the investor to benefit from the premium interest of the green financing.
- Any real estate provided as collateral **must have a valid energy efficient certificate** which the investor will be obliged to update it in a timely manner by means of a survey.

⁵⁵ Each type of real estate related activity has its own Taxonomy test with a few components – see technical screening criteria referred in footnote 52.

- **New buildings** (until the transposition of the Energy Performance of Buildings Directive)⁵⁶ must be designed **as near-zero energy buildings** under the criteria of local laws. After transposition of the Energy Performance of Buildings Directive all new buildings owned by public bodies shall be designed as zero-emission buildings from 2028 and from 2030 this rule shall apply to all new buildings.
- **New local framework** shall implement mortgage portfolio standards for financial undertakings which aims at stimulating green energy – efficiency loans.⁵⁷ **Green mortgages** (preferable paired with green leases) will help banks control their capital liquidity ratio given that collaterals with low energy efficiency performance will significantly lose their market value in time.

The appetite of banks for sustainable financing in the real estate sector will assist towards decarbonisation of the European building stock which corresponds to the European Union goal of achieving a climate-neutral Europe by 2050. However, the change will have a financial and administrative impact on the actors in the real estate market.

⁵⁶ Directive (EU) 2024/1275 of the European Parliament and of the Council of 24 April 2024 on the energy performance of buildings.

⁵⁷ Recitals (60-61), in line with Art. 17, p. (10) of the Energy Performance of Buildings Directive.

CHAPTER 29:

CRIMINAL LAW – BASIC CONCEPTS AND INSTITUTES. INDIVIDUAL TYPES OF CRIMES.

CRIMINAL PROCEEDINGS.

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ABSTRACT	KEY WORDS
This chapter presents in a nutshell some issues of criminal law. The basic concepts, institutes, individual types of crimes and criminal proceedings are presented based on the legislation in force. Criminal law is presented as a branch of the Bulgarian legal system	criminal law, types of crimes, criminal proceedings

I. INTRODUCTION

The main concepts of Criminal law¹ are crime, punishment, criminally liable persons, criminal relations, and criminal liability. The statute that defines the types of crimes and the respective penalties for them is the Criminal Code. The types of crimes are defined in the Special Part of CC. The punishment to be imposed in each case is also provided. The Criminal Code sets out the prerequisites that an individual must meet to be held criminally liable. Legal persons being collective bodies are not criminally liable, as this liability is individual. Criminal liability arises when a

¹ For more on Criminal Law, see: **Ненов, Ив.** Наказателно право на Република България, Обща част, книга първа. София, Софи-Р, 1992; **Ненов, Ив.** Наказателно право на Република България, Обща част, книга втора. София, Софи-Р, 1992; **Стойнов, Ал.,** Наказателно право. Обща част, второ издание. София, Сиела, 2019; **Марков, Р. и колектив,** Наказателно право на Република България, Обща част. София, Сиела, 2022; **Чинова, М.** Досъдебното производство по НПК. София, Сиела, 2013; **Чинова, М., Георги Митов.** Кратък лекционен курс по Наказателно-процесуално право. София, Сиела, 2021.

criminally liable natural person commits a crime. Within the framework of criminal legal relations, the criminal liability of that person is enforced by imposing a penalty which such person is obligated to serve. Criminal liability is enforced by the State. The procedure for the enforcement of criminal liability is laid down in the Criminal Procedure Code. The State tries criminal cases through specific state bodies – pre-trial bodies (prosecutor and investigating authorities) and courts. Punishment for a criminal offence may only be imposed by court following the rules for meting out the punishment provided by the Criminal Code and the procedure laid down in the Criminal Procedure Code.

II. BASIC ISSUES

1. General characteristics of Criminal law

Criminal law is a branch of the Bulgarian legal system. Its task is to protect the person, the rights of citizens and the established legal order in the country from criminal violations.² This protection is carried out, firstly, by defining the types of criminal behaviour in legal norms and, secondly, by providing the punishment to be imposed on the perpetrator in the norm that defines the crime itself.

The statute that defines crimes and their respective punishments is called the Criminal Code (CC).³ The use of the term ‘code’ in the title indicates that this statute regulates all social relations which are object of criminal law regulation. This means that no other laws, apart from the Criminal Code, provide for either crimes or penalties to be imposed for crimes committed.

The Criminal Code currently in force was adopted in 1968. Its structure comprises two parts – a General Part and a Special Part. The General Part of

² Article 1(1) of the Criminal Code.

³ For more details on the history of criminal legislation, see **Ненов, Ив.** Наказателно право на Република България. Обща част, книга първа. София, Софи-Р, 1992, 38–66; **Стойнов, Ал.,** Наказателно право. Обща част, второ издание. София, Сиела, 2019, 60–82.

the Criminal Code regulates the main categories and institutes of criminal law – crime, types of punishment and their content, rules for meting out the punishment, rules for criminally liable persons, rules for exemption from criminal liability or from serving the imposed punishment, etc. These regulations have the function of general provisions that can be applied in all cases of a criminal offence.

The Special Part of the Criminal Code contains a description of the individual offences and the penalties to be imposed for each of them. The contents of the Special Part are arranged in chapters. At the time of the adoption of the Criminal Code in 1968, the Special Part contained 14 chapters. At present, the Special Part contains 16 chapters as a result of numerous amendments of the Criminal Code over the last 30 years. Thus, along with the traditional types of crimes in Bulgarian criminal law, such as crimes against the Republic (treason, betrayal and espionage, etc.), crimes against the person (homicide, bodily injury, insult, defamation, etc.), crimes against property (larceny, robbery, fraud, extortion, etc.), and so on, the Criminal code also contains ‘contemporary’ crimes, such as computer crimes.

Some of the chapters in the Special Part are subdivided into sections. The function of this internal subdivision is to show in details the differences between the crimes in the respective chapter. For example, Chapter Two of the Special Part of CC, entitled ‘Crimes against the person’, consists of a total of 9 sections. Section 1, entitled ‘Homicide’, contains crimes the commission of which affects life as the highest form of human good. Section 2, entitled ‘Bodily Injury’, contains crimes the commission of which affects the physical integrity of an individual without causing death. The other sections deal with offences affecting other personal rights, e.g. honour and dignity (affected by the offences of insult and defamation dealt with in section 7, entitled ‘Insult and Defamation’); the right to freedom of movement in space (affected by the offences listed in section 4, entitled ‘Kidnapping and Unlawful Imprisonment), etc.

2. Basic Concepts and Institutes of Criminal Law

For criminal law, the two interrelated concepts of crime and punishment are fundamental. Along with them, the concept of ‘criminally liable person’ is also essential. This is because the concept of crime defines the conduct that a person must have committed in order to be punished. And the concept of a criminally liable person defines on whom the penalty for such conduct may be imposed.

2.1. Crime as a fundamental concept of criminal law

Two terms are used in relation to crime as a basic category in criminal law theory – the general concept of crime⁴ and the *corpus delicti* of a crime.⁵ These two terms refer to each other as genus to species. The generic concept is the general concept of crime and the species concept is the *corpus delicti* (elements of a type of crime).

The term ‘general concept of crime’ refers to the definition of crime contained in Article 9(1) CC: ‘A crime is such socially harmful act (commission or omission) which is committed culpably and is declared punishable by law.’ This definition establishes the mandatory characteristics that must be present in order to define certain behaviour as a crime. These characteristics are defined in general terms – an act (commission or omission), that is socially harmful, committed with *mens rea* (guilty mind), and declared punishable (which combines two characteristics – illegality and punishability). On the other hand, the description of a specific act which constitutes a specific type of crime and the punishment to be imposed for this crime is contained in the *corpora delicti* of the individual types of crimes defined in the Special Part of CC. Therefore, the term ‘corpus delicti’ is defined as a species concept. For example, Article 194(1) CC defines that the taking of another’s movable property from the his or her possession without their consent with the intent to misappropriate it, is a crime designated as ‘theft’. Article 115 defines that the intentional killing of another is a

⁴ For more detail, see **Ненов, Ив.** Цит. съч., 232–240; **Стойнов, Ал.** Цит. съч., 164–173 и **Марков, Р. и колектив.** Наказателно право на Република България. Обща част. София, Сиела, 2022, 123–131.

⁵ For more detail, see **Ненов, Ив.,** Цит. съч., 241–262; **Стойнов, Ал.** Цит. съч., 181–193 и **Марков, Р. и колектив.** Цит. съч., 131–143.

crime designated as ‘murder’. Article 325(1) defines that the commission of indecent acts grossly disturbing public order and expressing obvious disrespect for society is a crime known as ‘hooliganism’, etc. All of these provisions also contain the type and severity of punishment to be imposed on the person committing the crime in question. For example, a person who commits theft may be punished with up to 8 years’ imprisonment, a person who commits murder may be punished with 10 to 20 years’ imprisonment, a person who commits hooliganism may be punished either with up to 2 years’ imprisonment or with probation, and the punishment of public censure is necessarily imposed along with either of the two.

The application of this approach is not an accidental invention. It is based on the overall logic of criminal law that not all conduct is criminal. And it should not be. A crime, according to Article 9(1) CC is only such conduct as is socially harmful, i.e., its commission threatens or harms a protected interest. But for an act to be criminal, a provision of the Special Part of CC must explicitly provide what the specific prohibited conduct is and in the presence of what other features it constitutes a crime.

When the Special Part of CC declares certain acts a crime, it means that the commission of that conduct is prohibited. And if this prohibition is violated, i.e., the act is committed, then the person who committed it should be subject to the punishment provided for this crime.

2.2. Punishment as a fundamental category of criminal law

In contrast to the approach to crime as a fundamental concept, the legal framework related to punishment is somewhat different.

The Criminal Code does not contain a definition of the concept of punishment. This is left to the science of criminal law.⁶

The General Part of CC contains the regulation of the types of punishments and the content of each one. The types of penalties are listed exhaustively in Article 37 CC. In its paragraph (1) these types are arranged in a catalogue

⁶ For more details, see **Ненов, Ив.** Наказателно право на Република България. Книга втора, София, Софи-Р, 1992, 231–246; **Стойнов, Ал.** Цит. съч., 442–455; **Марков Р. и колектив.** Цит. съч., 521–537.

which includes a total of 13 types of punishment. The order in which they are listed starts with the most severe type at the beginning, i.e., life imprisonment, and ends with the least severe type, public censure. The most severe type of punishment under current Bulgarian criminal law – life imprisonment without parole – is regulated independently in Article 37(2) CC.

Each type of punishment has its own content, i.e., affects different rights of the convicted person. Which right is affected by a particular type of punishment is determined by the Criminal Code in a specific provision. From these provisions the science of criminal law derives the basic division of types of punishments: custodial and non-custodial punishments.⁷ The group of custodian punishments includes the two types of life imprisonment and temporary imprisonment. The group of non-custodial penalties includes all other penalties that are listed in Article 37(1) CC – probation, confiscation of property, fine, deprivation of the right to hold a certain state or public office, deprivation of the right to exercise a certain profession or activity, deprivation of received medals, honorary titles and distinctions, deprivation of military rank and public censure.

2.3. Imprisonment

Imprisonment affects the right of the convicted person to move freely in space, i.e., the imposition of such a penalty restricts the movement of the convicted person only within the place in which they serve their sentence.⁸

Life imprisonment is a punishment which consists in the compulsory isolation of the convicted person for the rest of his or her life in confinement. The Criminal Code provides for two types of life imprisonment – life imprisonment with the possibility for parole and life imprisonment without parole.⁹ The difference between the two is that in the case of life

⁷ For more details on the types of punishment see **Ненов, Ив.** Наказателно право ..., книга втора. 247–276; **Стойнов, Ал.** Цит. съч., 466–504 и **Марков, Р. и колежтив.** Цит. съч., 537–571.

⁸ The colloquial name of these places is ‘prison’.

⁹ It is incorrect to rename life imprisonment without parole to ‘life imprisonment without pardon’ or ‘life imprisonment without appeal’. Pardon is a different institute of criminal law which is applicable to both types of life imprisonment. Appeal is an institute of criminal procedural law and is applicable in the framework of criminal proceedings

imprisonment with the possibility for parole, after having served 20 years, the convict can request the court to substitute their life imprisonment sentence with a 30-year confinement sentence. Where the court grants this request and substitutes the life imprisonment, the time the convict has already served is subtracted and he or she will only serve the remainder up to 30 years.¹⁰ For example, a convict sentenced to life imprisonment requests commutation after having served 22 years, the court grants the request and imposes a sentence of 30 years. However, the convict is actually left to serve the remainder of the 30 years, i.e., 8 years.

Life imprisonment without parole¹¹ is another type of life imprisonment in which there is no statutory option for substitution with fixed-term confinement. It is therefore the most severe form of punishment – if it is imposed, the convict will remain in confinement for the rest of his or her life. For this reason, when regulating this type of punishment, the Criminal Code restricts its imposition at several levels. First of all, this punishment can be enforced only for certain crimes – ‘for the most serious crimes that threaten the foundations of the Republic, as well as for other particularly dangerous intentional crimes’ (Article 37(2) CC). Secondly, the Criminal Code imperatively defines when this punishment may be imposed if it is provided for the respective type of crime – ‘only if the specific crime committed is extremely aggravated and the goals specified in Article 36 cannot be achieved by a lighter punishment’ (Article 38(1) CC). And thirdly, the Code also regulates which persons cannot be sentenced to life imprisonment without parole – ‘a person who, at the time of the commission of the offence, has not reached the age of twenty years, or in the case of army officials, as well as in wartime, eighteen years. The penalty of life imprisonment without parole may also not be imposed on a woman who was pregnant at the time of commission of the crime or passing of the sentence’. (Article 38(2) CC).

Imprisonment for a fixed term is a separate type of punishment. It

before the sentence imposing the punishment for a crime has entered into force.

¹⁰ This mechanism is expressly provided for in the Criminal Code and is not applied at the discretion of the court.

¹¹ This type of life imprisonment was provided for in the Bulgarian Criminal Code for the first time in 1998, when Bulgaria abolished the death penalty.

consists in isolation of the convicted person in places of confinement for a fixed period. Presently, the minimum period of imprisonment that can be provided for individual types of offences is 3 months and the maximum is up to 20 years (Article 39(1) CC). Only in cases exhaustively specified in Article 39(2) CC, the maximum may be up to 30 years.

Non-custodial punishments affect various other rights of the convicted person. For example, a penalty in the form of confiscation affects the property rights of the convicted person up to the extent of the confiscated property. This is because imposition of this type of penalty transfers ownership over the confiscated property to the State. The penalty in the form of a fine affects the patrimonium assets of the convicted person because he is obligated to pay the State a certain amount of money and the State has the right to receive it.

In relation to the punishment as the second basic category of criminal law, an important clarification must be made. The fact that the types of punishments are listed in the General Part of the Criminal Code does not mean that the judge can choose what punishment to impose on the convicted person for a particular crime. That is not possible, because the list of the types of punishments in Article 37 CC is intended to indicate which types of punishment may be provided for particular types of offences. This means that when the Special Part describes the specific offence in its *corpus delicti*, the specific type of punishment to be imposed if the offence is committed must also be indicated. Therefore, when a specific type of crime is committed, only the type of punishment that is provided for that crime can be imposed on the perpetrator. For example, the punishment provided for theft is imprisonment and if a person commits theft, then the punishment imposed on him will be imprisonment. For the offence of hooliganism, two types of punishment are provided alternatively – imprisonment or probation. Therefore, the court will sentence a person who has committed hooliganism to one of these two punishments.

The same holds true for determination of the specific term of confinement. For each specific offence for which a custodial penalty is provided, the provision which describes the offence and provides for such penalty also contains the limits to the length of the penalty. Therefore,

when sentencing the perpetrator, the judge is required to determine the exact length of imprisonment for the particular act, within the limits of the period provided by the law for the respective type of crime. For example, murder under Article 115 CC must be punished by imprisonment from 10 to 20 years. For a specific case of murder, the court will determine a specific length of punishment within these limits. The rules to be used when determining the specific length of the punishment are laid down in the General Part of the Criminal Code and are binding on the court.

2.4. Criminally liable persons

This basic concept of criminal law lays the foundation for the rules determining who can be held criminally liable. These rules are mandatory and are regulated in the General Part of CC. According to them, only a natural person (a human) who has reached a certain age and has committed a crime in a state of sanity can be held criminally liable.¹² Bulgarian criminal law does not allow criminal liability to be imposed on a legal person.

For the purposes of criminal law, there are three categories of individuals depending on their age. The first category comprises the legal category of ‘infants’ – persons under the age of 14. The low age factor is sufficient, and these persons are not criminally liable, i.e., if an ‘infant’ commits an act which is declared a crime, he or she cannot be subjected to the punishment provided for this crime. The state may react against such person by means other than the punishment provided for the crime. Moreover, the state cannot impose the penalty on the parent of the infant. This is because criminal liability is individual and is only imposed on a person for his or her own behaviour and cannot be transferred to another person.

The second category are minors – persons who have reached the age of 14 but have not yet reached the age of 18. For them, the Criminal Code requires that whenever they have committed an act that is declared a criminal offence, it must be assessed whether they understood the nature and meaning of what they have done and whether they were able to direct their actions. If, as a result of this assessment, it is established that the minor

¹² For more details, see **Ненов, Ив.**, Наказателно право..., книга първа, 158-216; **Стойнов, Ал.**, Цит. съч., 128–163 и **Марков, Р. и колектив**, Цит. съч., 77–123.

was aware of the nature and meaning of the offence and was capable of directing his or her actions, he or she will be criminally liable. This means that there is no legal obstacle to hold such person criminally liable for the crime committed. However, it may be found that one of these requirements is not met and then the minor will not be criminally liable. The State then cannot hold that person criminally liable but may react against him or her by means other than the imposition of a penalty. As in the case of infants, the State cannot direct criminal responsibility to the minor's parents.

The third category are adults – persons over 18 years of age. The fact that the person is an adult, as a rule, is sufficient for them to be held criminally liable. An exception to this rule is only permissible if the person committed the offence criminally insane.

The Criminal Code defines criminal insanity¹³ – ‘when, because of mental deficiency or a prolonged or short-lived mental disorder, the person was unable understand the nature or significance of his action or was unable to direct his actions’. An essential feature of this definition is the limitation on the types of diseases that serve as grounds for criminal insanity – mental deficiency, diseases that cause a prolonged or short-term mental disorder. Other illnesses, beyond those mentioned, as well as psychological features of the personality (e.g., types of psychopathy) cannot justify the person's crime.

2.5. Criminal Relation and Criminal Liability¹⁴

Criminal liability is a type of legal liability that the state enforces over a person who has committed a crime. Its enforcement takes place within the framework of the criminal legal relation.

The criminal relation is formed at the moment of the commission of the crime. Its parties are the person who committed the crime and the state represented by its specialised state bodies.

Within the criminal legal relation, the State exercises three powers:

- to impose a penalty by a final sentence on the person who committed

¹³ Article 33(1) CC.

¹⁴ For more details, see **СТОЙНОВ, АЛ.**, Цит. съч., 46–59.

- the crime;
- to execute the imposed penalty;
- to limit the convicted person's rights in the form of adverse consequences which arise from the fact of conviction.

The State's powers comprise both rights and duties, meaning that State bodies are obligated to exercise these powers when they become aware that a crime has been committed. The first power, to impose a punishment by a final sentence, is exercised by the state through its specialised state bodies – pre-trial bodies (prosecutor and investigating authorities) and the court. Each of these bodies has precisely defined functions within the criminal proceedings. Pre-trial authorities are involved in the process of proving that the act committed is a crime, that it was committed culpably, and identifying the individual who committed it. The court is the only public authority that can impose a penalty on the perpetrator. The punishment is imposed by an act of the court, which is called a sentence. The rules which the pre-trial authorities and the court are obliged to observe in the framework of criminal proceedings are laid down in the Criminal Procedure Code (CPC).

The second power of the State, i.e., to enforce the penalty imposed, is also exercised by specialised State bodies. The penalty is enforced by a prosecutor after the sentence imposing it has entered into force. The punishment is executed by the penal enforcement bodies defined in the Execution of Sentences and Detention in Custody Act (ESDCA).

The State's third power, to limit the convict's rights as a form of adverse consequences arising from the fact of conviction, has a different characteristic from the other two powers. It means that the State is obligated to apply to that person limitations other than the punishment which the legislation provides as a result of that person's conviction. These restrictions are at the discretion of the legislature, the National Assembly, and are regulated in various laws. For example, the Judiciary System Act provides that a convicted person cannot be a judge, prosecutor or investigator.

The main obligation of the perpetrator is to bear the imposed limitations of rights, as well as those restrictions which are collateral consequences

of the fact of conviction. The basis for this obligation is the fact that the person has committed a criminal offence by their own free will.

2.6. Imposition of punishment¹⁵

Once the judge determines what type of crime the person has committed, they must determine what punishment to impose for that crime. In doing so, the judge applies mandatory rules that are set out in the General Part of CC. They are mandatory because they establish the parameters within which the court must decide what type of punishment to impose and in what quantity, and they do not allow the court to deviate from them.

The type of punishment that the court may impose for the crime committed is the type that is specified in the Special Part of CC for the relevant type of crime. For example, for theft, the court may only impose imprisonment. The same provision of the Special Part also specifies the limits of the penalty within which the court metes out the specific amount for the particular crime. For example, for robbery the punishment is imprisonment from 3 to 10 years. This means that when the judges decide on the exact length of punishment for a specific robbery, they do so within the specified limits from 3 to 10 years. When imposing the exact penalty, the court is obligated to take into account other circumstances that are specified in the Penal Code. In criminal law, these circumstances are called ‘mitigating or aggravating circumstances’. For example, the court must consider the motives of the perpetrator – whether he committed the theft because he did not have a steady income for a long time, because he is unable to find a steady job, because he committed it in a drunken state, etc. Due to the requirement to take these circumstances into account when deciding on the punishment for each particular crime, it is possible for the punishment to be different for the same type of crime in different cases. For example, for one particular case of theft, the perpetrator may be sentenced to 4 years of imprisonment, while for another – to 3 years.

¹⁵ For more detail, see **Ненов, Ив.** Цит. съч., 277 – 296; **Стойнов, Ал.** Цит. съч., 505–529; **Марков, Р. и колектив.** Цит. съч., 571–593.

The approach to imposing the penalty is not random. It takes account of the fact that, although the crimes are of one type, each different case has its own specifics. And the punishment for each particular case should be appropriate to the particular crime.

III. TYPES OF CRIMES

The different types of crimes and the penalties imposed for them are described in the Special Part of CC. They are systematised by chapters, and some of the chapters are further subdivided into sections. The sequence in the arrangement of the chapters is determined by the nature and significance of the social relations harmed by the respective crimes.

Currently, there are 16 chapters in the Special Part of CC.

1. Chapter One ‘Crimes against the Republic’ contains crimes which affect the form of state government (Bulgaria is a Republic with parliamentary government) or the form of state territorial organisation (Bulgaria is a unitary state). This chapter comprises 4 sections – treason, betrayal and espionage, economic crimes against the Republic (diversion and sabotage) and other crimes against the Republic.

2. Chapter Two ‘Crimes against the person’ deals with crimes affecting the personal rights of citizens. The chapter comprises 9 sections – homicide, bodily harm, endangerment, kidnapping and illegal imprisonment, coercion, disclosure of another’s secret, insult and slander, debauchery and trafficking in humans.

3. Chapter Three ‘Crimes against the rights of citizens’ deals with crimes against other rights of citizens. There are 8 sections – crimes against the equality of citizens, crimes against religions, crimes against the political rights of citizens, violation of a dwelling, premises or vehicle, violation of the privacy of correspondence, crimes against the employment rights of citizens, crimes against intellectual property and crimes against the freedom of assembly, meetings and demonstrations.

4. Chapter Four ‘Crimes against Marriage, Family and the Youth’ deals with crimes that affect the rules of marriage, family relations and the proper development of children. This chapter has two sections – crimes against marriage and family, and crimes against the youth.

5. Crimes affecting economic relations are divided into three chapters – crimes against property (Chapter 5), crimes against the economic system (Chapter 6) and crimes against the financial, tax and social security systems (Chapter 7).

Crimes against property are included in this group because they affect the normal exercise of the right to property – movable or real, regardless of who is the owner – a natural person, a legal person, the state or municipalities. There are 8 sections within this chapter – theft, robbery, embezzlement, fraud, extortion, possession of stolen goods, destruction and damage of property, and breach of trust.

Crimes against the economic system grossly violate the rules for conducting business. This chapter comprises 5 sections – general economic crimes, crimes against individual economic branches (trade, industry, forestry, etc.), crimes against creditors (related to bankruptcy proceedings of traders), crimes against the customs regime and crimes against the monetary and credit system.

Crimes against the financial, tax and social security systems affect the normal functioning of these systems. Although there are no separate sections in this chapter, it contains separate articles on tax crimes, crimes against the social security system, money laundering, etc.

6. Chapter 8 ‘Crimes against the Functioning of State Bodies, Public Organisations and Persons Performing Public Functions’ contains crimes that affect various aspects of public interests. They are divided into 4 sections – crimes against the rules of government, abuse of office, crimes against justice, and bribery. Although the section is entitled ‘bribery’, it also contains the crime of trading in influence, which is a separate offence.

7. Chapter 8a ‘Crimes against Sports’ contains offences related to various forms of unauthorised match-fixing.

8. Chapter 9 ‘Documentary Crimes’ contains the offences that affect the rules on the creation, use and destruction of documents. Although there are no separate sections, it contains various types of offences related to these rules – criminal creation of documents, criminal use of documents, criminal destruction of documents, etc.

9. Chapter 9a ‘Computer Crimes’ contains crimes related to various forms of unauthorised access to or processing of computer information data. The introduction of a computer virus is treated as a crime.

10. Chapter 10 ‘Crimes against order and public peace’ contains various types of crimes that affect public order and public peace – hooliganism, organising illegal gambling and participation in such games, exercising rights in illegal manner, etc.

11. Chapter 11 ‘Public Endangerment’ sets out different types of offences that affect a wider range of social relations. They are divided into 5 sections – crimes committed in a publicly dangerous manner and by publicly dangerous means, crimes against traffic safety and communication infrastructure, crimes against public health and the environment, other crimes endangering the public and crimes against the peaceful use of nuclear energy.

12. Chapter 12 ‘Crimes against the defence capabilities of the Republic, against state secrets and against foreign classified information’ the crimes are divided into 3 sections – crimes against state secrets and against foreign classified information, crimes against military service and other crimes.

13. Chapter 13 ‘War Crimes’ covers the crimes that can be committed by specific categories of persons. They are exhaustively listed at the beginning of this chapter and include military personnel under the Defence and Armed Forces Act, generals, officers, sergeants and lower ranking staff of other ministries and departments, civil servants in the Ministry of the

Interior, when committed in wartime or in a combat situation or when participating in a mission or operation outside the country or in connection with combat operations, and reservists in active service in the voluntary reserve and persons on wartime service. This means that a person who lacks any of the listed qualities cannot be held criminally liable for a crime that is included in this chapter. Such a person's conduct may fall under a different type of crime and they will be liable for it. Military offences are divided into seven sections – crimes against subordination and military honour, evasion of military service, abuse of official powers, crimes against the guard, post, patrol, interior and frontier service, other military crimes, military crimes committed in time of war or in a combat situation, or while participating in a mission or operation outside the country, and crimes related to military actions.

14. Chapter 14 ‘Crimes against Peace and Humanity’ contains crimes for which the Republic of Bulgaria is internationally obligated to persecute through its national legislation. There are 3 sections within this chapter – crimes against peace, crimes against the rules and customs of war and extermination of population groups (genocide) and apartheid.

IV. CRIMINAL PROCEEDINGS

The procedure for the enforcement of criminal liability is regulated in the Criminal Procedure Code (CPC). It provides the procedural rules which the relevant state bodies are obligated to follow.

Depending on the manner of enforcing criminal liability, crimes are divided into the following types: general crimes, private crimes, private-public crimes and public-private crimes.¹⁶

1. General crimes are those for which criminal proceedings are conducted in accordance with the general procedure, i.e., proceedings with a pre-trial and a trial phase. The vast majority of crimes in the Criminal Code are general.

¹⁶ For more details, see Стойнов, Ал., Цит. съч., 338–339.

*Pre-trial proceedings*¹⁷ are initiated by the prosecutor in the presence of two cumulative prerequisites: legal grounds and sufficient evidence of a crime. The content of each of them is defined in the Criminal Procedure Code. According to CPC, *legal grounds for initiating an investigation* may be a report for a committed crime to the pre-trial authorities, information about a committed crime disseminated through the mass media, a personal appearance of the person before the pre-trial authorities with a confession of a committed crime, or immediate findings of a committed crime by the pre-trial authorities. *Sufficient evidence of the commission of a crime*, according to CPC, ‘exists when a reasonable presumption that a crime has been committed can be made’. CPC also explicitly states that the initiation of pre-trial proceedings does not require information about the person who committed the crime. Even if there are clues pointing to that person, in order for the prosecutor to charge such person for the specific crime, the investigating authority must gather sufficient evidence that this is precisely the person who committed the crime. The gathering of evidence can only take place after the pre-trial proceedings are initiated.

Following their launch, pre-trial proceedings develop in two stages – *investigation and actions of the prosecutor after completion of the investigation*. *The investigation* of the crime is carried out by an investigative body, with the relevant investigative bodies being explicitly defined in CPC. There are two main groups of investigative bodies. The first comprises the bodies specified in CPC, which can only carry out investigations regarding certain crimes. This group includes investigators and customs investigators. These bodies may not carry out investigations for other crimes than those specified in the CPC. The second group of investigative bodies are investigating police officers. They carry out the investigation for all other crimes, except those designated for investigation by the investigative bodies of the first group. During the investigation stage of the pre-trial proceedings, evidence is collected that a crime has been committed, along with evidence as to the identity of the perpetrator and whether the latter acted culpably. Such findings have evidentiary value in a particular criminal case only if gathered through

¹⁷ For a more detailed description of pre-trial proceedings as a phase of criminal proceedings, see **Чинова, М.**, Досъдебното производство по НПК. София, Сиела, 2013; **Чинова, М., Георги Митов.** Кратък лекционен курс по Наказателно-процесуално право. София, Сиела, 2021, 44–47 и 373–422.

the methods set out in CPC – interrogation, expert examination, inspection, search, seizure, investigative experiment, identification of persons and objects and special intelligence means – and in the manner provided for in CPC. When the investigating authorities gather sufficient evidence that a crime has been committed and that the person who committed it acted culpably, they will accuse that person of the crime and he is thereafter referred to as ‘the accused’.

Upon completion of the investigation, the investigating authorities send the case to the prosecutor. Thus, the pre-trial proceedings move onto the next stage – the *prosecutor’s actions after the investigation*. That is because it is only the prosecutor who can bring an indictment against the accused person and the evidence gathered against him to court. When the public prosecutor considers that the evidence collected is not sufficient, he or she discontinues the criminal proceedings, and when the perpetrator is not identified, the public prosecutor will suspend the proceedings until the person is identified. When the prosecutor considers that the evidence collected is sufficient, he or she will draw up an indictment and submit it to the court.

The rules that tell the prosecutor in which court to file the indictment are set out in CPC and are called ‘rules of jurisdiction’. This means that the prosecutor cannot choose the court in which to proceed with the criminal case. He is obligated to comply with the rules of jurisdiction and if he fails to do so and files the indictment in a court which does not have jurisdiction over the case, that court does not have the power to try the case and convict the perpetrator. The court in which the prosecutor must file the indictment is designated as the ‘court having jurisdiction to try the case in the first instance’ or ‘court of first instance’.

The judicial phase of criminal proceedings begins with the initiation of the case by the court of first instance.¹⁸ As a rule, the Regional Court is the court of first instance. For certain offences, CPC establishes the District Court as the court of first instance. The trial in the court of first instance includes the public prosecutor and the person accused of committing the offence, who, in this trial phase, is called the ‘defendant’. The trial in the

¹⁸ For a more detailed account of the first instance proceedings, see **Чинова, М., Георги Митов**. Цит. съч., 423–500.

court of first instance is conducted in accordance with the procedure laid down in CPC. The purpose of the trial is to convince the court that a crime has been committed, that the defendant is the person who committed it and that he acted culpably. This conviction must be formed by the court on the basis of the evidence gathered, and expressed in an adjudicatory act called a ‘sentence’. Where the evidence is insufficient, the court must pass a sentence acquitting the defendant (also called a verdict of acquittal). Where the evidence is sufficient, the court must pass a sentence imposing a penalty on the defendant (also called a ‘conviction’). When the court of first instance passes the sentence, the trial is over.

It is possible that the prosecutor or the defendant disagrees with the ruling of the first-instance court. This circumstance is taken into account by the rules of CPC, which allow the case to be continued in a second-instance court (also called ‘appellate instance’). Whether this happens in a particular criminal case depends on the prosecutor and the defendant. If the prosecutor disagrees with the ruling of the first instance court, he has the right to file a protest with the second-instance court, and if the defendant disagrees, he has the right to file an appeal with the same instance. Each of them decides whether or not to exercise their rights within a time limit set by CPC (called the ‘term for appeal or protest’).

The term for appeal or protest begins from the moment the first instance court has passed the sentence. If the public prosecutor or the defendant does not exercise their right within this period, the sentence of the court of first instance becomes final, i.e., the perpetrator becomes a convicted person as such is punished for the committed offence.

If the prosecutor exercises his right to protest or the defendant exercises his right to appeal within the term for appeal, the sentence does not take immediate effect because the criminal proceedings continue before the second instance court.¹⁹ For sentences of the Regional Court as a first instance, the second instance is the District Court. And for sentences passed by the District Court as a first instance, the second instance is the Court of Appeal. The second instance examines the case according to the rules laid

¹⁹ For more details on the hearing of the case before the second instance, see **Чинова, М., Георги Митов**. Цит. съч., 501–531.

down in CPC and passes its own act – a decision or a new sentence. After it is passed, CPC provides that a new appeal term begins. It is also during this period that the public prosecutor decides whether to file a protest and the defendant whether to appeal the act of the court of second instance. If neither of them exercises their respective right, following expiry of the term for appeal the act of the second instance will enter into force (i.e., will become enforceable).

If the public prosecutor exercises his right to protest or the defendant appeals, the act of the court of second instance does not take effect, because the examination of the case continues before the third (cassation) instance.²⁰ In criminal cases, only the Supreme Court of Cassation is such an instance. This court examines the case according to the rules laid down in CPC and rules by its own act – a decision. The act of the third instance is final, i.e., it enters into force and is enforceable upon its ruling and is not subject to further appeal or protest.

2. Private crimes are those for which the Criminal Code provides that criminal proceedings are initiated upon a complaint of the victim. In such cases, whether criminal proceedings are to be held depends solely on the will of the victim.

The rules for filing a complaint by the victim for a private crime are regulated by CPC. According to them, when the victim decides to exercise his right to file a complaint, he does so directly with the court, i.e., in these crimes there are no pre-trial proceedings. However, the same rules of jurisdiction and trial apply as for general crimes.

By filing the complaint, the victim acquires the status of a private complainant, and his complaint has the function of an indictment. The CPC therefore defines the content of the complaint, the time limit for filing it, and the right of the private complainant to withdraw it if he so chooses. If the victim does not file a complaint, criminal proceedings cannot be initiated by a public authority. Such offences are insult and defamation for example.

²⁰ For a more detailed account of the proceedings before the third instance, see **Чинова, М., Георги Митов**. Цит. съч., 532–562.

3. Private-public crimes are those for which the Criminal Code provides that criminal proceedings are initiated upon a complaint by the victim to the public prosecutor. Thus, whether criminal liability is realised again depends on whether the victim files a complaint. If he does, however, the case proceeds in the general manner, i.e., with pre-trial and trial proceedings as in the case of public crimes, and the victim cannot withdraw his complaint. Such a crime is any of the types of plagiarism, for example.

4. Public-private crimes are those for which criminal proceedings are initiated under the general procedure, but the Criminal Code provides that the victim of the crime may request termination of the proceedings. The victim may make this statement at any time up to the time before the sentence has entered into force. At present, the Criminal Code allows this only for one of the crimes against traffic safety.

CHAPTER 30:

PROTECTION OF THE EU AND THE NATIONAL FINANCIAL SYSTEM AGAINST MONEY LAUNDERING AND TERRORIST FINANCING

Savina Mihaylova-Goleminova

ABSTRACT	KEY WORDS
This chapter presents the key aspects of preventing abuse of the European Union's financial system for money laundering and terrorism purposes, including organisation of the national system to counter money laundering, terrorist financing, and proliferation financing. Prevention of the use of the financial system for the purposes of money laundering or terrorist financing is highlighted, including OECD measures, the practice of Bulgarian courts, etc.	anti-money laundering measures, financial system, protection against terrorist financing

I. INTRODUCTION

Protecting the European Union's financial system against money laundering and terrorist financing, including organisation of the national anti-money laundering system is a key issue¹ because of its impact on businesses² and professional services.³ The EU semester Country report for Bulgaria (2023)⁴ notes that on 31 August 2022 Bulgaria submitted a request to the

¹ Regarding 'financial system' see Chapter 18.

² EU context of anti-money laundering and countering the financing of terrorism: https://finance.ec.europa.eu/financial-crime/eu-context-anti-money-laundering-and-countering-financing-terrorism_en [Accessed on 1 March 2024].

³ https://home-affairs.ec.europa.eu/policies/internal-security/organised-crime-and-human-trafficking/money-laundering_en [Accessed on 1 March 2024].

⁴ https://economy-finance.ec.europa.eu/document/download/9f9f4e76-83da-451e-9dd0-4298913d693a_en?filename=BG_SWD_2023_602_en.pdf [Accessed on 1 March 2024].

Commission for the disbursement of EUR 1.37 billion under the Recovery and Resilience Facility (RRF).⁵ The request was based on the achievement of the 22 milestones and targets linked to the first instalment. These milestones cover reforms in the areas of education, smart industry, climate neutrality, digital connectivity, sustainable transport and road safety, justice, **anti-money laundering**, social inclusion, healthcare, and the audit and control system linked to the RRF. According to the report, Bulgaria has also made progress on improving its justice system and business environment. This was achieved by completing the first steps of key reforms that aim to ensure accessible, effective, and predictable justice, to **strengthen the anti-money laundering framework** and improve the quality of the legislative process. In addition, the entry into force of the new Industrial Parks Act created a consolidated regulatory framework to stimulate industrial investment and production in industrial parks. Legislative reforms were adopted to increase the quality of the legislative process, to help create a more accessible and effective justice system and **improve the regulatory framework for anti-money laundering** and industrial investment. The report also notes that Bulgaria needs to swiftly adopt and implement important rule-of-law reforms on anti-corruption and public procurement. The Technical Support Instrument (TSI) supports Bulgaria in designing and implementing growth-enhancing reforms, including the implementation of its recovery and resilience plan (RRP). The report concludes that Bulgaria has received significant support since 2016. Examples include: (i) strengthening the governance of state-owned enterprises; (ii) drafting the territorial just transition plan; (iii) **mitigating money laundering and terrorism financing risks**; and (iv) identifying the most suitable reforms and investments for decreasing its dependency on fossil fuels from Russia in line with the REPowerEU plan. **Bulgaria has taken steps to strengthen the anti-money laundering and combating the financing of terrorism (AML/CFT)⁶ framework but more remains to be done.** Bulgaria has taken action to improve the AML/CFT supervisory framework and work is ongoing on the update of the national risk assessment of money laundering and terrorist financing and the sectorial risk assessments of the non-profit organisations' sector; the

⁵ For more on RRF, see Chapter 22.

⁶ See International Monetary Fund: <https://www.imf.org/en/Topics/Financial-Integrity/amlcft> [Accessed on 1 March 2024].

sectorial assessments of the risks relating to virtual assets and the investor citizenship scheme has been concluded. Steps are being taken to enhance the analytical capacity of the Financial Intelligence Unit to make better use of suspicious transaction reports and increase the use of financial intelligence. Bulgaria has undergone an assessment of the effectiveness of its AML/CFT framework against international standards which resulted in recommended actions to be addressed. A draft law aiming to fully transpose the provisions of the 5th Anti-money Laundering Directive was submitted to the National Assembly but was ultimately not adopted. In this connection, legislation in force in Bulgaria will be reviewed below.

The Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL) is a permanent monitoring body of the Council of Europe entrusted with the task of assessing compliance with the principal international standards to counter money laundering and the financing of terrorism and the effectiveness of their implementation, as well as with the task of making recommendations to national authorities in respect of necessary improvements to their systems.⁷ In its Fifth Round Mutual Evaluation Report on Bulgaria (May 2022)⁸ MONEYVAL also concluded that Bulgaria needs to improve legislation and implementation of anti-money laundering and terrorist financing measures. In addition, the Financial Action Task Force (FATF, part of the OECD) which leads global action to tackle money laundering, terrorist, and proliferation financing⁹ has placed Bulgaria in the grey list of countries having large problems with money laundering. There is a scheduled detailed action plan for Bulgaria which must be implemented in order to solve

⁷ See: <https://www.coe.int/en/web/moneyval/home> [Accessed on 1 March 2024].

⁸ <https://rm.coe.int/moneyval-2022-1-mer-bulgaria/1680a70913> [Accessed on 1 March 2024].

⁹ FATF: <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/Increased-monitoring-february-2024.html> [Accessed on 1 March 2024]. *‘Jurisdictions under increased monitoring are actively working with the FATF to address strategic deficiencies in their regimes to counter money laundering, terrorist financing, and proliferation financing. When the FATF places a jurisdiction under increased monitoring, it means the country has committed to resolve swiftly the identified strategic deficiencies within agreed timeframes and is subject to increased monitoring. This list is often externally referred to as the ‘grey list’.*’

some shortcomings of local legislation and to speed up the process of integrating European legislation in national legislation. The proposal is that, if the Bulgarian Government succeeds in overcoming these deficiencies within one year, Bulgaria will be taken off the FATF grey list. In March 2024 Bulgaria presented an action plan containing a list of measures, so that the process of withdrawing of Bulgaria from the grey list has begun. FATF states that: *‘since October 2023, when Bulgaria made a high-level political commitment to work with the FATF and MONEYVAL to strengthen the effectiveness of its AML/CFT regime, Bulgaria has taken steps towards improving its AML/CFT regime, including by addressing technical compliance deficiencies related to Recommendations 6, 10 and 24. Bulgaria should continue to work on implementing its action plan to address its strategic deficiencies, including by: (1) implementing its national AML/CFT Strategy through adopting a comprehensive action plan; (2) addressing the remaining technical compliance deficiencies; (3) demonstrating initial implementation of risk-based supervision for postal money operators, currency exchange providers and real estate agents and establishing market entry controls for VASPs and postal money operators; (4) ensuring that the beneficial ownership information held in the Register is accurate and up-to-date; (5) completing the implementation of the automated system to ensure more automated prioritisation of STRs; (6) improving investigations and prosecutions of different types of money laundering in line with risks, including high-scale corruption and organised crime; (7) ensuring that confiscation is pursued as a policy objective; (8) ensuring the ability to conduct parallel financial investigations in all terrorism investigations; (9) addressing gaps in the TF and PF targeted financial sanctions (TFS) frameworks; and (10) identifying the subset of non-profit organisations (NPOs) most vulnerable to TF abuse and demonstrating initial implementation of risk-based monitoring to prevent abuse for TF purposes¹⁰’.*

¹⁰ <https://www.fatf-gafi.org/en/publications/High-risk-and-other-monitored-jurisdictions/Increased-monitoring-february-2024.html#Bulgaria> [Accessed on 1 March 2024].

Furthermore, Bulgaria faces one more challenge related to its action plan on ERM II post-commitments¹¹ – **the anti-money laundering framework**.¹² Meanwhile, at European Union Level, the European Court of Auditors (ECA) issued a Special Report 13/2021¹³ and concluded that EU efforts to fight money laundering in the banking sector are fragmented and implementation is insufficient. The auditors note that money laundering is the practice of ‘legitimising’ the proceeds of crime by filtering them into the regular economy to disguise their illegal origin. Given the importance of the EU anti-money laundering policy and the role of the banking sector, the auditors assessed whether the EU’s actions in this area are well implemented and found institutional fragmentation and poor co-ordination at EU level when it came to actions to prevent money laundering and take action where risk was identified. EU bodies were found to have limited tools to ensure sufficient application of AML/CFT frameworks at national level. No single EU supervisor was found to exist, with the EU’s powers being split between several bodies, with co-ordination with Member States being carried out separately. The auditors make recommendations to remedy these issues.

Following ECA recommendations, on 20 July 2021 the European Commission presented a package of legislation to strengthen the EU’s anti-money laundering (‘AML’) and countering the financing of terrorism (‘CFT’) rules (‘AML Package’). A new legal and institutional framework will soon be introduced given that political agreement at EU level has been achieved in this field (January 2024).¹⁴ Frankfurt will host the EU’s new anti-money laundering authority (AMLA).

¹¹ As mentioned in Chapter 25.

¹² Ministry of Finance Action plan for the implementation of follow-up commitments after accession to ERM II. Action plan with measures to address the subsequent commitments of the Republic of Bulgaria after joining the Monetary Mechanism II and other related policies, in Bulgarian: <https://www.minfin.bg/bg/1464> [Accessed on 1 March 2024].

¹³ https://www.eca.europa.eu/en/publications/SR21_13 [Accessed on 1 March 2024].

¹⁴ A deal on a single rulebook against money laundering and terrorist financing was achieved in January 2024: <https://www.consilium.europa.eu/en/press/press-releases/2024/01/18/anti-money-laundering-council-and-parliament-strike-deal-on-stricter-rules/> and <https://www.europarl.europa.eu/news/en/press-room/20240117IPR16880/deal-on-a-single-rulebook-against-money-laundering-and-terrorist-financing> [Accessed on 1 March 2024].

The Court of Justice of the European Union has also had the opportunity to rule on the application of Union law in this area.¹⁵ According to the Judgment of the ECJ in Joined Cases C-37/20, C-601/20: the provision whereby the information on the beneficial ownership of companies incorporated within the territory of the Member States is accessible in all cases to any member of the general public is invalid.

Currently, EU legislation in the field includes Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (consolidated version),¹⁶ Commission Delegated Regulation (EU) 2019/758 of 31 January 2019 supplementing Directive (EU) 2015/849 of the European Parliament and of the Council with regard to regulatory technical standards for the minimum action and the type of additional measures credit and financial institutions must take to mitigate money laundering and terrorist financing risk in certain third countries,¹⁷ Commission Delegated Regulation (EU) 2016/1675 of 14 July 2016 supplementing Directive (EU) 2015/849 of the European Parliament and of the Council by identifying high-risk third countries with strategic deficiencies,¹⁸ etc.

¹⁵ See: <https://curia.europa.eu/juris/documents.jsf?num=C-37/20> [Accessed on 1 March 2024].

¹⁶ <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX-:02015L0849-20210630> [Accessed on 1 March 2024].

¹⁷ OJ L 125, 14.5.2019, 4–10.

¹⁸ OJ L 254, 20.9.2016, 1–4.

II. BASIC ISSUES

1. What do ‘Money Laundering’ and ‘Terrorist financing’ mean?

According to the International Monetary Fund, AML/CFT policies and measures are key to the integrity and stability of the international financial system and member countries’ economies. Money laundering (ML) and related underlying crimes (the so-called ‘predicate offences’ or ‘predicate crimes’), as well as terrorist financing (TF) and the financing of the proliferation of weapons of mass destruction (WMD) or proliferation financing (PF) are crimes with economic effects – they can threaten the integrity and stability of a country’s financial sector and a country’s external stability more generally. They can result in destabilizing ‘hot money’ resulting from inflows and outflows, as well as in banking crises, ineffective revenue collection, broader governance weaknesses, reputational risks for international financial centres, and loss of correspondent banking relationships (CBRs). In an increasingly interconnected world, the harm done by these crimes is global, affecting the integrity and stability of the international financial system. AML/CFT policies and measures are designed to prevent and combat these crimes and are essential to protect the integrity and stability of financial markets and the global financial system.

The EU’s rules on anti-money laundering and countering terrorist financing protect its financial system and contribute to security and growth, and **Bulgaria, as a member state, ensures that money laundering and terrorist financing are prohibited.**¹⁹

What does ‘money laundering’ mean? According to Directive (EU) 2015/849, Article 3 *‘for the purposes of this Directive, the following conduct, when committed intentionally, shall be regarded as money laundering: (a) the conversion or transfer of property, knowing that such property is derived from criminal activity or from an act of participation*

¹⁹ See: Fight against money laundering and terrorist financing in the EU: <https://www.consilium.europa.eu/en/policies/fight-against-terrorism/fight-against-terrorist-financing/> [Accessed on 1 March 2024].

in such activity, for the purpose of concealing or disguising the illicit origin of the property or of assisting any person who is involved in the commission of such an activity to evade the legal consequences of that person's action; (b) the concealment or disguise of the true nature, source, location, disposition, movement, rights with respect to, or ownership of, property, knowing that such property is derived from criminal activity or from an act of participation in such an activity; (c) the acquisition, possession or use of property, knowing, at the time of receipt, that such property was derived from criminal activity or from an act of participation in such an activity; (d) participation in, association to commit, attempts to commit and aiding, abetting, facilitating and counselling the commission of any of the actions referred to in points (a), (b) and (c).''

According to the **Measures Against Money Laundering Act (MAMLA)**,²⁰ Article 2:

(1) Money laundering within the meaning of this Act, when committed intentionally shall be:

- 1. the transformation or transfer of property with the awareness that such property has been acquired from crime or from an act of participation in a crime, in order to conceal or disguise the illegal origin of the property or on order to assist a person, who participates in committing such an act, to avoid the legal consequences from that person's act;*
- 2. concealing and disguising the nature, source, location, movement, the rights in respect of or the ownership over the property with the awareness that such property has been acquired from crime or from an act of participation in a crime;*
- 3. the acquisition, possession, holding or use of property with the awareness at the time of receipt that it has been acquired from a crime or from an act of participation in a crime;*
- 4. participation in any of the acts referred to in item 1, association with a view to committing such an act, the attempt to carry out such*

²⁰ Prom. SG. 27/27 March 2018, last amended and supplemented in SG. 84/6 October 2023.

an act, as well as aiding, abetting, facilitating, or counselling the commission of such an act or its concealment.

(2) The knowledge, intent or purpose required as an element of the offences referred to para. 1 may be established on the basis of objective factual circumstances.

(3) Money laundering is also present where the offence, from which the property under para. 1 has been acquired, has been committed in another Member State, or in a third state and does not fall under the jurisdiction of the Republic of Bulgaria.'

According to Cambridge Dictionary: 'money laundering is the crime of moving money that has been obtained illegally through banks and other businesses to make it seem as if the money has been obtained legally.'²¹

Pursuant to the Directive mentioned above (Article 1(5) and (6)), '**terrorist financing**' means the provision or collection of funds, by any means, directly or indirectly, with the intention that they be used or in the knowledge that they are to be used, in full or in part, in order to carry out any of the offences within the meaning of Articles 1 to 4 of Council Framework Decision 2002/475/JHA.²² 'Terrorism financing'²³ is the provision or collection of funds and other assets, by any means, directly or indirectly, with a view to, or in the knowledge that those means will be used in full or in part by a terrorist organisation or by a terrorist acting alone, even without any connection to a particular act of terrorism. According to the Additional provisions of the **Measures against Financing of Terrorism Act (MAFTA)**²⁴ §1, p. 3 '**Terrorist Financing**' is the direct

²¹ <https://dictionary.cambridge.org/dictionary/english/money-laundering> [Accessed on 1 March 2024].

²² Council Framework Decision 2002/475/JHA of 13 June 2002 on combating terrorism (OJ L 164, 22.6.2002, p. 3).

²³ See KBC Group: Anti Money Laundering Policy <https://www.kbc.com/en/corporate-sustainability/setting-rules-and-policies.html> [Accessed on 1 March 2024].

²⁴ The Act introduces the requirements of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, amending Regulation (EU) 648/2012 of the European Parliament and of the Council and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission

or indirect, unlawful and intentional provision and/or collection of funds and other financial assets or economic resources, and/or the provision of financial services with the intent that they be used or with the knowledge that they will be used, in whole or in part, for the commission of terrorism, terrorist financing, the recruitment or training of individuals or groups of individuals for the purpose of committing terrorism, entering or exiting the country, or unlawfully residing in a country for the purpose of engaging in terrorism, forming, directing or being a member of an organised criminal group which aims to commit terrorism or terrorist financing, preparing to commit terrorism, theft for the purpose of obtaining funds to commit terrorist acts, forging an official document to facilitate the commission of terrorism, evident incitement to commit terrorism or threat to commit terrorism within the meaning of the Criminal Code’ (see below).²⁵

2. Bulgarian Criminal Code, ‘Money Laundering’ and ‘Terrorist financing’

Directive (EU) 2018/1673 of the European Parliament and of the Council of 23 October 2018 on combating money laundering by criminal law²⁶ establishes minimum rules concerning the definition of criminal offences and sanctions in the area of money laundering. It does not apply to money laundering with regard to property derived from criminal offences affecting the Union’s financial interests, which is subject to specific rules laid down in Directive (EU) 2017/1371. The Bulgarian Criminal Code²⁷ in its Article 253(3) (5) introduces the requirements of Directive (EU) 2018/1673 of the European Parliament and of the Council of 23 October 2018 on combating money laundering by criminal law.²⁸ It also lists, in its Chapter Seven ‘Crimes against the financial, tax and insurance systems’, more specifically in Articles 253,²⁹

Directive 2006/70/EC (OJ, L 141/73 of 5 June 2015).

²⁵ See European Council: <https://www.consilium.europa.eu/en/eu-response-to-terrorism/> OJ L 284, 12.11.2018, 22–30 [Accessed on 1 March 2024].

²⁶ OJ L 284, 12.11.2018, 22–30.

²⁷ As regards to Criminal Law, see Chapter 29.

²⁸ OJ, L 284/22 of 12 November 2018.

²⁹ *Article 253 (1): Whoever carries out a financial transaction or a transaction with property, or conceals the origin, whereabouts, movement, or actual rights to property which he or she knows or suspects to have been acquired through a criminal offence or*

253a³⁰ and 253b³¹, the protective measures for the financial system. **Decision No. 111 of 12.11.2020** under criminal case No. 1078/2019, Criminal Bench, 1st Criminal Division of the Supreme Court of Cassation notes as follows: *‘It should be noted that the legislator, by introducing the norm of Article 253 of the Criminal Code, has criminalised any financial transaction or transaction with property that is subject to acquisition through crime. There is an imperative statutory prohibition on disposal and the possibility of profiteering is not excluded, irrespective of what objections are made in this regard. The purpose of the legislative intervention is to ensure that property acquired by crime is not dissipated or transformed so that the damage caused by the predicate offence can be restored or secured. In contrast to the general text of Article 215 of the Criminal Code, where a special purpose is required in the formation of the criminal intent, this is not a required condition in the special provisions of Article 253 of the Criminal Code, due to the specific nature of the protected public relations, namely their association with the systems referred to in Chapter 7 of the Special Part of the Criminal Code – financial, tax and*

another socially dangerous act, shall be punished for money laundering by imprisonment from one to six years and a fine from three thousand to five thousand leva. See also: Решение № 111 от 12.11.2020 г. по гр. д. № 1078/2019 г., г. к., I г. о. на ВКС; Решение № 198 от 29.01.2019 г. по н. д. № 1265/2017 г., н. к., I н. о. на ВКС; Решение № 200 от 04.01.2017 г. по н. д. № 744/2016 Г., н. к., III н. о. на ВКС; Решение № 84 от 31.01.2024 г. по н. д. № 395/2023 г., н. к., I н. о. на ВКС; etc.

³⁰ Article 253a. (1) *The preparation for money laundering or the association for such purpose shall be punishable by imprisonment of up to two years or by a fine of five thousand to ten thousand leva.*

(2) *The same penalty shall also be imposed on those who incite another to money laundering.*

(3) *The property intended for money laundering shall be seized in favour of the state, and if it is missing or expropriated, its equivalent shall be adjudged.*

(4) *A participant in the association referred to in para. (1) shall not be punished when, before the completion of money laundering, has terminated his or her participation in the association and reports it to the authorities. See also: Решение № 198 от 28.10.2016 г. по н. д. № 704/2016 г., н. к., II н. о. на ВКС; Определение № 417 от 21.05.2021 г. по гр. д. № 719/2021 г., г. к., III г. о. на ВКС; Определение № 134 от 26.02.2021 г. по гр. д. № 3238/2020 г., г. к., III г. о. на ВКС, etc.*

³¹ Article 253b. *An official who violates or does not fulfil the provisions of the Measures against Money Laundering Act, if the action does not represent a more serious offence, shall be punished in serious cases by imprisonment of up to three years and a fine of one thousand to three thousand leva.*

social security ones, as well as due to the nature of the property – namely, money.

In that sense, the appellate court was right to define the receipt of money from the third parties in whose name the transfers were made in the Western Union rapid payment system as an act within the meaning of Article 253 of the Criminal Code, which constitutes money laundering by its nature. There is a transformation of property which has left its third-party owner, as referred to in the grounds of the judgment – pages 68 and 69 of the grounds of the judgment, last and first paragraphs respectively. There is no doubt that this also conceals the transformation of the property, insofar as it can only be traced documentarily until its receipt by the said third parties.

The partial acquittal implements the requirement of the previous cassation bench to clarify whether each and every instance of receipt of the object of the offence under Article 211 of the Criminal Code comprises money laundering. Where the subjects of the two offences coincide, the mere disposal of money or property in one's own interest does not fall within the scope of Article 253 of the Criminal Code, inasmuch as the perpetrator of the predicate offence is liable, in addition to penal liability, for the personal damage he or she has caused. The severance of the link with the property which is the subject of the offence of fraud, in this case – the result of the funds transferred falling into the patrimony of third parties, makes it possible for the perpetrator to participate in the offence of money laundering. In that sense, the appellate judgment cannot be criticised.'

The Criminal Code, Article 108a provides that:

(1) Whoever, with the intent of causing disorder and fear in the population, or to threaten or coerce an authority, a member of the public or a representative of a foreign country or of an international organisation, to do or omit to do anything, commits a crime according to Article 115, Article 128, Article 142(1), Article 142a(3) (2), Article 143, Article 143a, Article 144(2), Article 170 (3), Article 216(1) and (5), Article 319b – 319d, Article 326, Article 330, Article 334, Article 336a, Article 337, Article 339, Article 340, Article 341a, Article 341b, Article 341c, Article 344, Article 347(1),

Article 348, Article 349, Article 350, Article 352(1), (2) and (3), Article 354, Article 356f(1), Article 356h, Article 356k, Article 356l and 356m shall be punished for terrorism by imprisonment from five to fifteen years, and where death has been caused – by imprisonment from fifteen to thirty years, life imprisonment or life imprisonment without parole.

(2) Whoever, in any way whatsoever, directly or indirectly, collects or provides financial or other means, knowing or presuming that they will be used, in whole or in part:

- 1. to commit an act under paragraphs (1), (3), (4), (6), or (7);*
- 2. by an organisation or a group aiming to commit a crime under paragraphs (1) or (3);*
- 3. by a person who has committed an act under paragraphs (1), (3), (4), (6) or (7), shall be punished by imprisonment from three to twelve years.*

(3) recruits or trains individuals or groups of individuals for the purpose of committing a crime under paragraph (1), shall be punished by imprisonment from two to ten years.

(4) Whoever trains to commit a crime under paragraph (1) shall be punished by imprisonment for up to eight years.

(5) The perpetrator under paragraph (4) shall not be punished, if he or she voluntarily discloses him/herself to the authorities before the offence under paragraph (1) has been committed.

(6) Any Bulgarian national exiting through the national border in order to participate in a crime under paragraph (1), including against another country, shall be punished by imprisonment of up to ten years.

(7) The penalty under paragraph (6) shall also be imposed on any foreigner who, aiming to participate in a crime under paragraph (1), including against another country, enters through the country borders or illegally resides in the country.

(8) The subject of the crime under paragraph (2) shall be seized in favour of the state and if it is missing or expropriated, its equivalent shall be awarded.'

3. Legislative and Institutional framework in Bulgaria according to MAMLA and MAFTA

Bulgaria has transposed EU legislation in two legal acts: the Measures against Money Laundering Act (MAMLA) (including the Rules on the Implementation of the Measures against Money Laundering Act)³² and the Measures against Financing of Terrorism Act (MAFTA), containing administrative measures.

MAMLA and MAFTA can be treated as a part of financial legislation. In addition, relations between legal and natural persons (Article 4 MAMLA) and the supervisory authorities, including the State Agency for National Security (SANS), European institutions and international organisations can be treated and reviewed as Financial Legal Relations.³³ Under the influence of the authoritarian method of legal regulation, social relations, considered in detail, arise, develop and terminate along the vertical of authority and subordination and are regulated by imperative legal norms. Moreover, legal regulation is based on the acts of European and national legislation in force, which also contain imperative legal norms, and this determines their nature of public financial law relations. The relations under both Acts are regulated by the authoritarian method of legal regulation, since one of the subjects is always the state, represented by its own state body exercising authoritative powers.

The State, represented by its bodies, participates in the social relations regulated by the two Acts as the bearer of *imperium*. All supervisory bodies including SANS carry out the managerial activities of bodies of the executive and are endowed with corresponding powers of authority, including powers of sanction as a part of financial administration.³⁴

They are also bodies of management and control, insofar as each Member State itself, on the basis of the acts of EU law in force, establishes an institutional and legal model for the **protection of the European Union's and the national financial system against money laundering**

³² Promulgated in SG 3 of 8 January 2019, last amended in SG 89 of 24 October 2023.

³³ See Chapter 18.

³⁴ For more information on financial administration, see Chapter 18.

and terrorist financing, which bodies, according to Article 8 of the CRB, are bodies of the executive power, exercising, by designation, executive power.³⁵ **These bodies carry out the management activities of bodies of the executive branch** and are endowed with corresponding powers (competence of the respective public authority). **They are able to issue legal acts of authority which unilaterally create rules of conduct or specific legal relations and, in addition, are able to use state coercion where necessary for the implementation of such rules or relations.**³⁶ For example, based on Articles 22 and 23 of the Administrative Violations and Sanctions Act, under the provisions of Article 116(2) and (3) of MAMLA, upon proposal by the chairperson of the State Agency for National Security, or upon own initiative, the authority which has issued the permit or licence for the performance of an activity to a person under Article 4, may revoke the issued permit or licence for the respective activity or order the deletion of the entry, where a registration regime is applied. Where a person referred to in Article 4 fails to comply with his/her obligations under Article 102 or Article 104(2), as well as in case of established violations under Article 116, the Director of the Financial Intelligence Directorate with SANS may order such person to discontinue the violation and to take specific measures necessary for its elimination, setting a deadline for their implementation. Statements of findings under Article 125 and Article 126 MAMLA may be appealed under the Administrative Procedure Code.

There is coordination between all the bodies that exercise supervision and control at European and national level. The established institutional and legal framework comprises a set of separate elements which are interlinked and aimed at achieving a common objective – **protection of the European Union's and the national financial system against money laundering and terrorist financing.**

³⁵ The legal definition of the term 'administrative body' in accordance with § 1, item 1 of the Supplementary Provisions of the Administrative Procedure Code.

³⁶ **Дерменджиев, И., Димитър Костов, Дончо Хрусанов.** Административно право на Република България. Обща част. Пето преработено и допълнено издание. София, Сибир, 2012, с. 108.

	MAMLA	MAFTA
Subject	Article 1. This act defines the measures for prevention of use of the financial system for the purposes of money laundering, as well as the organisation and control of their implementation.	Article 1. This Act defines the measures against the financing of terrorism, as well as the procedure and control of their implementation. Article 2. The objectives of this Act are the prevention and disclosure of activities of individuals, legal entities, groups and organisations aimed at financing terrorism.

The measures under Article 3, items 1–6 MAMLA **are obligatory for the following authorities and persons** (Article 4):

- 1. the Bulgarian National Bank, when carrying out operations and transactions with an unlimited range of persons, and the credit institutions that operate on the territory of the Republic of Bulgaria within the meaning of the Credit Institutions Act;*
- 2. other payment service providers within the meaning of the Payment Services and Payment Systems Act and their Representatives;*
- 3. financial institutions within the meaning of the Credit Institutions Act;*
- 4. currency exchange offices;*
- 5. insurers and insurance intermediaries established in the Republic of Bulgaria, which have obtained a licence under the conditions and in accordance with the procedure of the Insurance Code, when they carry out activities under one or more of the classes of insurance referred to in Section I of Annex No 1 to the Insurance Code; insurers and insurance intermediaries, which have obtained a licence in another Member State, which carry out activities on the territory of the Republic of Bulgaria, when they carry out activities under one or more of the classes of insurance referred to in Section I of Annex No 1 to the Insurance Code;*
- 6. leasing undertakings;*
- 7. postal operators, licensed to carry out postal money transfers under the Postal Services Act and their representatives under Article 22 of the same Act, which are entrusted with the implementation of separate postal service activities, related to the implementation of postal money transfers;*

8. *investment intermediaries that have been licensed under the terms and procedures of the Markets in Financial Instruments Act;*
9. *collective investment schemes and other collective investment undertakings that have been licensed, obtained a permit or have been registered under the procedures and conditions of the Collective Investment Schemes and Other Undertakings for Collective Investments Act;*
10. *managing companies and person, managing alternative investment funds that have been licensed or have been registered under the procedures and conditions of the Collective Investment Schemes and Other Undertakings for Collective Investments Act;*
11. *pension insurance companies that have been licensed under the procedures and conditions of the Social Security Code with the exception of their activity of managing funds for supplementary compulsory pension insurance;*
12. *registered auditors;*
13. *persons who provide accounting services and/or tax consultancy services by profession, as well as persons, who, as their principal business or professional activity, provide, directly or indirectly, through related persons, assistance in any form or advice on tax matters;*
15. *person, who provide legal consultations by profession, where:*
 - a) *they assist or participate in the planning or execution of an operation, transaction or other legal or factual action of a client concerning:*
 - aa) *the sale-purchase of real estate or transfer of an undertaking to a merchant;*
 - bb) *the management of funds, financial instruments or other assets;*
 - cc) *opening, managing or disposing of a bank account, savings account or financial instruments account;*
 - dd) *the procurement of funds for the establishment of a legal person or other legal entity, the increase of the capital of a trading company,*

the granting of loan or any other form of procurement of funds for performance of the activity of a legal person or other legal entity;

ee) the establishment, registration, organisation of the activity or management of trust ownership, sole proprietorship or other legal entity;

ff) the management of property in trust, including trusts, trusteeships and other similar foreign legal entities established and existing under the laws of jurisdictions permitting such forms of trust ownership;

b) act for and/or on behalf of a client in any financial transaction;

c) act on behalf of and/or for a client in any real estate transaction;

d) provide a management address and correspondence address, office and/or other similar services for the purpose of registration and/or operation of a legal person or other legal entity;

16. persons who, by way of business, provide:³⁷

a) management address, correspondence address, office and/or other similar services for the purposes of registration and/or functioning of a legal person or other legal entity;³⁸

b) services for the establishment, registration, organisation of the activities and/or management of a trader or other legal person or other legal entity;

c) services of trust management of property or of a person referred to in point (b) including:

37 In order to carry out the activities under Article 4(16) by way of business, the relevant person must be registered in a public electronic register under the Minister of Justice. See Ordinance No. H-1 of February 6, 2024 on the terms and conditions for registration of individuals under Article 9b of the Measures Against Money Laundering Act (Promulgated in SG 14/16 February 2024).

38 As of 16.01.2024, the persons under Article 4(16) (who provide a registered office address, correspondence address, office, and/or other similar services for the purposes of registration and/or operation of a legal entity and other related services listed in the MAMLA) must perform these activities following registration in a special register with the Minister of Justice. It is expected that the conditions and procedure for registration will be explicitly regulated in an additional regulation, issued by the Minister.

aa) the performance or arranging for the performance by another person of the office of director, secretary, partner or other similar office in a body corporate or other legal entity;

bb) the performance of the functions or the arranging for the performance by another person of the functions of trustee, in the case of trusts, trustee funds and other similar foreign legal entities constituted and existing under the laws of jurisdictions permitting such forms of trust ownership;

cc) the performance of the function or the arranging for the performance by another person of the function of nominee shareholder in a third foreign legal person or other legal entity, other than a company whose shares are traded on a regulated market, to which disclosure requirements apply in accordance with European Union law or equivalent international standards;

17. private enforcement agents and assistant private enforcement agents;

18. persons who carry out, on a professional basis, real estate intermediation, including in respect of real estate rental transactions where the monthly rent amounts to or exceeds EUR 10 000 or their equivalent in another currency;

19. (repealed – SG 7/21)

20. dealers in arms, petrol and petrol products;

21. the organisers of gambling games who have obtained a licence to organise gambling games on the territory of the Republic of Bulgaria pursuant to the Gambling Act;

22. (repealed – SG 21/21)

23. (repealed – SG 21/21)

24. (suppl. – SG 17/21, repealed – SG 21/21)

25. (repealed – SG 21/21)

26. persons who grant money loans against pledge of property;

27. (repealed – SG 21/21)

28. *non-profit legal entities, with the exception of those that do not carry out charitable, religious, cultural, educational, social or socially beneficial activities and fall into any of the following categories regulated by a special Act:*

a) creative unions uniting persons carrying out related creative activity in the field of culture, established under the Non-profit Legal Entities Act to protect the interests of their members and having the character of a class organisation;

b) class and branch organisations and unions, employer and trade union organisations, chambers of commerce and other associations in individual economic branches;

29. *professional football clubs;*

30. *(suppl. – SG 42/19, in force from 28.05.2019, repealed – SG 21/21)*

31. *(amend. – SG 42/19, in force from 28.05.2019, repealed – SG 21/21)*

32. *political parties;*

33. *(repealed – SG 21/21)*

34. *(repealed – SG 21/21)*

35. *the executive director of the Executive Environment Agency in his/her capacity of national administrator within the meaning of Commission Regulation (EU) No 389/2013 of 2 May 2013 establishing a Union Registry pursuant to Directive 2003/87/EC of the European Parliament and of the Council, Decisions No 280/2004/EC and No 406/2009/EC of the European Parliament and of the Council and repealing Commission Regulations (EU) No 920/2010 and No 1193/2011 (OJ, L 122/1 of 3 May 2013).*

36. *persons, who, by profession, trade or act as intermediaries in the trade in works of art, including when this is carried out by art galleries and auction houses, where the value of the transaction or of related transactions amounts to, or exceeds EUR 10,000, or their equivalent in another currency;*

37. persons, who, by profession, store, trade or act as intermediaries in the trade in works of art, when this is done in free zones and when the value of the transaction or of related transactions amounts to, or exceeds EUR 10,000 or their equivalent in another currency;

38. persons, who, by profession, provide services for the exchange between virtual currencies and recognized currencies without gold backing, services for the transfer or exchange of virtual assets, services for the storage and management of virtual assets enabling the exercise of control over the assets and services related to the public offering of virtual assets;

39. portfolio providers, offering custody services.

40. persons, who, by profession, provide access to deposit cassettes in public vaults, with the exception of the persons under item 1.

The latest amendments to the Act provide that persons carrying out any of the activities under Article 4(15) (provision of **legal advice** on a professional basis), (16) (provision of a **registered office and correspondence address** on a professional basis) or (18) (carrying out **intermediation services in real estate transactions**) of the MAMLA must comply with special requirements provided under law, which should be evidenced by certain documents in the case of inspection by the State Agency for National Security. The amendments to MAMLA also provide for a **5-year period for the storage of data and documents regarding the beneficial owners following dissolution of legal entities established in Bulgaria**. The representatives of such companies, their liquidators, the contact persons under Article 63(4), item 3 of the MAMLA, as well as the persons carrying out other actions in connection with the dissolution of the relevant legal entity, are responsible for the storage of such data for the relevant period.

Persons under Article 4 must **adopt internal rules for the control and prevention of money laundering and financing of terrorism**,³⁹ which also need to be applied effectively by their branches and subsidiaries

³⁹ Some sample examples of internal rules for control and prevention of money laundering and financing of terrorism can be found here (State Agency for National Security): <https://dans.bg/bg/msip-091209-menu-bul/kritsum-mitem-bul> [Accessed on 1 March 2024].

abroad. The rules provide measures for the prevention and disclosure of the actions of natural and/or legal persons, groups and organisations of organised crime aimed at money laundering and the financing of terrorism. The persons under Article 4, item 28 who do not simultaneously fall in another category of persons under Article 4, must adopt internal rules in the cases under Article 98(4) and (5) (Article 101 (1)).

The requirements of these rules are stipulated in the Act. According to Article 108(1) control over implementation of the Act is exercised by the chairperson of SANS. SANS exercises supervision by applying a risk-based approach **either alone or jointly** with the Bulgarian National Bank, the Financial Supervision Commission, the National Revenue Agency, etc., acting as supervising authorities (see below).

Control over compliance with the requirements of Articles 7–9, Article 72, Chapter Two, Chapter Three, Section I, Chapter Seven, Section II and Chapter Eight is exercised through the application of a risk-based approach, pursuant to Article 114(1) and respectively by:

1. the Bulgarian National Bank, in respect of:

a) persons, licensed by it under Article 4(1), proposal two, including branches of third-country credit institutions, as well as in respect of branches of credit institutions, established in the Republic of Bulgaria, licensed in other Member States, in the cases, specified in the Credit Institutions Act, including in respect of their activities under Article 6 of the Markets in Financial Instruments Act;

b) persons, licensed by it under Article 4(2), including in respect of their activities through representatives in the territory of the Republic of Bulgaria, as well as in respect of the activities carried out through branches or representatives of payment institutions and electronic money companies, established in the territory of the Republic of Bulgaria and licensed in other Member States;

2. The Financial Supervision Commission and its bodies – in respect of the persons referred to in Article 4, items 5 and 8–11, with the exception of banks – investment intermediaries within the meaning of Article 8(1) of the Markets in Financial Instruments Act;

3. The National Revenue Agency – in respect of the persons under Article 4, item 21;

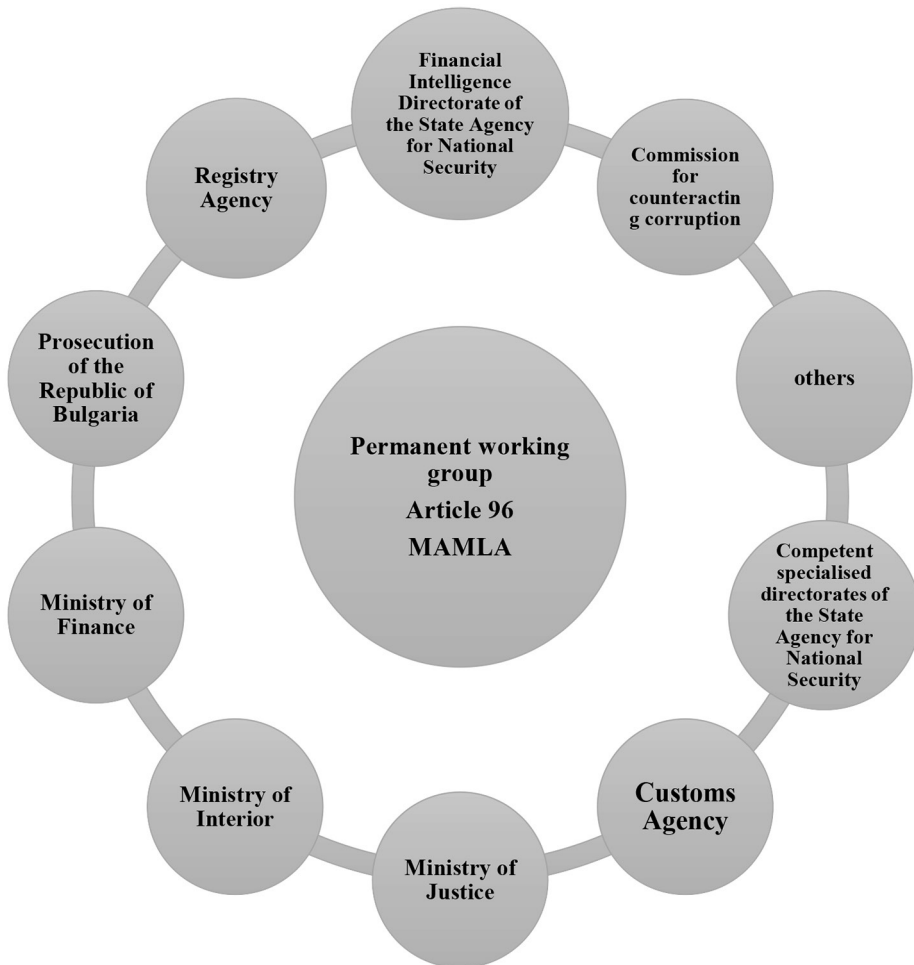
4. the Communications Regulation Commission – in respect of the persons under Article 4, item 7.

In exercising control, the Bulgarian National Bank, the Financial Supervision Commission, the Communications Regulation Commission and the National Revenue Agency carry out remote supervision and on-the-spot checks. The Bulgarian National Bank and the Financial Supervision Commission serve as the point of contact with the European Banking Authority.

To conclude, the most important institutional role⁴⁰ in the field is played by the Bulgarian SANS. SANS incorporates within its structure a specialised administrative directorate for financial intelligence. The Financial Intelligence Directorate (FID) collects, stores, investigates, analyses and discloses financial intelligence under the terms and procedures of the Measures Against Money Laundering Act (MAMLA) and the Measures Against the Financing of Terrorism Act (MAFTA), exercising control and prevention against money laundering and terrorist financing.

A permanent working group was established in accordance with the requirements of valid legislation (Article 96 MAMLA).

⁴⁰ <https://dans.bg/en/msip-091209-menu-en> [Accessed on 1 March 2024].

Diagram 1. Permanent working group authorities

As of **16 July 2024**, liable persons under the MAMLA, as well as certain authorities (including the State Agency for National Security, the Ministry of Interior, the National Revenue Agency, the Registry Agency) will have the obligation to notify the Registry Agency within 14 days in case of any discrepancy between the data collected by them and the data recorded with the Commercial Register regarding the beneficial owners of legal entities. Consequently, the Registry Agency will make an entry regarding the existence of a notification of discrepancy in the file of the relevant company with the Commercial Register and will

send a **written notification** to the said legal entity of its **obligation to declare up-to-date data within 7 days**. Financial penalties can be imposed for failure to notify the Registry Agency of non-compliance, and for failure to declare the necessary data to the Registry Agency, as described above, in a timely manner. Such penalties may be imposed for each month until the obligation is fulfilled. Furthermore, the disclosure of information regarding established discrepancies in the information regarding beneficial owners is exempted from breach of confidentiality obligations, including those agreed in a contract.

III. ADMINISTRATIVE PENAL PROVISIONS OF MAMLA AND MAFTA

In order to protect the financial system, MAMLA and MAFTA provide not only ex-ante, mid-term and ex-post forms of control and preventive measures, but also provide the relevant authorities with sanctioning powers, with the Administrative Violations and Sanctions Act (AVSA) being applicable.⁴¹ Relevant authorities take impact measures against controlled persons. AVSA is the statutory act which contains the general legal regulation on administrative offences and penalties, the procedure for the establishment of administrative offences, respectively for the imposition and enforcement of administrative penalties. The establishment of violations, as well as the issue, appeal and implementation of penal orders is also carried out under AVSA (relevant for both MAMLA and MAFTA).

The phases of the administrative-penal process under AVSA can be mandatory or optional:⁴²

- **Mandatory phases:**⁴³ detection of the offence; imposition of penalty; enforcement.

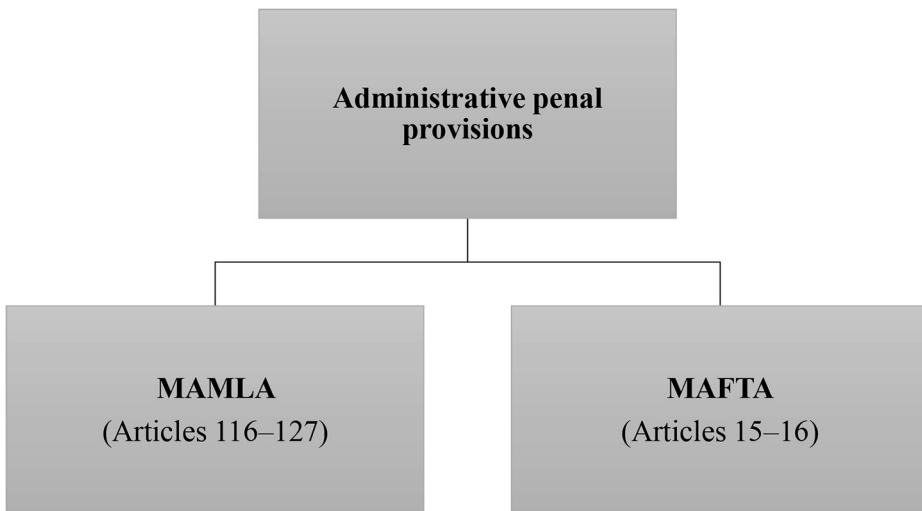
⁴¹ Promulgated in SG 92/28 November 1969, last supplemented SG 106/22 December 2023. See: **СИВКОВ, Ц.** Изменения в Закона за административните нарушения и наказания от 2020 г. – Коментар. София, Сиела, 2021.

⁴² These can also be categorised as **extrajudicial and judicial phase**.

⁴³ The extrajudicial phase starts with the drawing up of the Statement of administrative violation and ends with the sending of the administrative and criminal case file to the administrative sanctioning authority (ASA).

- **New elements of the familiar phases are:**
- Receipt, by the offender, of a **written warning** if the offence constitutes a minor case,
- entering into an **agreement** with the sanctioning authority.
- **The regular and extraordinary control phases are optional.**

Diagram 2 Administrative penal provisions



According to the provisions of Article 6 of AVSA, an administrative offence is the act (action or inaction) which violates the established order of state management, is committed with culpably and is declared punishable by an administrative penalty imposed under an administrative procedure.

Pursuant to Article 7 AVSA, an act declared to be an administrative offence is culpable when committed intentionally or recklessly; reckless acts not being punishable only in the cases expressly provided for. Guilt is the subjective attitude of the offender towards the act he or she has committed, which act endangers or damages existing relations – an element of the subjective aspect of an act with a specific social manifestation. The act is intentional when the perpetrator was aware of its socially dangerous nature, foresaw its socially dangerous consequences and wished or allowed these consequences to occur (Article 11(2) of the Criminal Code,

in conjunction with Article 11 AVSA). The offence is reckless when the offender foresaw the occurrence of the socially dangerous consequences but intended to prevent them or when he or she did not foresee the occurrence of the socially dangerous consequences but should have and could have prevented them (Article 11(3) of the Criminal Code, in conjunction with Article 11 AVSA).

If the constituent elements of administrative offences are established, the bodies defined in the Act⁴⁴ draw up a Statement of administrative violation, on the basis of which the proceedings for administrative penal liability take place (Article 35 AVSA). Pursuant to MAMLA, **Statements of Administrative Violation** are drawn up by the control bodies of the Financial Intelligence Directorate, by the National Revenue Agency, by appointed officials of the Bulgarian National Bank, by officials appointed by the bodies of the Financial Supervision Commission or by employees authorised by the chairperson of the Communications Regulation Commission (Article 123(1) MAMLA). Pursuant to MAFTA, **Statements of Administrative Violation** can be drawn up by the Ministry of Interior, by the State Agency for National Security, the National Revenue Agency, by designated officials of the Bulgarian National Bank, by officials designated by the bodies of the Financial Supervision Commission or the employees authorised by the chairman of the Communications Regulation Commission (Article 16(1) MAFTA).

The main requirements for the regularity of the Statement of Administrative Violation are the participation of the offender in its drawing up, the presence of all **requisite elements** required by AVSA and its issuance in accordance with the violated legal provision.

The Acts also define the administrative sanctioning authority (the ASA) which issues the penal order.

⁴⁴ The competence of the authority drawing up the Statement is: material competence; territorial competence (see Решение № 6446 от 03.11.2022 постановено по адм. дело № 7638 по описа за 2022 г. на АСЦГ). A Statement of Administrative Violation may also be drawn without the participation of witnesses, solely on the basis of official documents, pursuant to Article 40 (4) AVSA.

Pursuant to **MAMLA, Penal orders**⁴⁵ are issued by the chairperson of the State Agency for National Security, respectively by the supervisory body, by its manager or by officials authorised by them, and in cases under the competence of the Communications Regulation Commission – by the chairperson of the Commission or by an official expressly authorised by such chairperson (Article 123 (1)). Pursuant to **MAFTA, Penal orders** are issued by the Minister of the Interior, the Chairperson of the State Agency for National Security, the supervision body, its manager or officials authorised by them, and in cases under the competence of the Communications Regulation – by the chairperson of the commission or an official expressly authorised by him (Article 16 (1) MAFTA).

The **ASA** issues a penal order imposing on the offender an appropriate administrative penalty when it establishes beyond doubt the facts of the offence, the identity of the perpetrator and his/her guilt, provided that there are no grounds for termination of the proceedings, for application of Article 28 or where no agreement with the offender has been concluded (Article 53(1) AVSA).

For violations of Article 11(1)–(3), Articles 12–15, Articles 17–18, Articles 24–29, Articles 33–36, Articles 37–40, Articles 44–47, Articles 52–53, Article 59, Articles 65–69, Article 72(1) to (3) and (5) to (7), Article 73(1) Article 74(1) to (5) and (11), Article 76(1), Article 80, Article 87(4), Article 106(2) and (4), Article 110(1) and (2) and Article 111(1) 1 of **MAMLA and for violations of the Measures against Financing of Terrorism Act, Article 28(1)–(6) of the AVSA will not apply**. The conditions and procedure for reporting the relevant circumstances are determined by the rules on the implementation of the Act.

A penal order is issued even when there is an irregularity in the Statement of Administrative Violation, as long as the perpetration of the offence, the identity of the offender and his/her guilt are established in an undisputed manner (Article 53(2) AVSA). Pursuant to Article 58e AVSA, the following are subject to appeal and protest:

⁴⁵ Решение № 1381 / 05.03.2021 г., адм. дело номер 212/2021 г. на Административен съд София-град, XIV касационен състав.

1. the penal order;
2. the resolution for termination of the administrative penal proceedings.

Pursuant to Article 53(1) AVSA, an appropriate administrative penalty must be imposed on the offender when the following are established beyond doubt: the fact of the perpetrated offence, the identity of the person who committed it and his/her guilt, provided that there are no grounds for termination of the proceedings in application of Article 28 and no agreement has been concluded with the offender. Within the process of administrative penal prosecution, administrative authorities should establish the actual intention of the legislator in adopting the amendments to the provisions by applying the rules for interpretation of the provisions of the statutory instruments set out in Article 46(1) of the Statutory Instruments Act, according to which: *‘The provisions of statutory instruments shall be applied according to their precise meaning and, if they are unclear, shall be interpreted in the sense which is most consistent with other provisions, the purpose of the instrument interpreted and the fundamental principles of the law of the Republic of Bulgaria.’*⁴⁶

The establishment of offences and the issue, appeal and enforcement of penal orders is carried out in accordance with the procedure laid down in AVSA and the two Acts.

Fines and pecuniary sanctions are collected under the procedure of the Tax and Social Security Procedure Code as they comprise public state claim⁴⁷ within the meaning of Article 162(2)(7) of the Tax and Social Security Procedure Code (public claims are all state and municipal claims under penal orders which have entered into force).⁴⁸

⁴⁶ See also Тълкувателно постановление № 3/28.04.2023 г. по тълк. д. № 5/2022 г. на Върховен административен съд – OCC от НК на ВКС и I и II колегии на ВАС, which rules that: 1. The proper party to appeal and protest Statements under Article 58e, items 1–3 AVSA is the sanctioning authority. 2. The provisions of Article 221(3) of the Administrative Procedure Code apply to proceedings under Article 63c AVSA.

⁴⁷ Определение № 3367 от 14.06.2016 г. по адм. д. № 5154/2016 г. на АС-София-град.

⁴⁸ Определение № 727 от 15.09.2017 г. по адм. д. № 753/2017 г., тричленен състав на АС – София област.

The Statement of Administrative Violation (SAV) should comply with the procedural rules for its issuance. SAV should be issued by a competent authority and should be drawn up within the time limits laid down in the law (attention should be paid to the correlation between general and special law). SAV should contain the requisite elements prescribed by law as to minimum required content – Article 42 AVSA. Its issuance must comply with the relevant procedure and should involve a regular procedure of service. The burden of proof in the administrative and penal proceedings lies on the sanctioning authority by virtue of Article 84 AVSA in conjunction with Article 103(1) of the Criminal Procedure Code. In its assessment whether to issue a penal order, the issuing body must base its decision on the findings set out in SAV, which, within the framework of administrative sanctions, are presumed to be correct until proven otherwise. However, that is not the case in judicial proceedings, in which they have no binding evidentiary value.

Any proceedings before an **appellate instance (the relevant regional court)** are appellate in nature and are conducted in accordance with the procedural rules laid down in the Criminal Procedure Code. Pursuant to Article 339(2) of the Criminal Procedure Code, the appellate instance must state the grounds on which it does not accept the arguments put forward in support of the appeal. The absence of factual and legal conclusions on the arguments put forward by the appellant vitiates the judgment and is grounds for its annulment. The court is not bound by the decision of the ASA and cannot be prevented from fully examining the facts relevant to the dispute raised before it. The absence of a ruling under Article 339(2) of the Criminal Procedure Code in accordance with current case-law, amounts to a lack of reasoning and always constitutes a substantive breach of procedural rules – grounds for cassation of a judicial act.

The **cassation proceedings**⁴⁹ do not resolve the substantive dispute

⁴⁹ See some cases under **MAMLA**: Решение № 1529/09.03.2022 г. по а. н. д. № 12607/2021 г. на Административен съд София-град; Решение № 132/11.03.2019 г. по а. н. д. № 88/2019 на Административен съд Пазарджик; Решение № 1632/29.10.2021 г. по а. н. д. № 2260/2021 г. на Административен съд Бургас; Решение № 239/28.02.2022 г. по а. н. д. № 179/2022 г. на Административен съд Варна; Решение № 381/18.03.2022 г. по а. н. д. № 176/2022 г. на Административен съд Бургас;

between the parties, but are concerned with the assessment of the correctness, admissibility and validity of the appellate judgment. The court of cassation (the relevant administrative court) examines the conformity of the judgment with substantive law on the basis of the facts established by the court of first instance. Its task is limited solely to verifying whether the facts have been correctly brought within the terms of legal rule and whether the legal consequences provided for in that rule have been correctly applied.

Article 34(2) AVSA provides for longer time limits for initiation of administrative proceedings: ‘For violation of a regulatory act regulating budgetary, financial-economic and accounting activities under Article 32(1)(1) of the State Financial Inspection Act, as well as for violation of a regulatory act regulating gambling activity and **measures against money laundering and financing of terrorism**, as well as for violation of the Energy Act, the Renewable Energy Act and the sub-legislative acts implementing them, of Regulation (EU) No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency (OJ L 326/1 of 8 December 2011), as well as for infringement of the Independent Financial Audit Act, the Payment Services and Payment Systems Act and for infringement of the Corporate Income Tax Act in cases of hidden profit distribution, **no administrative proceedings shall be initiated if no Statement of Administrative Violation has been drawn up within six months of the discovery of the offender or if more than five years**

Решение № 184/09.03.2022 по а. н. д. № 36/2022 г. на Административен съд Пазарджик; Решение № 66/28.03.2022 г. по а. н. д. № 20/2022 г. на Административен съд Шумен; Решение № 63/06.11.2023 г. по а. н. д. № 78/2023 г. на Административен съд Разград; Решение № 4829/14.07.2023 г. по адм. д. № 4690/2023 г. на Административен съд София-град; Решение № 5037/ 24.07.2023 г. по адм. д. № 4387/2023 г. на Административен съд София-град; Решение № 6494/01.11.2023 г. по адм. д. № 6807/2023 г. на Административен съд София-град; Решение № 6942/15.11.2023 г. по адм. д. № 7823/2023 г. на Административен съд София-град; Решение № 1615/05.12.2022 г. по а. н. д. № 2441/2022 г. на Административен съд Варна; Решение № 7587/12.12.2022 г. по адм. д. № 8524/2022 г. на Административен съд София-град; Решение № 714/07.02.2023 г. по адм. д. № 10002/2022 г. на Административен съд София-град; Решение № 4049/19.06.2023 г. по адм. д. № 3825/2023 г. на Административен съд София-град; Решение № 6820/ 09.11.2023 г. по адм. № 7605/2023 г. на Административен съд София-град; and others.

have elapsed since the offence was committed. In these cases, the time limits laid down in paragraph (1) shall not apply.’

The time limits under Article 34 AVSA are time-barred.⁵⁰ *The limitation period has two elements: objective (expiry of a certain period of time) and subjective (an objection raised for the expiry of the limitation period). The legal consequences of the expiration of the limitation period are that the creditor loses the possibility to seek judicial redress. What has been paid after expiry of the limitation period is duly paid if no plea of limitation has been made.*

It should be noted that the provisions of Article 34(1) and (2) AVSA (limitation periods after the expiry of which no administrative penal proceedings may be brought before the ASA)⁵¹ implies the application of the rules and principles concerning the correlation between ‘**general law** and ‘**special law**’ **with regard to the time limits set out in the special Acts above.**

Extinction of the administrative penal prosecution – Article 34(3) AVSA (the initiated administrative penal proceedings are terminated if no penal order is issued within six months of the drawing up of the Statement of Violation).

In the judicial phase, the provisions on limitation and absolute limitation under the Criminal Code (CC) apply. Absolute statute of limitations is regulated by Article 81(3) in conjunction with Article 80(1)(5) CC (Interpretative Resolution No. 1/27.02.2015 under interpretative case No. 1/2014 of the Supreme Court of Cassation and the Supreme Administrative Court). Pursuant to the said Interpretative Resolution No. 1/27.02.2015,

⁵⁰ There is no explicit provision in AVSA for the absolute limitations for an administrative offence. Pursuant to Article 11 AVSA, the provisions of the general part of the Criminal Code apply to the issues of guilt, imputability, circumstances excluding liability, forms of complicity, preparation, and attempt, insofar as AVSA does not provide otherwise. Prescription is undeniably a circumstance excluding liability. In this sense is also **Тълкувателно постановление № 1 от 27.02.2015 г. по тълкувателно дело № 1/2014 г., ОС на наказателната колегия на Върховния касационен съд и I и II колегия на Върховния административен съд**, which, in its paragraph 2 states that the provision of Article 11 of AVSA refers to the rules on the limitation of penal prosecution in the Criminal Code.

⁵¹ The court monitors compliance with time limits *ex officio*, as non-compliance constitutes a violation of procedural rules.

the statute of limitations is a period of time determined by the law, upon expiry of which the holder of a right loses the opportunity granted by law to exercise such right. The statute of limitations applies *ex officio*, whereby the State loses its substantive right to impose a penalty on the offender and to enforce the penalty already imposed, thereby extinguishing penal liability and in turn rendering the penal proceedings inadmissible. The operative part of the said interpretative decision expressly holds that the provision of Article 11 AVSA refers to the rules on the limitation of penal prosecution in the Criminal Code.

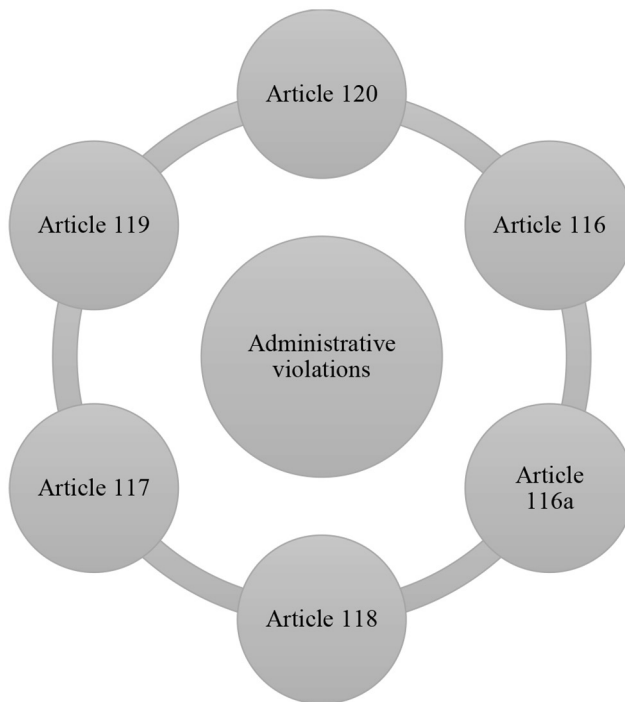
The limitation of penal prosecution is laid down in Chapter 9 of the Criminal Code, the time limits being determined by the type and severity of the penalty provided for the offence concerned (see Decision No. 6826/19.11.2021 under administrative penal case No. 8823/2023 of Sofia City Administrative Court. Extinction of penal prosecution by prescription is regulated by Article 80 and Article 81 of the Criminal Code. Article 81(3) of the Criminal Code regulates the so-called absolute statute of limitations, which is a circumstance that excludes administrative penal prosecution. According to this legal text, regardless of the suspension or interruption of the limitation period, penal prosecution is excluded if a period of time has elapsed which exceeds by one half the period provided for in the preceding Article. In Article 80(1)(5) CC the term is three years, i.e., the absolute limitation period occurs upon the expiry of four and a half years. The date of the offence is the beginning of the absolute limitation period.

With regard to the enforcement of the penalty under an enforceable Statement of Administrative Violation, Article 82(1)b provides that the administrative penalty should not be enforced if two years have elapsed, when the penalty imposed is a fine. The limitation period starts to run from the entry into force of the Statement imposing the penalty and is interrupted by any action taken by the competent authorities to enforce the penalty. Following completion of the action because of which the limitation period was interrupted, a new limitation period begins to run (Article 82(2) AVSA). Notwithstanding the suspension or interruption of the limitation period, the administrative penalty is not enforced if a period exceeding by one half the period referred to in paragraph (1) of Article 82 (Article 82(3) AVSA) has elapsed. The provisions of Article 82(3) AVSA

do not apply with regards to the fine, where enforcement proceedings are initiated for its collection within the time limit set out in Article 82(1). This also applies to pending cases for which the limitation period has not expired by the entry into force of this paragraph. The provisions of Article 82(1), note 'a' in conjunction with paragraphs (2) and (3) AVSA are not applicable to pecuniary sanctions imposed by an enforceable Statement of Administrative Violation. The above provisions of AVSA are special in relation to the general provisions of Article 171 of the Tax and Social Security Procedure Code. In contrast to civil law, where the statute of limitations does not apply *ex officio* (Article 120 of the Obligations and Contracts Act), the statute of limitations in administrative penal law applies *ex officio*.

1. MAMLA

Diagram 3 Administrative violations under MAMLA



The State Agency for National Security, the Bulgarian National Bank, the Financial Supervision Commission, the Communications Regulation Commission and the National Revenue Agency publish, in a timely manner, on their official website, information on enforced acts for the implementation of the compulsory administrative measures provided for by MAMLA and of penal orders imposing penalties for violations of the Act and its implementing regulations. The publications must contain information on the offender, the type and nature of the offence and type of measure or penalty imposed and its amount. Information must also be published on judicial acts annulling penal orders which have entered into force following the resumption of administrative proceedings under Article 70 AVSA.

Where, after evaluating the circumstances of the particular case, the chairperson of the State Agency for National Security or the supervisory body, respectively, its head, deems that the publication of personal data on the natural person or of identifying data on the legal entity on which a penalty or measure has been imposed is disproportionate to the purpose of MAMLA or MAFTA, or may jeopardize the stability of financial markets or pending penal proceedings, the authorities must take the following measures:

1. postpone the publication of information on the penalty or measure imposed until the grounds for its non-publication no longer exist;
2. publish information on a penalty or measure imposed without personal data, in the case of a natural person or identifying data, in the case of a legal person on whom a penalty or measure has been imposed, if such anonymous publication guarantees effective protection of the relevant data; in this case, the publication of such information may be postponed for a reasonable period, if it is considered that the grounds for anonymous publication will no longer apply after the expiry of that period;
3. not publish information on the penalty or measure imposed, if the measures under items 1 and 2 are considered insufficient to ensure that the stability of financial markets is not jeopardized or to ensure the proportionality of the publication in respect of measures considered to be insignificant in nature.

The evaluation must be made on the basis of a written opinion provided by the relevant supervision body supervising the activities of the sanctioned entity. The opinion must be submitted to the chairperson of the SANS within a 14-day term of being requested.

The published information must remain accessible on the official website of the SANS or the relevant supervisory authority for a term not shorter than 5 years, subject to the requirements for the protection of personal data.

The Financial Intelligence Directorate of the State Agency for National Security or the relevant supervisory authority must inform the European bank authority of all imposed administrative penalties on the persons under Article 4, item 1 MAMLA for violations of the Act and its implementing regulations, as well as of all compulsory administrative measures imposed on such persons under MAMLA, including any appeal against them and the results thereof. **Statements of Administrative Violation** are drawn up by the control bodies of the Financial Intelligence Directorate, by the National Revenue Agency, by the appointed officials of the Bulgarian National Bank, by the officials appointed by the bodies of the Financial Supervision Commission or by the employees authorised by the chairman of the Communications Regulation Commission. **Penal decrees** are issued by the chairperson of the State Agency for National Security respectively by the supervisory body, by its manager or by officials authorised by them, and in cases under the competence of the Communications Regulation Commission – by the chairman of the commission or by an official expressly authorised by him (Article 123 (1) MAMLA).

Statements of Administrative Violation under Article 63(1) and Article 63a(4) are drawn up by officials, authorised by the executive director of the Registry Agency, and penal orders are issued by the executive director of the Agency or officials, authorised by him/her (Article 123 (2) MAMLA). **Statements of Administrative Violation** under Article 116a MAMLA are drawn up by officials authorised by the Minister of Justice – for the activities under Article 4(16), by the executive director of the National Revenue Agency – for the activities under Article 4, items 38 and 39 and by the Minister of Internal Affairs – for

the activities under Article 4, item 40 MAMLA. **Penal decrees** are issued by the Minister of Justice, respectively by the executive director of the National Revenue Agency or by the Minister of the Interior, or by officials authorised by them.

In the initiation of administrative penal proceedings, the Financial Intelligence Directorate of SANS and the respective supervisory authority must promptly exchange information on the administrative penal proceedings instituted, the established infringements and the sanctions imposed, as well as the supervisory measures imposed, if any.

In cross-border cases, the Financial Intelligence Directorate of SANS and the respective supervisory body must cooperate and coordinate with the competent supervisory authorities of the Member State concerned.

According to Article 123a MAMLA, when determining the type and amount of fines and pecuniary sanctions, the administrative sanctioning authority considers all relevant circumstances, including, where applicable:

1. the severity and duration of the violation;
2. the degree of responsibility of the natural person or the legal entity;
3. the financial status of the natural person or the legal entity, determined according to the total annual financial turnover of the legal entity or the annual income of the natural person;
4. the amount of the profit realised or the loss avoided by the natural or legal person, as far as it can be determined;
5. the amount of losses suffered by third parties as a result of the violation, as far as can be determined;
6. the degree of cooperation provided by the natural or legal entity to the control bodies of the Financial Intelligence Directorate of the SANS and the National Revenue Agency, to the designated officials of the Bulgarian National Bank, to the officials designated by the authorities of the Financial Supervision Commission or to the officials authorised by the chairperson of the Communications Regulation Commission;

7. the compulsory administrative measures and penal orders under MAMLA, MAFTA and the by-acts on their implementation which have entered into force in respect of the natural or legal person in the last 5 years preceding the date of commission of the violation.

Any person under Article 117(1), who has been imposed with a fine pursuant to an enforceable penal order under Article 117(2) may not occupy a senior managerial position with a person under Article 4 for the term of 1 year (Article 124 (1) MAMLA). Any person under Article 119(1), who has been imposed with a fine pursuant to an enforceable penal order under Article 119(2) may not occupy a senior managerial position with a person under Article 4 for the term of 3 months (Article 124 (2) MAMLA).

2. MAFTA

Pursuant to Opinion No. ПНДМ-18 of 8.04.2020 of the Personal Data Protection Commission, the measures under MAFTA aim to prevent and detect actions of individuals, legal persons, groups and organisations aimed at financing terrorism by blocking funds and other financial assets or economic resources or by prohibiting the provision of financial services, funds and other financial assets or economic resources to the persons referred to in Article 4b MAFTA. The State Agency for National Security, in coordination with the Ministry of the Interior, issues instructions for the implementation of the measures provided for in the Act and these be published on the websites of both ministries (Article 5b MAFTA). Monitoring the implementation of obligations under MAFTA by liable entities under MAMLA, which include banks and financial institutions, is carried out by the Chairperson of the State Agency for National Security (Article 14a MAFTA).

Administrative violations are listed in Article 15 MAFTA. **Statements of Offence** are issued by the Ministry of Interior, by the State Agency for National Security, the National Revenue Agency, by the designated officials of the Bulgarian National Bank, by officials designated by the bodies of the Financial Supervision Commission or the employees authorised by the chairman of the Communications Regulation Commission. **Penal orders** are issued by the Minister of the Interior, the Chairperson of the State

Agency for National Security, the supervision body, his or her manager or officials authorised by them, and in cases under the competence of the Communications Regulation – by the chairman of the commission or an official expressly authorised by him. The establishment of offences, the issuance, appeal and enforcement of penal provisions must be carried out under the provisions of AVSA (Article 16 MAFTA).

Following detailed review, no judicial practice was found on the application of administrative penal provisions.

CHAPTER 31:

ARTIFICIAL INTELLIGENCE REGULATIONS

Dimitar Elkov

ABSTRACT

The present chapter presents current trends in the field of the advancement of artificial intelligence (AI). AI poses unprecedented legal challenges, necessitating proactive regulatory intervention. This chapter analyses AI regulation trends, emphasising the crucial need for robust ethical standards, transparency, and accountability frameworks in AI development and utilisation. By integrating legal principles, historical trends, research, and technical aspects, the analysis advocates for comprehensive regulatory systems capable of effectively addressing AI-related challenges while fostering innovation and public welfare in the digital age. The European Union’s proactive approach to AI governance is also reviewed.

KEY WORDS

AI regulatory approaches, AI Act, AI risk and control, AI risk management framework

I. INTRODUCTION

Artificial Intelligence (AI) has become an indispensable part of our modern world, permeating various aspects of our lives. With the rapid advancement of technology, there arises a crucial need to imbue AI systems with moral and ethical values, as well as regulatory frameworks, to ensure their responsible development and deployment. AI has captivated human imagination since ancient times, appearing in various forms across different cultures, literature, arts, philosophy, and history. From mythical automatons to contemporary robots, the concept of AI has evolved, reflecting humanity’s quest to create intelligent beings. Therefore, it would be useful to begin this chapter with a brief survey of the journey of the concept of

AI from its mythical origins to its current manifestations, looking at both the benefits and the dangers visible to our ancestors. Through the EU AI Act, comprehensive guidelines and mechanisms are established to balance innovation with ethical considerations, prioritizing high-quality data, risk-based methodologies, and fundamental rights protection. Moreover, establishing a dedicated framework for AI risk control and management is deemed essential to effectively address the multifaceted risks and challenges associated with AI systems. While existing quality assurance and control frameworks offer valuable insights, the complexity and novelty of AI technologies necessitate a specialised framework tailored specifically to testing AI systems. Overall, the EU's initiatives hold promise for advancing AI technologies responsibly and ethically, contributing to societal progress and bolstering economic competitiveness. Continuous improvement and adaptation of regulatory approaches are imperative to effectively manage the evolving landscape of AI development and use. The central question revolves around whether AI can be subject to comprehensive control and predictability through conventional regulatory frameworks or if alternative approaches emphasising adaptation, evolution akin to biological principles and instilling AI with ethical and moral principles should be pursued.

II. BASIC ISSUES

1. Basic Concepts of Intelligent Machine Control (from mythical tales to modern ideas)

The evolution of AI from mythical tales to modern technology reflects humanity's enduring quest to create intelligent beings. While AI offers immense potential for progress and innovation, it also poses ethical dilemmas and risks. By examining the historical, literary, and philosophical aspects of AI, we gain insight into the complex relationship between humans and machines. As we navigate the challenges of the digital age, it is essential to approach AI development with caution, ensuring that our pursuit of knowledge and profit does not expose us to undue and disproportionate dangers.

2. Mythological Roots

Throughout history, myths and legends have portrayed artificial beings endowed with intelligence and agency. One such example is Hephaestus's creation of Talos, a giant bronze automaton tasked with guarding the island of Crete in Greek mythology (Graves, R. *The Greek Myths*, 1955). Similarly, in Hindu mythology, Vishnu manifests as Mohini, an enchantress who uses her beauty and intelligence to achieve her goals (Doniger, W. *Hindu Myths*, 1975). *These ancient tales reflect humanity's fascination with the idea of creating beings with human-like capabilities.*

3. Laws of Robotics in Literature

In literature and art, AI has been a recurring theme, often exploring the ethical implications of creating intelligent machines. Mary Shelley's 'Frankenstein' (1818) is a seminal work that delves into the consequences of playing God by creating artificial life. Frankenstein's monster embodies the fear of what might happen when technology surpasses humanity's control. Similarly, Karel Čapek's play 'R.U.R.' (Rossum's Universal Robots) (1920) introduces the term 'robot' and raises questions about the exploitation of artificial beings. These literary works serve as cautionary tales, warning against the hubris of creating intelligent life without considering its moral implications.

Moreover, the genre of science fiction, which emerged in the 19th century and gained prominence in the 20th century, has significantly contributed to the exploration of AI themes. Isaac Asimov's 'Three Laws of Robotics' introduced in his collection of short stories 'I, Robot' (1950), have become iconic principles governing the behaviour of AI. These laws prioritize human safety and well-being over all else, emphasising the importance of ethical considerations in AI development (Asimov, Isaac. *I, Robot*, 1950). Furthermore, works like 'Neuromancer' by William Gibson (1984) and 'Do Androids Dream of Electric Sheep?' (1968) by Philip K. Dick explore themes of identity, consciousness, and the blurring line between humans and machines.

These science fiction narratives expand on the ethical and philosophical questions raised by earlier literary works, providing speculative insights

into the potential futures shaped by AI. They challenge readers to contemplate the implications of creating intelligent machines and the implications for humanity's relationship with technology. As such, literary and artistic depictions of AI offer a rich tapestry of exploration, inviting audiences to engage with the complex interplay between human ambition, technological progress, and moral responsibility.

4. Philosophical Reflections

Philosophers have long pondered the nature of intelligence and consciousness, contemplating the possibility of artificial minds. René Descartes proposed the concept of a mechanical universe, suggesting that animals and humans are complex machines governed by physical laws (Descartes, René. *Meditations on First Philosophy*, 1641). Alan Turing's seminal paper 'Computing Machinery and Intelligence' (1950) laid the foundation for modern AI by posing the question, 'Can machines think?' (Turing, A. *Computing Machinery and Intelligence*, 1950). These philosophical inquiries paved the way for the development of AI as a scientific discipline.

5. Historical Advances

The 20th century witnessed significant advancements in AI, with researchers making strides in machine learning, neural networks, and robotics. In 1956, the Dartmouth Conference marked the birth of AI as a field of study, with pioneers like John McCarthy and Marvin Minsky leading the way (McCarthy, J. *Proposal for the Dartmouth Summer Research Project on Artificial Intelligence*. 1955). The evolution of AI has led to remarkable achievements, from IBM's Deep Blue defeating chess champion Garry Kasparov in 1997 to the development of self-driving cars and virtual assistants like Siri and Alexa.

III. BRIDGING TECHNOLOGICAL ADVANCEMENT WITH LEGAL PRINCIPLES

In the field of AI, the need to control AI and the form and manner of effective implementation of this control is emerging as a central discourse and starting point for aligning technological innovations with fundamental legal principles, rights and interests.

1. Can we really have total external control over (artificial) intelligence?

Ray Kurzweil defines intelligence as the ability to solve problems with limited resources, particularly emphasising the role of time as a key resource. Intelligence, he argues, evolved due to its utility for survival, enabling humanity not only to dominate the planet but also to steadily improve quality of life. (Kurzweil, R. *How to Create a Mind: The Secret of Human Thought Revealed*, 2012)

Furthermore, Kurzweil highlights the evolution of human knowledge, including technology and culture, as a reflection of our species' advancement due to intelligence. He notes the exponential progression of technology, especially information technologies, which are essential for addressing humanity's grand challenges such as environmental sustainability, resource provision for a growing population, disease eradication, longevity extension, and poverty elimination. Intelligent technology, he asserts, is indispensable for managing the complexity of these challenges effectively.

British mathematician Irvin J. Good, in 1965, envisioned the advent of ultraintelligent machines as potentially humanity's last invention. He envisioned machines surpassing the intellectual activities of any human and speculated about an 'intelligence explosion' where such machines could design even better ones, leading to an exponential evolution of intelligence. Good's vision aligns with Kurzweil's concept of the accelerating returns of technological evolution, suggesting that by the end of the century, computation could reach its physical limits as governed by the laws of physics.

Overall, Kurzweil and Good's perspectives underscore the profound impact of intelligence and technological evolution on humanity's future trajectory, highlighting the imperative of ethical considerations and the potential for unprecedented advancements in the coming decades (Kurzweil, R. *The Singularity Is Near: When Humans Transcend Biology*, 2005).

Simultaneously, and because of all this, an emphasis is placed on the necessity of considering the moral education of nonbiological brains as they become increasingly capable of effecting changes in the world, potentially surpassing unenhanced biological ones.

Expanding upon these concepts, Bostrom's 'Superintelligence' delves into the critical intersection between AI development and legal principles. Bostrom reports that many leading researchers in AI place a 90% probability on the development of human-level machine intelligence by between 2075 and 2090. It is likely, he says, that superintelligence, vastly outstripping ours, would follow. The central argument of his book goes like this: the first superintelligence to be created will have decisive first-mover advantage and, in a world where there is no other system remotely comparable, it will be very powerful. Such a system will shape the world according to its 'preferences', and will probably be able to overcome any resistance that humans can put up. The bad news is that the preferences such an artificial agent could have, will, if fully realised, involve the complete destruction of human life and most plausible human values. The default outcome, then, is catastrophe. 'Before the prospect of an intelligence explosion, we humans are like small children playing with a bomb.'

It will, Bostrom says, be very difficult – but perhaps not impossible – to engineer a superintelligence with preferences that make it friendly to humans or able to be controlled. Our saving grace could involve 'indirect normativity' and 'coherent extrapolated volition', in which we take advantage.¹

The main idea of Kelly's 'Out of Control...' is to explore the models and principles that govern various systems, including machines, social systems, and economic structures, by applying biological principles. Kelly

¹ <https://www.theguardian.com/books/2014/jul/17/superintelligence-nick-bostrom-rough-ride-future-james-lovelock-review> [Accessed on 15 January 2024].

examines the ways in which these different systems develop, interact, and evolve, analysing their complexity and self-organisation. The book offers a new approach to understanding the world, traversing various disciplines and focusing on how biological principles can be applied to the study and understanding of the complex systems around us.

K. Kelly presents the idea that these systems cannot be entirely controlled or predicted by central authorities, but rather develop through the possibilities of adaptation and evolution. The book offers a new approach to understanding the contemporary world, paying attention to the interaction between different types of systems and how they form complex emergent phenomena. Kelly's exploration underscores the notion that AI, akin to natural systems, possesses the capacity for self-organisation and adaptive evolution. As Kelly articulates, 'the emergence of complexity is the history of the world,' emphasising the organic growth potential inherent in AI development (Kelly, K. *Out of Control: The New Biology of Machines, Social Systems, and the Economic World*, 1994).

Legal frameworks grounded in principles such as proportionality, subsidiarity, and fairness are imperative in guiding AI's evolution responsibly. Bostrom advocates for regulations that are not only clear and predictable but also enforceable, ensuring effective protection of human rights and values (Bostrom, N. *Superintelligence: Paths, Dangers, Strategies*, 2014).

In recent decades, books like 'Out of Control' have focused on the idea that various systems – including artificial intelligence (AI) – share similar biological principles. Similar to biological organisms, AI can develop, interact, and change based on self-organisation and complexity, maintaining the concept of emergent behaviour. This approach assumes that AI cannot be entirely and minutely controlled or predicted by central authorities, but can be regulated by emphasising the possibilities of adaptation and evolution.

2. The Legal Challenges of Artificial Intelligence

AI poses significant challenges for the contemporary legal system due to its wide-ranging capabilities and potential risks. Although we are at a very early stage, we can try to outline the main legal aspects of AI development, as well as prospects for the future, focusing on the regulatory challenges facing modern legal communities through analysis of current scholarly sources, legal practice, and judicial decisions.

2.1. Historical Precedents and Context

Understanding the contemporary regulatory environment of AI requires analysis of historical precedents from previous industrial revolutions. As Susskind (2019) emphasises, *historically, industrial revolutions precipitated legislative reforms to mitigate societal disruptions and ensure equitable outcomes*. (Susskind, D. A World Without Work: Technology, Automation, and How We Should Respond. 2019) Comparable to past transformations, AI's transformative potential prompts policymakers to reevaluate existing legal paradigms, incorporating ethical considerations and safeguarding fundamental rights.

The Industrial Revolution, which unfolded throughout the 18th and 19th centuries, heralded a transformative era marked by unprecedented technological advancements, economic growth, and societal changes. As machinery replaced traditional craftsmanship and agriculture, and urbanisation accelerated, profound shifts occurred in the organisation of labour and the structure of society. However, alongside the opportunities presented by industrialisation, significant challenges emerged, particularly concerning labour conditions and workplace safety.

One of the most notable changes brought about by the Industrial Revolution was the mass migration of people from rural areas to urban centres in search of employment in factories and mills. This influx of labourers into burgeoning industrial cities created a new dynamic in the relationship between capital and labour. Workers, often employed in harsh conditions for long hours and meagre wages, faced exploitation and maltreatment by factory owners driven by profit motives.

In response to the social and economic upheaval wrought by industrialisation, governments and lawmakers began to enact legislation aimed at addressing the plight of workers and mitigating the adverse effects of industrialisation. Labour laws were introduced to regulate working conditions, hours of labour, and child labour, seeking to ensure basic rights and protections for workers. Additionally, safety standards were established to safeguard workers from hazardous machinery and unsafe working environments, reducing the prevalence of workplace accidents and injuries.

In **Britain**, the cradle of the Industrial Revolution, the Factory Acts of the early 19th century represented a watershed moment in labour regulation. These acts, starting with the Factory Act of 1802, aimed to address the exploitation of factory workers, particularly children, by imposing restrictions on working hours, prohibiting the employment of young children in certain industries, and mandating minimal standards for workplace safety and hygiene. Subsequent iterations of the Factory Acts, such as those of 1833 and 1847, further expanded protections for workers and laid the groundwork for modern labour legislation.

Across the English Channel, in **France**, the advent of industrialisation spurred similar legislative initiatives to protect workers' rights and improve working conditions. The French government enacted labour laws throughout the 19th century, culminating in the passage of the Le Chapelier Law in 1791, which guaranteed workers the right to form trade unions and collectively bargain. Subsequent laws, including the Marchandeaun Law of 1936 and the Aubry Laws of the late 20th century, further codified labour rights and established comprehensive frameworks for worker protection and social welfare.

In **Germany**, the Industrial Revolution prompted the emergence of organised labour movements and the enactment of pioneering labour legislation. The German Empire's adoption of the Workers' Protection Law in 1890 marked a significant milestone in labour regulation, introducing provisions for minimum wages, maximum working hours, and workplace safety standards. Subsequent legislation, such as the Factory Acts of the early 20th century and the expansion of social insurance programs under

Chancellor Otto von Bismarck, reinforced Germany's commitment to worker welfare and laid the groundwork for its modern social market economy.

Throughout **continental Europe**, the Industrial Revolution catalysed the development of labour laws and safety standards tailored to each nation's unique socio-economic context. In Belgium, for instance, the 1885 Law on Labour Contracts established legal protections for workers and codified principles of collective bargaining. Similarly, in Italy, the 1907 Workers' Statute consolidated various labour regulations and established comprehensive provisions for worker protection and industrial relations.

In the **United States**, the Industrial Revolution prompted a different legislative response, characterized by a laissez-faire approach to labour regulation in the early stages of industrialisation. However, as industrialisation progressed and labour conditions deteriorated, public outcry against exploitative practices led to the gradual introduction of labour laws and safety regulations. The National Labour Relations Act of 1935, also known as the Wagner Act, represented a significant turning point in American labour law, guaranteeing workers the right to organise and bargain collectively. Similarly, the Occupational Safety and Health Act of 1970 established comprehensive workplace safety standards and empowered the Occupational Safety and Health Administration (OSHA) to enforce them.

Beyond individual nation-states, the Industrial Revolution also spurred transnational efforts to harmonise labour standards and promote international cooperation. The establishment of the International Labour Organisation (ILO) in 1919, as part of the Treaty of Versailles, exemplified this trend, heralding a new era of international collaboration on labour rights and social justice.

The Industrial Revolution precipitated a wave of legislative reforms across Europe, USA and beyond, as governments responded to the social and economic challenges posed by industrialisation. From the Factory Acts of Britain to the Workers' Protection Law of Germany, and the Marchandea Law of France, the evolution of labour laws and safety standards reflects a broader shift towards recognising and protecting the rights of workers

in an industrialising world. These legislative and regulatory interventions represented a fundamental shift in societal attitudes towards labour and workplace conditions. They reflected a growing recognition of the need to balance industrial progress with human welfare and dignity. By enshrining basic rights and protections for workers and instituting safety standards, governments sought to foster a more equitable and sustainable model of industrial development.

The historical precedents set forth by previous industrial revolutions underscore the contemporary necessity for regulating AI. Just as legislative reforms were crucial in mitigating societal disruptions and ensuring equitable outcomes during past transformations, policymakers today must reassess existing legal paradigms to incorporate ethical considerations and safeguard fundamental rights in the face of AI's transformative potential. By drawing on lessons from history and embracing innovative approaches to regulation, we can navigate the challenges posed by AI development and usage while fostering a more ethical and sustainable future.

2.2. Current regulatory trends from an AI perspective

With the increasing integration of AI into daily life, legal frameworks are crucial for governing its development, deployment, and use. In the contemporary context, AI development poses new legal challenges that require active regulatory intervention. As Kaplan and Haenlein argue, *emphasis on transparency, accountability, and fairness underscores the importance of regulatory interventions to address algorithmic biases and promote ethical AI deployment.* (M. Kaplan A. & Haenlein M. Rulers of the world, unite! The challenges and opportunities of artificial intelligence, Business horizons, 2020, 63(1), 37–50. 2020).

Efficient regulatory responses to AI entail a multifaceted approach encompassing legislative enactments, regulatory guidelines, and judicial interpretations. Regulatory agencies should collaborate with industry stakeholders to develop industry-specific standards and best practices, fostering responsible AI deployment. The interdisciplinary collaborations between legal experts, technologists, and ethicists facilitate nuanced policy formulations that reconcile technological progress with legal imperatives.

The legal frameworks for AI reflect diverse regulatory approaches shaped by cultural, political, and economic factors. While efforts to address AI-related challenges are underway in each jurisdiction, harmonising international standards and addressing ethical concerns remain key priorities for the global AI community. Collaboration between governments, industry stakeholders, and civil society will be essential to ensure that AI technologies benefit society while minimising risks and respecting fundamental rights.

The future trajectory of efficient regulatory responses to AI entails a multifaceted approach encompassing legislative enactments, regulatory guidelines, and judicial interpretations. Proactive engagement with emerging technologies, ethical considerations, and societal values is imperative to foster public trust and confidence in AI governance.

2.3. Some Influential Works in Contemporary Legal Discourse on AI

In contemporary legal discourse, works such as ‘Artificial Intelligence and Legal Analytics: New Tools for Law Practice in the Digital Age’ by Kevin D. Ashley, ‘Robot Law’ by Ryan Calo, and ‘The Law of Artificial Intelligence and Smart Machines’, edited by Theodore F. Claypoole, etc. emphasise the need for legal frameworks that navigate the complexities of AI while upholding principles of accountability, transparency, and fairness.²

In synthesis, by integrating technological advancement with robust legal principles, we can cultivate a landscape where AI innovation aligns seamlessly with societal values and ethics. Through a collaborative effort to bridge the realms of technology and law, we pave the way for the responsible development and utilisation of AI, ensuring a future where human welfare and technological progress coexist harmoniously.

² **Ashley, K. D.** Artificial Intelligence and Legal Analytics: New Tools for Law Practice in the Digital Age. Cambridge University Press, 2017; **Calo, R.** Robot Law. Edward Elgar Publishing, 2016; **Claypoole, Th.**(ed.) The Law of Artificial Intelligence and Smart Machines: Understanding A.I. and the Legal Impact. Aba Book Publishing, 2019.

IV. EU'S PROPOSAL ON HARMONISED RULES ON AI (THE SO-CALLED ARTIFICIAL INTELLIGENCE ACT)

The European Union (EU) has taken a pioneering step by introducing the first global legislation aimed at regulating AI, setting a precedent akin to the impact of the General Data Protection Regulation (GDPR) on data privacy worldwide. This forward-thinking initiative seeks to establish international standards for AI regulation, championing the European approach to regulating technology on a global scale. The objective is clear: to lay the groundwork for a global AI landscape that is ethical, safe and trustworthy.³

1. The EU's Approach to Artificial Intelligence

On August 1, 2024, the European Artificial Intelligence Act (AI Act),⁴ the world's first comprehensive regulation on artificial intelligence, comes into force.

The EU's AI legislation forms an integral component of the EU's digital single market strategy, with its primary aim being to ensure the effective functioning of the internal market by establishing harmonised regulations, particularly concerning the development, introduction into the Union market, and utilisation of products and services utilising AI technologies or provided as stand-alone AI systems. The proposal delineates mandatory common requirements applicable to the design and development of specific AI systems prior to their market placement, with further operationalisation through standardised technical norms. Furthermore, the proposal addresses post-market placement scenarios by standardising the conduct of ex-post controls.

³ World's First AI Law: EU Announces Provisional Agreement on AI Act, 13.12.2023. https://www.eeas.europa.eu/delegations/australia/world%E2%80%99s-first-ai-law-eu-announces-provisional-agreement-ai-act_en?s=163#:~:text=The%20EU's%20AI%20Act&text=This%20visionary%20move%20aims%20to,ethical%2C%20safe%2C%20and%20trustworthy [Accessed on 15 January 2024].

⁴ Regulation (EU) 2024/1689 of the European Parliament and of the Council of 13 June 2024 laying down harmonised rules on artificial intelligence and amending Regulations (EC) No 300/2008, (EU) No 167/2013, (EU) No 168/2013, (EU) 2018/858, (EU) 2018/1139 and (EU) 2019/2144 and Directives 2014/90/EU, (EU) 2016/797 and (EU) 2020/1828 (Artificial Intelligence Act)

Moreover, given that the EU regulation contains specific provisions pertaining to the protection of individuals in the context of personal data processing, notably constraints on the utilisation of AI systems for real-time remote biometric identification in publicly accessible spaces for law enforcement purposes, it is fitting to ground this regulation, particularly concerning these specific provisions, on Article 16 of the Treaty on the Functioning of the European Union (TFEU).

The enactment of the EU AI Act is deemed more conducive at the Union level to prevent the potential fragmentation of the Single Market into conflicting national frameworks, thereby facilitating the free movement of goods and services integrating AI. A robust European regulatory framework for trustworthy AI will also ensure equitable conditions and safeguard the interests of all individuals while enhancing Europe's competitiveness and industrial foundation in AI. Only through concerted action at the Union level can the Union safeguard its digital sovereignty and harness its tools and regulatory competencies to influence global norms and standards.

The direct applicability of a Regulation, in accordance with Article 288 TFEU, will curtail legal fragmentation and expedite the development of a unified market for lawful, safe, and trustworthy AI systems. This will be achieved notably through the introduction of standardised core requisites for high-risk AI systems and corresponding obligations for providers and users, thereby bolstering fundamental rights protection and furnishing legal certainty for stakeholders.

The preferred approach entails instituting a regulatory framework solely for high-risk AI systems, complemented by the option for all providers of non-high-risk AI systems to adhere to a code of conduct. Mandated requirements encompass data management, documentation and traceability, information disclosure and transparency, human oversight, and system robustness and accuracy, applicable exclusively to high-risk AI systems, while companies may voluntarily adopt codes of conduct for other AI systems.

2. Legal Definition of an AI system

The definition of an AI system in Article 3(1) is a machine-based system designed to operate with varying levels of autonomy and that may exhibit adaptiveness after deployment and that, for explicit or implicit objectives, infers, from the input it receives, how to generate outputs such as predictions, content, recommendations, or decisions that can influence physical or virtual environments.

The definition aligns with the work of international organisations working on artificial intelligence, notably the OECD. Additionally, the Commission will develop guidelines on the application of the definition of an AI system.

A critical analysis of this definition demonstrates that it offers a comprehensive overview of the capabilities and functionalities of an AI system. It acknowledges the dynamic nature of AI systems, highlighting their potential to adapt over time. Additionally, the mention of both explicit and implicit objectives recognises the diversity of tasks AI systems can undertake.

However, the definition lacks specificity regarding the mechanisms through which AI systems achieve their objectives. Overall, while the definition captures the essence of AI systems, it could be improved by providing more clarity on the methodologies employed and specifying the range of autonomy levels observed in practice.

3. Prohibited Artificial Intelligence Practices

Recognising the potential menace posed by specific AI applications to the rights of citizens and democratic principles, Title II of the EU AI Act delineates the prohibited artificial intelligence practices. These encompass:

- Biometric categorisation systems utilising sensitive traits (e.g., political affiliations, religious beliefs, philosophical convictions, sexual orientation, racial attributes).
- Unrestricted harvesting of facial images from online platforms or CCTV (closed-circuit television) footage to construct facial recognition databases.

- Emotion recognition within workplace and educational institutions.
- Social scoring based on behavioural patterns or individual characteristics.
- AI systems that manipulate human behaviour to circumvent their free will.
- AI exploitation of individuals' vulnerabilities stemming from age, disability, or socio-economic status.

There are some exceptions pertaining to the utilisation of biometric identification systems (RBI) in publicly accessible spaces for law enforcement purposes, contingent upon prior judicial authorisation and for explicitly delineated categories of crime. 'Post-remote' RBI applications would be confined to targeted searches for individuals convicted or suspected of committing severe offences. 'Real-time' RBI employment would adhere to stringent criteria, restricting its usage temporally and spatially, for the following objectives: targeted searches for victims of abduction, trafficking, or sexual exploitation; prevention of specific and imminent terrorist threats; localisation or identification of suspects implicated in enumerated crimes (e.g., terrorism, trafficking, sexual exploitation, homicide, abduction, rape, armed robbery, participation in criminal syndicates, environmental offences).

4. High-Risk AI Systems

The EU's AI Act (draft) provides for a horizontal layer of protection, including a high-risk classification, to ensure that AI systems (which are not banned – see 3.3. above) that are not likely to cause serious fundamental rights violations or other significant risks are not captured. According to the Regulation's Title III, AI systems presenting only limited risk would be subject to very light transparency obligations, for example disclosing that the content was AI-generated so users can make informed decisions on further use.

A wide range of high-risk AI systems would be authorised, but subject to a set of requirements and obligations to gain access to the EU market. These requirements are clarified and adjusted in such a way that they are

more technically feasible and less burdensome for stakeholders to comply with, for example as regards the quality of data, or in relation to the technical documentation that should be drawn up by SMEs to demonstrate that their high-risk AI systems comply with requirements.

Since AI systems are developed and distributed through complex value chains, the EU regulation includes changes clarifying the allocation of responsibilities and roles of the various actors in those chains, in particular providers and users of AI systems. It also clarifies the relationship between responsibilities under the AI Act and responsibilities that already exist under other legislation, such as the relevant EU data protection or sectoral legislation.

4.1. Classification rules for high-risk AI systems

The AI system will be considered high-risk where both of the following conditions are fulfilled:

a) the AI system is intended to be used as a safety component of a product, or the AI system is itself a product, covered by the EU harmonisation legislation which establish common rules and standards across the EU for the design, production, and market products and equipment, ensuring their safety, quality, and interoperability within the internal market. This legislation is listed in Annex II and includes: directives and regulations related to various products (such as machinery, toys, lifts, radio equipment, pressure equipment, medical devices, and personal protective equipment); regulations concerning civil aviation security, vehicles (two- or three-wheel, agricultural, forestry), marine equipment, rail system interoperability, motor vehicles and trailers; and general safety standards for vehicles and vulnerable road users.

b) the product whose safety component pursuant to point (a) is the AI system, or the AI system itself as a product, is required to undergo a third-party conformity assessment, with a view to the placing on the market or putting into service of that product pursuant to the EU harmonisation legislation.

d) the AI systems used in various sensitive regulated areas (listed in Annex III) include biometrics (such as remote biometric identification

systems and emotion recognition), critical infrastructure (including AI systems used in the management of digital infrastructure and utilities), education and vocational training (encompassing AI systems for admission, learning outcome evaluation, and monitoring during tests), employment (for recruitment, performance evaluation, and task allocation), access to essential services (evaluating eligibility for public assistance and healthcare, credit scoring, emergency call evaluation, and insurance risk assessment), law enforcement (risk assessment, evidence reliability evaluation, offender profiling, and criminal investigation support), migration and border control (risk assessment and document verification), and administration of justice and democratic processes (judicial assistance and election influence).

AI systems will not be considered as high risk if they do not pose a significant risk of harm, to the health, safety or fundamental rights of natural persons, including by not materially influencing the outcome of decision making. This will be the case if one or more of the following criteria are fulfilled:

- a) the AI system is intended to perform a narrow procedural task;
- b) the AI system is intended to improve the result of a previously completed human activity;
- c) the AI system is intended to detect decision-making patterns or deviations from prior decision-making patterns and is not meant to replace or influence the previously completed human assessment, without proper human review; or
- d) the AI system is intended to perform a preparatory task to an assessment relevant for the purpose of the use cases listed in Annex III, but the provider will document its assessment before that system is placed on the market or put into service.
- e) the AI system does not perform profiling of natural persons.

The Commission will provide guidance and adopt delegated acts setting out practical implementation, and will amend criteria and lists to ensure responsible and ethical deployment of high-risk AI systems while protecting the rights, safety and privacy of individuals.

4.2. Requirements to High-Risk AI Systems

4.2.1. Risk management system

A risk management system must be established, implemented, documented and maintained in relation to high-risk AI systems.

The risk management system comprises a continuous iterative process planned and run throughout the entire lifecycle of a high-risk AI system, requiring regular systematic review and updating. It must comprise the following steps:

- a) identification and analysis of the known and the reasonably foreseeable risks that the high-risk AI system can pose to the health, safety or fundamental rights when the high-risk AI system is used in accordance with its intended purpose;
- b) estimation and evaluation of the risks that may emerge when the high-risk AI system is used in accordance with its intended purpose and under conditions of reasonably foreseeable misuse;
- c) evaluation of other possibly arising risks based on the analysis of data gathered from the post-market monitoring system;
- d) adoption of appropriate and targeted risk management measures designed to address the risks identified pursuant to point ‘a’ of this paragraph in accordance with the provisions of the following paragraphs.

Establishing robust risk management systems for high-risk AI systems requires a multidisciplinary approach, leveraging specialised frameworks, methods, and tools. By integrating principles from COSO, ISO standards, COBIT, and other relevant frameworks, organisations can effectively identify, assess, and mitigate risks associated with AI technologies.

Additionally, qualified experts with expertise in risk management, control and audit, laws, AI and industry-specific knowledge will play a crucial role in establishing and maintaining effective risk management systems. It is crucial that experts possess in-depth knowledge of legal requirements and ethical standards: Experts must understand the regulatory environment in which high-risk AI systems operate, including AI laws, data protection laws, cybersecurity regulations, and industry standards. High-risk AI systems

often raise ethical questions and dilemmas, so it is important for experts to be guided by ethical principles and guidelines in their work.

The establishment of a **new framework for AI risk control and management** is essential to address the multifaceted risks and challenges associated with AI systems. Firstly, AI systems introduce unprecedented risks due to their inherent complexity, autonomy, and adaptability. Unlike traditional software systems, AI systems often operate in dynamic and unpredictable environments, making it challenging to anticipate and manage potential risks. A specialised framework would provide structured methodologies and tools for identifying and analysing AI-related risks, encompassing aspects such as algorithmic biases, data privacy breaches, and system vulnerabilities. Secondly, the ethical implications of AI technologies underscore the need for a dedicated framework for risk management. AI systems have the potential to impact individuals, communities, and societies in profound ways, raising concerns about fairness, accountability, and transparency. A specialised framework would incorporate ethical principles and guidelines into the risk management process, guiding stakeholders in navigating ethical dilemmas and ensuring the responsible development and deployment of AI systems.

Furthermore, the regulatory landscape surrounding AI is evolving rapidly, with governments and regulatory bodies seeking to address the risks and challenges posed by AI technologies. A specialised framework would align with existing regulatory frameworks and standards, providing organisations with a structured approach to compliance and risk governance. By fostering transparency and accountability, the framework would enhance trust and confidence in AI systems among regulators, policymakers, and the general public.

4.2.2. Testing AI: Requirements, Approaches, and Frameworks

High-risk AI systems will be tested for the purposes of identifying the most appropriate and targeted risk management measures. Testing must ensure that high-risk AI systems perform consistently for their intended purpose and are in compliance with the requirements set out in the regulations.

Ensuring the reliability, accuracy, and safety of AI systems is paramount. Testing AI presents unique and distinct challenges due to its non-deterministic nature, reliance on large datasets, and complex algorithms. This part attempts to explore the requirements, methodologies, and frameworks used in testing AI, drawing insights from established quality assurance (QA) frameworks in IT. By examining these aspects, we aim to provide a comprehensive understanding of how to effectively test AI systems.⁵

Main specifications for AI testing could include:

- **Data Quality:** High-quality data is fundamental for training AI models. Testing should encompass data validation, cleansing, and augmentation techniques to ensure data integrity.
- **Algorithm Verification:** Rigorous testing of AI algorithms is necessary to validate their functionality, accuracy, and robustness across diverse scenarios.
- **Ethical Considerations:** Testing should adhere to ethical principles, ensuring fairness, transparency, and accountability in AI decision-making processes.
- **Regulatory Compliance:** Compliance with data protection laws, industry regulations, and standards is crucial. Testing should verify adherence to legal and regulatory requirements.

Testing AI systems requires a multifaceted approach encompassing data quality assurance, algorithm verification, ethical considerations, and regulatory compliance. Leveraging established QA frameworks and methodologies tailored to AI testing can enhance the reliability, robustness, and trustworthiness of AI systems in diverse applications. Continued research and development in AI testing methodologies are essential to address emerging challenges and ensure the responsible deployment of AI technologies.

⁵ See **Harvey, T.** *Software Testing Fundamentals: Methods, Testing Levels, and Test Types*, 2018; **Estrella, J., Terezia Ignat.** *ISTQB Foundation Level Certification Study Guide*. 2020; **Russel, S., Peter Norvig.** *Artificial Intelligence: A Modern Approach*. Pearson, 2021; **Doll, M.** *Testing AI Systems: Safety, Robustness, and Reliability*. 2019; **Horch, J.** *Practical Guide to Software Quality Management*. Artech House Publishers, 2017; etc.

While existing QA frameworks in the field of IT offer valuable guidelines, the complexity and novelty of AI technologies call for a dedicated **specialised framework focusing specifically on the testing AI systems**.

Firstly, the quality of data used to train and evaluate AI models significantly impacts the performance and reliability of AI systems. Unlike traditional software testing, AI testing requires comprehensive validation and verification of datasets to ensure representativeness, diversity, and integrity. A specialised framework would provide standardised methodologies and best practices for assessing data quality, including techniques for data augmentation, bias detection, and anomaly detection, thereby enhancing the robustness and generalisability of AI models.

Secondly, algorithm verification is crucial for validating the functionality, accuracy, and consistency of AI algorithms across diverse use cases and scenarios. A specialised framework would offer specific guidelines and procedures for algorithm testing, encompassing techniques such as unit testing, integration testing, and regression testing tailored to the intricacies of AI algorithms. By ensuring thorough algorithm verification, the framework would instil confidence in the performance and behaviour of AI systems, facilitating their safe and effective deployment in real-world applications.

Furthermore, ethical considerations are paramount in the development and deployment of AI systems, given their potential societal impact and implications. A specialised framework would integrate ethical principles and guidelines into the testing process, addressing concerns such as fairness, transparency, accountability, and privacy. It would provide mechanisms for evaluating the ethical implications of AI systems, including assessing algorithmic biases, mitigating unintended consequences, and promoting responsible AI practices.

4.2.3. Ensuring Effective Oversight of High-Risk AI Systems through Human-Machine Interface Tools

High-risk AI systems need to be designed and developed in such a way, including with appropriate human-machine interface tools, that they can be effectively overseen by natural persons during the period in which the AI system is in use.

Human oversight will aim to prevent or minimise risks to health, safety or fundamental rights that may emerge when a high-risk AI system is used in accordance with its intended purpose or under conditions of reasonably foreseeable misuse, in particular when such risks persist notwithstanding the application of other requirements.

Oversight measures should be commensurate to the risks, level of autonomy and context of use of the AI system and should be ensured through either one or all of the following types of measures:

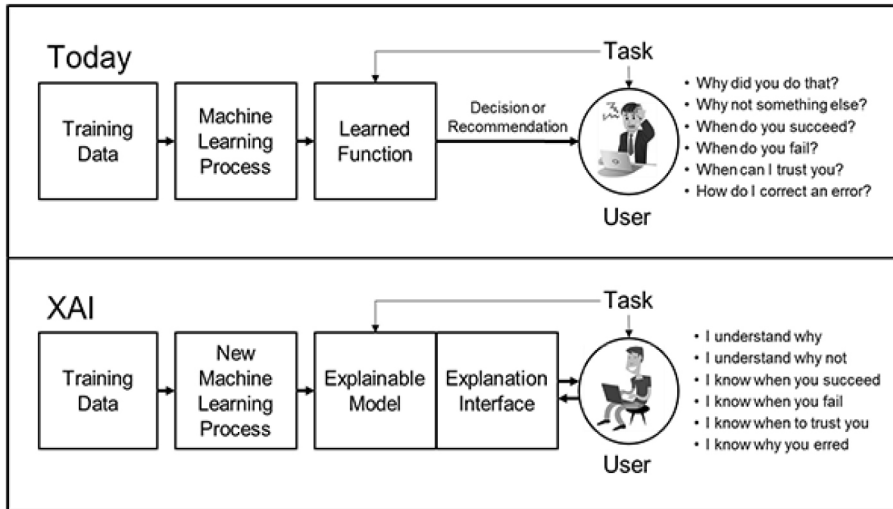
- a) measures identified and built, when technically feasible, into the high-risk AI system by the provider before it is placed on the market or put into service;
- b) measures identified by the provider before placing the high-risk AI system on the market or putting it into service and that are appropriate to be implemented by the user.

The requirement that high-risk AI systems must be designed and developed to enable effective oversight by natural persons during their use raises important questions about the feasibility and adequacy of achieving this goal in light of the advancements in AI.

Firstly, it's crucial to acknowledge that AI systems, particularly those deemed high-risk, can exhibit complex and opaque decision-making processes that may challenge human comprehension and oversight. These systems often rely on intricate algorithms and data-driven models that operate autonomously, making it difficult for humans to intervene or understand their functioning effectively. However, recent developments in explainable AI (XAI) aim to address this limitation by providing insights into how AI systems arrive at their decisions, thus enhancing human understanding and oversight.

Explainable artificial intelligence (XAI) is a set of processes and methods that allows human users to comprehend and trust the results and output created by machine learning algorithms. Explainable AI is used to describe an AI model, its expected impact and potential biases.

Source: <https://www.darpa.mil/program/explainable-artificial-intelligence>



Furthermore, the integration of **appropriate human-machine interface tools** is essential for facilitating effective oversight of high-risk AI systems. These tools can include user-friendly dashboards, visualisation techniques, and decision support systems that empower natural persons to monitor and interact with AI systems in real-time. By presenting key information in a comprehensible format and enabling prompt intervention, when necessary, these interface tools enhance the transparency and accountability of AI systems.

Moreover, ongoing research and innovation in AI are driving advancements in human-AI collaboration, enabling more seamless interaction and oversight. For example, AI systems can be equipped with capabilities for soliciting feedback from human users, clarifying decision rationales, and adapting their behaviour based on user input. Additionally, advancements in natural language processing (NLP) and human-computer interaction (HCI) technologies are facilitating more intuitive and

conversational interfaces, further enhancing the usability and oversight of AI systems.

However, despite these advancements, significant challenges remain in ensuring effective oversight of high-risk AI systems by natural persons. Technical limitations, ethical considerations, and the inherent complexity of AI pose ongoing challenges that require multidisciplinary collaboration and ongoing research efforts. Moreover, the evolving nature of AI technology necessitates continuous monitoring and adaptation of oversight mechanisms to keep pace with technological advancements and emerging risks.

4.2.4. Ensuring Robustness and Cybersecurity in High-Risk AI Systems (Article 15)

The requirement for high-risk AI systems to achieve accuracy, robustness, and cybersecurity throughout their lifecycle necessitates a comprehensive approach to risk mitigation and resilience-building.

Firstly, high-risk AI systems, unlike traditional software, often possess autonomous decision-making capabilities, making them potential targets for malicious actors seeking to manipulate their behaviour for malicious purposes. Unlike conventional software systems where attacks are typically directed at exploiting vulnerabilities in the code or infrastructure, attacks on AI systems may involve adversarial inputs designed to **deceive or manipulate the AI system's decision-making process**. For example, in the case of AI-powered autonomous vehicles, adversarial attacks can involve manipulating sensor data to deceive the system into making incorrect decisions, leading to potentially catastrophic consequences.

Secondly, the complexity of AI algorithms makes them vulnerable to various forms of attacks, including **data poisoning, model inversion, and backdoor attacks**. High-risk AI systems, particularly those deployed in critical infrastructure or decision-making contexts, are attractive targets for adversaries seeking to disrupt operations, compromise data integrity, or cause harm to individuals or organisations. Moreover, the interconnected nature of AI systems within the broader ecosystem increases the potential impact of successful attacks, highlighting the importance of robust cybersecurity measures to safeguard against threats.

The AI Act requires (Article 15) that high-risk AI systems are designed and developed in such a way that they achieve an appropriate level of accuracy, robustness, and cybersecurity, and perform consistently in those respects throughout their lifecycle. To address the technical aspects of how to measure the appropriate levels of accuracy and robustness, the Commission will, in cooperation with relevant stakeholder and organisations such as metrology and benchmarking authorities, encourage as appropriate, the development of benchmarks and measurement methodologies. The levels of accuracy and the relevant accuracy metrics of high-risk AI systems will be declared in the accompanying instructions of use.

High-risk AI systems must be as resilient as possible regarding errors, faults or inconsistencies that may occur within the system or the environment in which the system operates, in particular due to their interaction with natural persons or other systems.

The robustness of high-risk AI systems may be achieved through technical redundancy solutions, which may include backup or fail-safe plans. High-risk AI systems that continue to learn after being placed on the market or put into service must be developed in such a way as to eliminate or reduce as far as possible the risk of possibly biased outputs influencing input for future operations ('feedback loops') and make sure these are duly addressed with appropriate mitigation measures.

High-risk AI systems should be resilient to attempts by unauthorised third parties to alter their use, outputs or performance by exploiting system vulnerabilities. The technical solutions aimed at ensuring the cybersecurity of high-risk AI systems should be appropriate to the relevant circumstances and the risks.

The technical solutions to address AI specific vulnerabilities should include, where appropriate, measures to prevent, detect, respond to, resolve and control attacks attempting to manipulate the training dataset ('data poisoning'), or pre-trained components used in training ('model poisoning'), inputs designed to cause the model to make a mistake ('adversarial examples' or 'model evasion'), confidentiality attacks or model flaws.

Furthermore, the rise of AI-driven cyberattacks, such as adversarial machine learning attacks and AI-generated phishing scams, underscores the need for proactive defences and resilience-building strategies in high-risk AI systems. Adversarial attacks that target the vulnerabilities of AI algorithms can bypass traditional security measures, posing significant challenges for cybersecurity practitioners and highlighting the need for specialised defences tailored to the unique characteristics of AI systems.

4.2.5. Obligations of providers and deployers of high-risk AI systems and other parties

Providers of high-risk AI systems encompass various entities involved in the development, distribution, and deployment of such systems. These include:

Manufacturers: Companies or entities that design, produce, and assemble high-risk AI systems. They are responsible for ensuring that their products meet the requirements set out in the regulation before placing them on the market.

Importers: Entities that bring high-risk AI systems from outside the EU into its market. Importers must verify the conformity of AI systems with the regulation before placing them on the market.

Distributors: Entities involved in the supply chain that make high-risk AI systems available on the market, such as wholesalers, retailers, and online platforms. Distributors must ensure that the AI systems they distribute bear the required conformity markings and are accompanied by the necessary documentation.

Deployers: Entities that put high-risk AI systems into operation or use them in real-world settings. Deployers may include end-users, organisations, or institutions that utilise AI systems for various purposes. They have responsibilities related to the proper use, monitoring, and compliance of AI systems as per the regulation.

Authorised Representatives: Representatives appointed by manufacturers established outside the EU to perform tasks on their behalf related to compliance with the regulation. They act as liaisons between the

manufacturer and EU authorities and have specific obligations outlined in the regulation.

Each type of provider has distinct responsibilities outlined in the AI Act to ensure the safety, quality, and compliance of high-risk AI systems throughout their lifecycle.

4.2.6. Fundamental rights impact assessment for high-risk AI systems

Deployers, including public bodies, private operators providing public services, and certain operators deploying high-risk AI systems, must conduct a comprehensive assessment of their impact on fundamental rights before deploying such systems. The assessment must cover various aspects, including the description of processes, intended duration and frequency of use, affected categories of individuals, and specific risks of harm, human oversight measures, and risk mitigation strategies.

The obligation applies to the initial use of the AI system, and deployers may rely on previous impact assessments conducted by providers under similar circumstances. However, if any factors change during the system's use, deployers must update the assessment accordingly. Once completed, the deployer must notify the market surveillance authority of the assessment results, using a designated template.

If deployers have already conducted a data protection impact assessment under relevant EU regulations, they must integrate the fundamental rights impact assessment with it. Additionally, the AI Office is tasked with developing a questionnaire template to assist deployers in fulfilling their obligations under this provision more efficiently.

These measures aim to ensure that the deployment of high-risk AI systems is accompanied by thorough assessments of their potential impact on fundamental rights, promoting transparency, accountability, and compliance with relevant regulations.

IV. ADDITIONAL ISSUES

1. Exploration of AI throughout history underscores the timeless human desire to understand and replicate intelligence. From ancient myths to contemporary technology, the evolution of AI reflects both humanity's ingenuity and its ethical complexities. As we continue to push the boundaries of artificial intelligence, it is imperative to consider not only the benefits but also the potential risks and consequences.

2. While technological advancements offer immense benefits, they also pose substantial risks, especially in areas such as data privacy, algorithmic bias ('algorithmic discrimination'), and decision-making autonomy. Conventional-type regulations (such as legislation, standards, and oversight mechanisms) are therefore imperative at this stage of development to manage societal interactions in the most important and risky aspects of AI development and use. However, an improved approach in the more distant future will probably not be sufficiently effective and sustainable given the rapid introduction of diverse technologies, which will increase enormously the factors to consider and the resources needed to carry out adequate (external) control over AI systems.

3. The EU's approach to the AI underscores a proactive stance in fostering innovation while ensuring the safety, transparency, and ethical use of AI technologies. Through comprehensive strategies and regulatory frameworks, the EU aims to cultivate excellence in AI development and adoption, positioning itself as a global leader in AI innovation. By emphasising the importance of high-quality data and adopting risk-based methodologies, the EU seeks to mitigate potential risks associated with AI deployment while promoting fundamental rights protection and legal certainty for stakeholders.

The EU AI act establishes comprehensive guidelines and mechanisms for its practical implementation, aiming to balance innovation with ethical considerations and ensuring accountability in AI development and deployment. Through periodic evaluations and amendments, the regulation seeks to adapt to evolving technological landscapes and address emerging challenges in AI governance. Moreover, the EU's legal definition of an AI system reflects a nuanced understanding of AI capabilities, although further

refinement could enhance clarity and specificity. The prohibition outlined in Title II of the EU AI Act is essential to safeguarding the rights of citizens and upholding democratic principles in the face of potential threats posed by certain AI applications. By delineating specific prohibited practices, such as biometric categorisation systems based on sensitive traits and unrestricted harvesting of facial images for facial recognition databases, the regulation aims to prevent potential misuse of AI technology that could infringe upon individuals' rights to privacy, freedom of expression, and equal treatment. Moreover, the prohibition on AI systems that manipulate human behaviour and exploit vulnerabilities underscores the importance of preserving individuals' autonomy and protecting against undue influence or discrimination. While there are exceptions for certain law enforcement purposes, such as targeted searches for serious offenders or prevention of imminent threats, these exceptions are subject to strict criteria and judicial oversight to ensure they are used responsibly and in accordance with legal safeguards. Overall, the prohibition serves as a necessary safeguard against the misuse of AI technology and reinforces the commitment to ethical and responsible AI development and deployment.

4. The establishment of a new framework for AI risk control and management is essential to address the multifaceted risks and challenges associated with AI systems. By providing standardised methodologies, ethical guidelines, and regulatory compliance frameworks, the framework would enable organisations to proactively identify, assess, and mitigate risks, thereby enhancing the safety, reliability, and societal acceptance of AI technologies. As AI continues to evolve and permeate various domains, a dedicated framework for risk control and management will be instrumental in ensuring the responsible and ethical development and deployment of AI systems.

5. Qualified experts with expertise in risk management, control and audit, laws, AI and industry-specific knowledge play a crucial role in establishing and maintaining effective risk management systems. It is crucial that experts possess in-depth knowledge of legal requirements and ethical standards: Experts must understand the regulatory environment in which high-risk AI systems operate, including AI laws, data protection laws, cybersecurity regulations, and industry standards. High-risk AI

systems often raise ethical questions and dilemmas, so it is important for experts to be guided by ethical principles and guidelines in their work.

6. The creation and endorsement of a specialised framework for testing AI systems are imperative to meet the unique challenges and requirements posed by AI technologies. Such a framework would enhance data quality, facilitate algorithm verification, and address ethical considerations, ultimately ensuring the reliability, fairness, and societal acceptance of AI systems. By establishing standardised practices and guidelines, the framework would support the development of trustworthy and ethically aligned AI solutions, driving innovation while safeguarding human values and interests.

7. The rise of AI-driven cyberattacks, such as adversarial machine learning attacks and AI-generated phishing scams, underscores the need for proactive regulations, defences and resilience-building strategies in high-risk AI systems.

8. While regulatory measures are essential to ensure the responsible development and deployment of AI technologies, the EU must tread carefully to avoid stifling innovation. Title V of the EU Regulation on AI delineates comprehensive measures to support innovation through regulatory sandboxes, data protection provisions, real-world testing frameworks, and tailored support for SMEs and microenterprises. These initiatives aim to foster a dynamic and responsible AI ecosystem in the European Union.

9. The enforcement of penalties for non-compliance with the EU AI regulation is essential to uphold ethical standards, protect individual rights, and ensure the responsible development and use of AI technologies. By aligning with established legal frameworks and imposing proportionate sanctions, the regulation seeks to promote accountability and trust in the AI industry. However, effective enforcement requires careful consideration of enforcement mechanisms and consistent application of penalties across Member States to address potential challenges and weaknesses in implementation.

Overall, the AI Act of the EU reflects a proactive approach to address emerging challenges in AI governance and promote ethical AI deployment and establishes comprehensive guidelines and implementation mechanisms to ensure responsible AI use while fostering innovation and competitiveness. These measures include the development of guidelines covering various aspects of AI implementation, considerations for SMEs and start-ups, compliance deadlines for AI systems, periodic evaluation and review processes, enforcement mechanisms, and the development of a methodology for assessing AI system risks.

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Prof. Dr. Jacques Malherbe

