ENERGY AND GOOD GOVERNANCE IN BULGARIA

TRENDS AND POLICY OPTIONS

CENTER FOR
THE STUDY OF
DEMOCRACY

The report explores the major deficiencies in the strategic, institutional, and legal framework of the Bulgarian energy sector. The analysis of the management of state-owned energy companies and large energy infrastructure projects reveals the disregard for even the most fundamental principles of accountability and control in their planning and implementation. This has affected negatively the Bulgarian taxpayers and consumers, has jeopardized the financial stability of the state-owned energy companies, and, ultimately, has reduced the energy security of the country. The report recommends that the implementation of the large energy infrastructure projects be reconsidered and be based on a sound cost-benefit analysis with regard to Bulgaria's energy security.

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The Center for the Study of Democracy would like to thank the following individuals for their contribution to this report:
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The publication is funded by the Norwegian Government through the Norwegian Cooperation Program for Economic Growth and Sustainable Development in Bulgaria and by the Konrad Adenauer Foundation

ISBN 978-954-477-167-6

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SUMMARY

The governance of Bulgaria's energy sector is faced with a number of problems of a technical, legal, and institutional nature. Recent audits of the implementation of large energy infrastructure projects have exposed some **serious governance issues**:

- A lack of sound energy strategy with clear priorities;
- Apparent conflicts of interest at the highest political level, leading to suspicions of corruption;
- Poor management of state enterprises;
- An absence of adequate independent oversight and numerous monopolistic abuses at the consumers' expense;
- Politically motivated privatization of assets and uncontrolled access of questionable capital to the energy sector.

The dynamic international environment places additional pressures on the national energy policy and requires **careful planning and public consensus in deciding future priorities for the sector**. Several factors have a large effect on Bulgaria's energy policy:

- Climate change and the related international agreements and binding targets of the European Union (EU) for the reduction of greenhouse gas emissions;
- The use of new technologies to reduce energy intensity and increase the share of renewable energy sources (RES);
- The global economic crisis associated with a more rapid decline in energy consumption than in GDP in all developed countries in contrast to emerging markets;
- Political pressure related to external geopolitical and economic interests.

The main **elements of energy sector governance**, which the current report reviews, comprise: (1) the strategic framework; (2) the legal framework; (3) the institutional structure; (4) the development and management of projects; and (5) public procurement as a tool for energy policy implementation.

A clear medium to long-term energy strategy outlining valid and realistic priorities should be at the basis of the decision-making process in Bulgaria's energy

sector. The June 2010 *Concept of the Bulgarian Energy Strategy until 2020*, currently under discussion, reflects the views and opinions of stakeholders to a greater extent than its predecessors. Yet, the analysis of existing energy strategies reveals some **recurring and persistent shortcomings of strategic planning** with respect to the Bulgarian energy sector:

- A **mismatch between the government's actions and the strategic framework**, given that the majority of the Bulgarian government's decisions over the last decade have been taken without proper strategic justification;

- Signs that **public policies have been captured by private interests –** for example, the predominance of projects that steer substantial funds to a limited number of private undertakings, e.g. constructing large generating capacities, instead of more promising solutions, e.g. stimulating energy efficiency;

- The **absence of financial justification** of pledged goals, leading to numerous and overly optimistic priorities and objectives. The latter allows for broad discretion in government policy making and, effectively, renders strategic planning meaningless;

- The **lack of a good governance framework** for the implementation of the energy strategy, with exact deadlines, clear responsibilities of institutions, and indicators for the assessment of results.

Compared to its predecessors, the June 2010 ***Concept of the Bulgarian Energy Strategy until 2020*** outlines more clearly the national priorities, is more responsible in budget terms, and attempts the introduction of scenario planning in the development of the national energy sector. The proposed strategy provides a good basis for public discussion as it incorporates the main guidelines of the *Energy Strategy for Europe 2020*. In order to achieve its objectives, the Cabinet and the National Assembly should adopt the Bulgarian Energy Strategy, including a budgetary framework for its implementation, as soon as possible. As a member of the EU, and in accordance with the EU's Energy and Climate Change Package from January 2007, **Bulgaria has undertaken a binding commitment to reduce its carbon emissions, reach a minimum share of RES in final energy consumption, and reduce its energy intensity**. Achieving these goals requires collaboration and coordination between government bodies and institutions involved in energy and environmental protection decision-making, as well as simultaneous and interrelated development of energy and climate change policies.

The second major energy sector governance element, which this report analyzes, is the **legal framework**. Activities in the country's energy sector are governed by a number of laws and over fifty regulations. Energy legislation in Bulgaria can be grouped into the following three categories:

- General regulation of the sector, as stipulated by the *Law on Energy* (2003);

- Nuclear energy and nuclear safety regulations;

- Sustainable energy (energy efficiency, RES, and biofuels).

The bulk of Bulgaria's legislation has been transposed from regulations in more advanced countries, most notably the European Union. This, together with the relatively limited national experience with implementation, has resulted in substantial **discrepancy between legislation and practice**. It has also provided **ample opportunities for the capture of the (weak) administration by (strong) corporate interests**. To overcome the above tendencies, the Bulgarian government needs to undertake sizable investments in strengthening the regulatory and governance capacity in the energy sector of the country.

The **organizational structure of the country's energy sector governance** is characterized by natural (geographical) monopolies on the one hand, and by fragmented management of state-owned assets on the other. The management of the energy sector is entrusted to various ministries, agencies, departments, and state enterprises, leading to **overlapping responsibilities and conflicts of interest**. Changes to the institutional structure of Bulgaria's energy sector governance are most commonly the result of external pressures. For example, the creation of the Bulgarian Energy Holding (BEH) via the pooling of the assets of a number of state-owned companies did not result in tightening financial discipline or in greater transparency of the government corporate sector. Two key energy enterprises **– the National Electric Company (NEK) and Bulgargaz – are in dire financial state** despite cutting their expenses in 2010. Moreover, BEH virtually duplicates the functions of the Ministry of Economy, Energy and Tourism, while NEK on its turn duplicates BEH's functions.

Bulgaria's binding commitment to separate energy transmission from energy generation and supply, as per EU's Third Liberalization Package, should be duly applied in order to eliminate the above inefficiencies. National specificities, such as the existence of a single supplier utilizing a single gas pipeline, should be carefully taken into account when implementing the Package. **Guaranteeing independence form the government and the proper functioning of the national energy regulator** (the State Energy and Water Regulatory Commission) should be a priority. Currently, the regulator has not demonstrated high regulatory potential and its functioning is not clearly separated from the executive.

The current governance model is not sustainable. On the one hand, state-owned enterprises are overburdened with numerous infrastructure projects and social services that limit their investment opportunities; on the other hand, private interests push them away from the most profitable market segments. There is a revolving door stream of personnel from the state to the private sector and back with no adequate assurances with respect to avoiding conflicts of interest. A more sustainable model entails pursuing one of the following two strategies: gradual privatization of state-owned assets via the stock exchange (while maintaining state control over key enterprises such as nuclear power, network operators, etc.); and/or developing a strategy to expand and position state enterprises on the regional (South-East Europe) or European market.

Project development is the fourth key element of energy sector governance, which the current report reviews. The construction of new generating capacities is among the activities most prone to corruption worldwide. During the past decade, the experience with managing large energy infrastructure projects in Bulgaria has pointed to major corruption-related risks and deficiencies:

- Due to their size and scale, the projects challenge the national economy's absorption capacity and **exceed the Bulgarian government and administration's management capacity**;

- These projects involve **considerable consulting fees** often for services provided prior to launching the project. Moreover, consulting services are difficult to quantify and are accompanied by intransparent accounting, which makes them the most commonly abused instrument for political corruption. Thus, large infrastructure projects create sizeable lobby groups that swamp the public with subjective judgments, while concealing their conflicts of interest. The latter obstructs the independent and impartial analysis of risks that inevitably arise;

- Finally, such projects are usually signed on a bilateral basis with countries that are characterized by higher corruption risks than Bulgaria, and with companies that are subject to no international ethical standards.

Belene Nuclear Power Plant (NPP) is the largest infrastructure project in Bulgarian history. It epitomizes the full range of opaque practices observed in the energy sector and the management of state enterprises over the past twenty years:

- It feeds a **strong nuclear energy lobby** of experts, politicians, and a number of private firms. The lobby aims to monopolize public debates and policies on nuclear energy. As a result, while supportive of nuclear energy, Bulgarians are **the least informed consumers in the EU** as regards the facts and risks associated with this kind of energy;

- It **contradicts the key priorit**y of both European and national strategic documents, namely, achieving energy security through diversification;

- It is **based on misleading market demand forecasts and ambiguous construction pricing mechanism** that excludes a number of hidden costs. The comparison of Belene NPP to similar projects carried out in the EU suggests that the **final project cost will amount to EUR 10 – 12 billion –** an amount that exceeds all EU funds earmarked for Bulgaria for the 2007-2013 period. Considering the serious difficulties that Bulgaria is facing with the absorption of EU funds and the substantial delays in the implementation of all large infrastructure projects in the sector, implementing a project of this size **may seriously threaten the long-term financial stability of the country**;

- It has been characterized by a number of violations and breaches of **good governance principles**. Public funds have been spent in a frivolous manner without regard to achieving project objectives. Consultancy costs have kept escalating and the conditions of already awarded public procurement contracts have been repeatedly altered at taxpayers' expense;

- The Bulgarian government has appointed as project manager the National Electric Company (NEK), whose financial condition has deteriorated continually and, as of 2010, the company was in violation of all of its credit obligations on other investment projects.

In light of the above, the memorandum for the creation of a joint project company (between NEK and Rosatom, Russia) signed in 2010 calls for **a careful reconsideration of the alternatives** and for the establishment of a national position based on the country's strategic priorities.

As Bulgaria faces tight budget and other resource constraints, its government should **sequence the implementation of all planned infrastructure projects based on clear priorities**. The planned gas infrastructure projects guaranteeing the necessary energy resources to meet national market demand (security of supply considerations) at the lowest price (maximal gain considerations) should take precedence. Using cost-benefit analysis from the point of view of energy security clearly demonstrates **the order in which projects should be implemented**:

- Developing **Bulgaria's own gas reserves** in the Black Sea shelf and exploring the option of using shale gas and other local alternative energy resources;

- Connecting the national gas system with neighboring countries' systems (gas **interconnectors**);

- The **Nabucco project**, which contributes to the diversification of both gas sources and supply routes, and its financing is supported by the EU;

- Building a **LNG terminal** at the Black Sea coast or jointly with Greece and/or Turkey at the Aegean Sea coast. This would ensure considerable flexibility of supply, though at a comparatively high cost;

- The **South Stream project**, which contributes to the diversification of gas supply routes only, yet its management is non-transparent and its implementation could prove costly due to its underwater segment.

The Bugras-Alexandroupolis oil pipeline project does not fit into the strategic framework for the development of the Bulgarian energy sector, defies established environmental standards, and is not expected to be a source of substantial future financial and/or economic benefits to Bulgaria.

The analysis of the management of key energy projects, such as Belene NPP, the Tzankov Kamak Hydro Power Plant (HPP) project, Maritsa Iztok 2 Thermal Power Plant (TPP), Toplofikacia Sofia, etc. has revealed **complete disregard for even basic rules of good governance**, leading to skyrocketing project costs at the expense of taxpayers and consumers. The absence of good governance practices has resulted in poor accountability, has threatened the financial stability of state-owned enterprises, increasing the risk of losing state control over them (i.e. hidden privatization), and has jeopardized the energy security of the country. This has exposed the **failure of the entire monitoring, regulatory and compliance control system**, including the political leadership, the internal control units of state-owned companies operating in the sector, as well as the independent regulator.

The failure of the checks and balances system, together with the mushrooming of project costs, raise **legitimate concerns of corrupt practices at all levels in the energy sector**, including the political leadership. Ultimately, this rampant lawlessness and lack of controls in the implementation of energy projects provide

significant grounds for **questioning the state's ability to manage large infrastructure projects worth over EUR 500 million**. This, in turn, raises doubts as to the benefit from developing such large projects at all.

Improving the functioning and management of state-owned energy enterprises entails, at the very least, the implementation of the following actions, which would require significant funding and at least 2 to 3 years to be completed:

- The **political leadership should reduce their direct involvement in the operational management** of energy enterprises and instead focus on policy development, the provision of public information, and control functions;

- The allocation of responsibilities and activities between the line Ministry and BEH should be reconsidered. **Duplicate functions and the blurring of responsibilities that are characteristic for the sector should be eliminated**. Extraneous expenses of state-owned enterprises need to be cut to optimize their financial performance;

- A publicly available online **energy information system and database** should be created;

- A system of financial controls of all activities in the sector should be put in place, including requirements for the financial auditing of the enterprises. Maintaining a **registry of public procurement contracts** of state-owned energy enterprises is also necessary;

- **Annual energy policy review** by the National Assembly that includes: evaluation of policy implementation vis-à-vis stated priorities, assessment of the financial standing of state-owned energy enterprises, and outline of the following year's priorities;

- Decisions concerning major investment projects in the energy sector must incorporate **comprehensive and transparent financial, economic, social, and environmental impact assessments**. The longer the delay in implementing these decisions, the higher the resulting sunk costs, and the stronger the incentives for corruption and the political pressures on key decision makers.

Accomplishing the suggested strategic, legal, and structural changes is not possible without **prosecuting and bringing to justice those responsible for the financial mismanagement of large energy projects and state-owned enterprises in the past**. The absence of administrative and criminal proceedings, especially at senior management level, in spite of publicized information about unprecedented increases in project costs, mismanagement, and abuses, creates an environment of impunity and non-transparency. This compounds the problems that Bulgaria is facing in counteracting corruption and organized crime, generating preconditions for the **penetration of the energy sector by national and international criminal interests**. Therefore, good governance in the energy sector becomes a prerequisite not only for the country's energy but also for its overall security.

Public procurement is the key instrument for implementing energy policies and projects. The disproportionately large concentration of public funds in energy public procurement puts this instrument at a constant risk of corruption, fraud, and/or misappropriation. Bulgaria's large energy companies top the list of major contractors in public procurement.

About 56 % of all registered public procurement procedures in the energy sector are not competitive. If contracts awarded through no public procurement procedure at all are added, it becomes clear that **the avoidance of market competition is the rule, rather than the exception**, in this sector of the economy.

The analysis of public procurement practices in the energy sector has revealed the following **problems**:

- Avoiding competitive bidding;
- Restricting public access to signed contracts and their terms;
- Awarding contracts without using public procurement procedures at all, negotiating strategic partnerships bypassing the law, and the common use of special procurement (e.g. citing national security concerns);
- Ambiguous or insufficient control systems and procedures;
- Launching inadequate public procurement procedures (serving no legitimate public interest) aimed solely at the expenditure of allocated funds or at private gains;
- Purposeful manipulation of procedures and/or application documents, as well as technical specifications, to fit the qualifications of the "desired" (preselected) applicant;
- Purposeful manipulation of the application criteria - inadequate qualification requirements;
- Applying political and/or administrative pressure to channel funds to specific beneficiaries;
- Abuse of trust or misuse of information, etc.

Almost all energy public procurement cases audited by the authorities have revealed **violations of procedures and best practice**, yet a few are emblematic:

- The bulk of **state – owned energy enterprises' funds are disproportionately concentrated into a handful of banks**, deposited without proper public procurement procedure;
- The **expenses for consulting services relating to Belene NPP** are so substantial that they exceed the rates elsewhere in Europe to such a degree that they defy market logic;

- The **management of special public procurement**, such as the maintenance of closed nuclear reactors at Kozloduy NPP, the supply of fresh nuclear fuel, and the hiring of a security company in Maritsa Iztok 2 TPP.

The absence of properly structured control and sanction mechanisms with respect to the large public procurement contracts obstructs the transparency and efficiency of spending in the energy sector. Sanctions for serious versus minor violations are not well differentiated and fines have insufficient deterrent effect. The National Audit Office and the Public Financial Inspection Agency are in charge of monitoring public procurement, yet they lack a sufficient number of qualified, narrowly specialized in energy matters, experts. While the outcomes of energy public procurement contracts affect all consumers, their content is not published or publically accessible. In a number of cases contractors have failed to publicize the signed contracts in accordance with the law, or these contracts have been publicized too late and/or without sufficient details.

There is no **mechanism for assessing the public benefit of individual public procurement contracts**. In addition, state enterprises do not have a practice of making public their annual plans for public procurement and/or for providing a justification for intended expenses. The audits of leading state-owned energy enterprises conducted by the Public Financial Inspection Agency have elucidated that **the time lag between disclosing an investment decision and opening a public procurement on it is utterly insufficient** for proper preparation of potential bidders.

In light of the above, **introducing a system for monitoring of public procurement in the energy sector** is essential. The first step towards making such a system operational could be the identification of a set of corruption risk indicators in the energy sector. Such indicators could include:

- Unjustified and/or unexpected increases in state-owned enterprises' expenses;
- Unwarranted decreases in state-owned enterprises' profits coupled with suspicious increases in the profitability of related lines of business;
- Changes in the management team immediately before and/or after parliamentary elections without clear justification;
- Multiple consecutive public procurement procedures with one and the same task;
- Unjustified termination of public procurement procedures;
- Using one and the same experts/consultants in various assignments;
- Systematic avoidance of open, market-based procurement procedures.

INTRODUCTION

The energy sector is the lifeblood of any economy: oil, natural gas, and electric power are crucial to maintaining sustainable economic growth. The safe, affordable, and reliable energy supply to any point along the value added chain is indispensable for the economic and social welfare and development of any state. Thus, good governance in the energy sector is a matter of national, rather than merely economic, security.

Bulgaria's energy sector is of key importance for the development of the country's economy. Over the past ten years, energy exports and imports accounted for 13 and 21 %, respectively, of the value of the total outgoing and incoming trade flows.[1] One in four public procurement contracts relates to the energy sector, which renders it one of the biggest spenders of taxpayer money. In 2008 alone, the Bulgarian government committed to energy projects that required investments equal to the entire EU budget allocated to Bulgaria for the period 2007-2013. Just two years later, these projects do not seem feasible **in the context of the global financial and economic crisis**, demonstrating the lack of capacity for good governance in the energy sector. They continue to consume considerable public and political attention. The pressure exerted by the financial crisis on public finances and audits in the energy sector have revealed **serious governance failures at multiple levels**: a lack of public information about national energy strategy and policy; clear conflicts of interest at the highest political level and related suspicions of corruption; poor management of state-owned companies; a lack of adequate supervision over the sector; abuse of monopoly powers at consumers' expense; politically motivated privatization of assets; and uncontrolled access of capital to state-subsidized newly emerging energy production markets.

The poor management of Bulgaria's energy sector is set against a rapidly changing international environment that presents additional challenges to national policy and calls for even more careful planning and public consensus in decision-making concerning the future of the sector:

- Climate change and the related **international agreements and binding commitments** of the European Union aimed at cutting greenhouse gas emissions;

- The development of **new technologies** for reducing energy intensity and increasing the share of renewable energy sources (RES) in final consumption;

[1] According to BNB data on exports (FOB) and imports (CIF) by end use.

- **Economic pressures**, which have increased in the context of the global economic crisis and have entailed more rapidly declining energy consumption compared to GDP in all developed countries in contrast to emerging markets;

- **Political pressures** from foreign geopolitical and economic interests.

The current report **analyzes the key components of governance in the energy sector**: (1) the strategic framework, (2) the legal framework, (3) the institutional structure, (4) project development, and (5) public procurement as a key instrument for energy policy implementation. Special attention has been devoted to large-scale infrastructure projects, which scope and investment weight are of particular importance to the Bulgarian energy sector and the economy, as a whole, and which attract broad public and international attention. Some of the **most notable problems** related to energy sector governance are:

- Lack of transparent and stable institutional environment and obscure principles of decision-making;

- Poor coordination and cooperation among major stakeholders in the sector;

- Low levels of implementation of strategic goals, laws, and obligations under international and EU agreements;

- Inconsistencies between the legal framework and strategic goals on the one hand, and the real needs of the energy sector and the economy, on the other;

- High corruption risks and lack of transparency in large-scale energy infrastructure projects and in the areas of public procurement, concessions, and licenses;

- Excessive influence of lobby groups on the decision-making process in the energy sector, which leads to unprofitable decisions for the state-owned companies and the misuse of the country's natural, financial, and administrative resources;

- Low efficiency of the energy sector public administration.

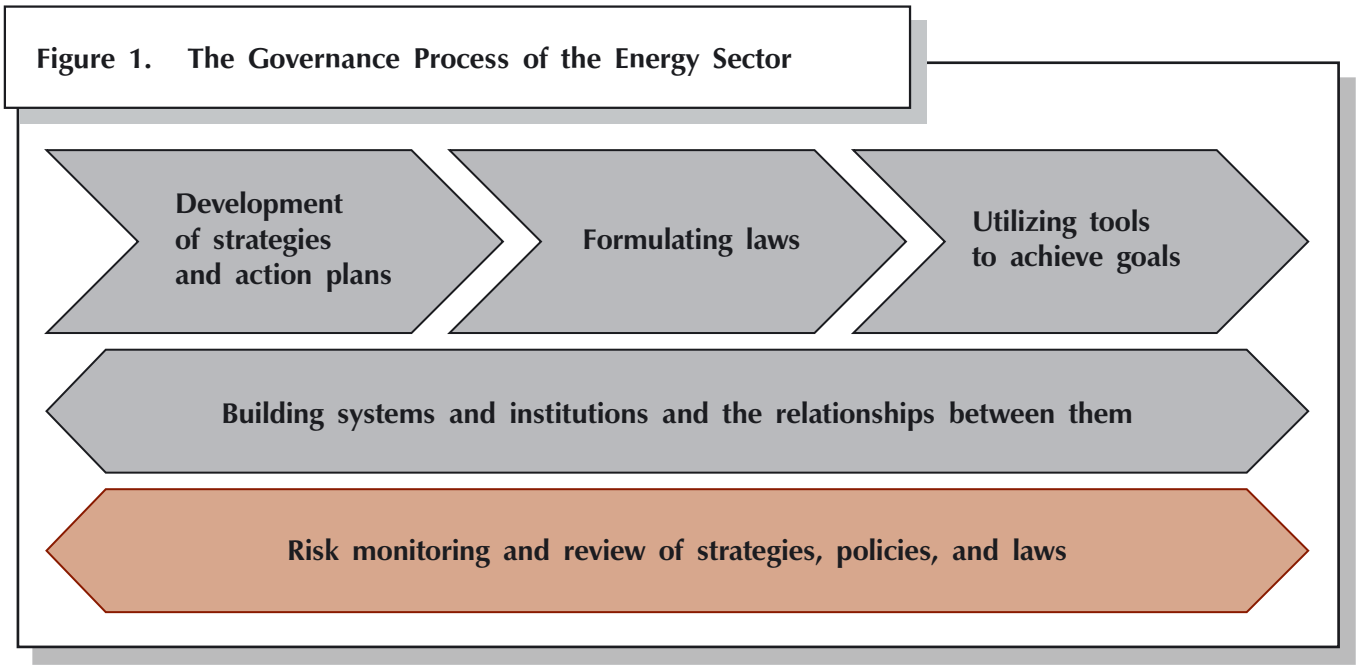
The report reviews the strategic, institutional, and legal framework and illustrates the major structural and governance problems in the management of state-owned enterprises and in the energy sector as a whole. In addition, the report explores governance practices in the planning and implementation of large-scale energy infrastructure projects, focusing on Belene NPP, South Stream and Nabucco gas pipelines, and Burgas-Alexandroupolis oil pipeline. It discusses various management problems of state-owned energy companies, with a focus on the Bulgarian Energy Holding, as well. Finally, the report provides an analysis of the sector's governance process at the macro level and at the level of public procurement.

1. THE INSTITUTIONAL STRUCTURE OF ENERGY SECTOR GOVERNANCE

1.1. ENERGY STRATEGY

The *Energy Strategy of Bulgaria* is the framework document outlining the political vision, government policies, and priorities for the development of the sector. It lays down the foundations for shaping the legal framework, and for reaching informed decisions on key investment projects. The Strategy should serve as a reference point when determining the state and evolution of the institutional structure governing the energy sector. It should also act as a coordinating mechanism for the activities of the numerous state institutions responsible for achieving of the sector's development goals.

Figure 1. The Governance Process of the Energy Sector



Source: Center for the Study of Democracy, 2010.

The first Bulgarian energy strategy was adopted in 1999 and endorsed by the National Assembly under the title *National Strategy for the Development of the Energy Sector and Energy Efficiency until 2010*. Three years later, a new *Energy Strategy until 2010*[2] was adopted, and is still in effect. A new Concept for a Bulgarian Energy Strategy until 2020[3] was developed and announced in 2008. The Concept was

[2] Decision of the Council of Ministers No 279 of 11.05.2002, endorsed by decision of the 39th National Assembly (SG No 71 of 23.07.2002).

[3] See www.mee.government.bg/doc_vop/Koncepcia_2008.pdf (last accessed on December 27, 2010).

updated and open for public discussion in June 2010.[4] It should be noted that despite the delayed adoption of the latest Concept by the Council of Ministers and the National Assembly, the process of its development reflects the views and opinions of all stakeholders to a greater extent than its predecessors, and constitutes a significant improvement in strategic planning.

A review of the three energy strategies reveals a number of **shortcomings of energy-related strategic planning in Bulgaria** over the past decade, most notably:

- **Inconsistencies between specific government actions and the strategic framework.** For example, the 2002 Strategy stipulated that large-scale energy projects should be postponed "owing to uncertain long-term consumption forecasts and a dynamically changing electric power market".[5] Yet only two years later, the construction of Belene NPP was resumed – a project exceeding in scale and costs all other investments in the energy sector over the past 20 years put together. Similar shifts in policy decisions should be preceded by an update of the strategic framework. In fact, many government decisions over the past ten years, having the potential to shape the development of the Bulgarian energy sector and the economy until 2050, were not based on or supported by the national strategic framework. The latter demonstrates a lack of stability in strategic planning and **a lack of continuity in the country's energy policy**. Each consecutive government should either endorse or update the strategic goals laid down in the respective planning document;

- **The absence of proper financial justification of adopted strategic goals.** Bulgaria's energy strategies do not include financial assessments of the necessary investments for planned projects or the impact of various policies on the economy, the budget, and individual stakeholders. This results in the adoption of an excessively optimistic outlook and of numerous goals and priorities that allow for broad discretion in decision-making, which ultimately undermines the very point of strategic planning. The resulting **imbalance between the actual significance of a given energy subsector and/or issue for the economy and its place in Bulgaria's strategic plans** is evident. For example, the nuclear power sector accounts for roughly 40 % of electricity production in the country, yet its future and development are referred to in Bulgarian energy strategies merely in general terms and in scarce few pages. Moreover, priorities in the nuclear power sector, gas supply, renewable energy sources, energy efficiency, coal mining, trade in greenhouse gas emissions, etc. are set without coordination or evaluation of the returns on planned investments;

- **The lack of a good governance framework for strategy implementation –** the absence of specific timelines, clearly defined institutional responsibilities, and performance indicators. Bulgaria's energy strategies lack statistical and other data on starting points and target values for key energy indicators. It is thus impossible to evaluate the relevance of the priorities that have been set to actual market needs. A case in point have been the financial forecasts of the National Electric Company (NEK) used to justify the need to construct new power generation facilities in Bulgaria since 2004. NEK foresaw an abrupt

[4] For a more detailed analysis of the draft strategy of 2008 see: Energy Strategy of Bulgaria 2020: Commentary and Proposals for Improved Governance, Policy Brief No 19, Center for the Study of Democracy, 2009 <http://www.csd.bg/artShowbg.php?id=9945>.

[5] Energy Strategy of the Republic of Bulgaria (SG No 71 of July 23, 2002).

surge in energy consumption around 2015, the year in which Belene NPP had been intended to start generating power, with no consideration of market supply and demand in the region.

The shortcomings outlined above point to yet another significant problem of strategic planning in Bulgaria's energy policy **– the absence of publicly stated long-term goals**. Bulgarian governments have tended to give preference to medium-term (up to 10-year) strategic frameworks. Aside from the unstable economic environment, another justification for the absence of longer-term planning could be the lack of administrative mechanisms and capacity for long-term forecasting (e.g., through foresight).

The *Concept of a Bulgarian Energy Strategy until 2020* **attempts to overcome some of the deficiencies** outlined above through:

- **A notably clearer outline of national priorities**, namely energy security and energy efficiency. It also includes, even if not fully elaborated, the Bulgarian government's position on reducing the country's natural gas dependency and on the future of the nuclear energy sector. For example, the Concept rightly assigns priority to building **intersystem gas connections to neighboring countries, completing the Nabucco project, and building up the domestic gas market**;

- A far **more cautious position on government budget expenditure in the energy sector**, regarding Belene NPP and renewable energy sources subsidies;

- An initial attempt at **scenario planning in energy development** and at setting quantifiable goals (e.g., in energy efficiency) to aid investment planning in the sector.

Though the latest Concept has shortcomings,[6] it **provides a good basis for public discussion** and outlines well developments in the energy subsectors. The text put forth for discussion also incorporates guidelines from the new *European Energy Strategy until 2020*, which places special emphasis on energy efficiency.[7] In order to achieve its goals, however, **the Council of Ministers and the National Assembly should adopt the proposed Concept no later than March 2011**. The strategy should include an estimate of the funding necessary to implement the proposed measures. This would help identify opportunity costs of alternative decisions and evaluate their relevance and feasibility.

Political and public pressures to set ever more ambitious targets for the energy sector have increased in accordance with international efforts to ensure sustainable development and prevent climate change and environmental pollution. As a Member of the European Union (EU), and in accordance with the EU's Energy and Climate Package of January 2007, Bulgaria has adopted binding commitments on reducing green house gas emissions, on achieving a minimum share of renewable energy sources (RES) in final energy consumption, and on reducing energy intensity. This **necessitates close coordination between energy**

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6 On the Draft Energy Strategy Bulgaria 2020, Position of the Center for the Study of Democracy, July 2010 <http://www.csd.bg/artShowbg.php?id=15193>.

7 Energy 2020 A strategy for competitive, sustainable and secure energy, COM(2010) 639 final, Brussels, 10.11.2010.

and environmental protection policies. In this context, Bulgaria's new energy strategy should place an emphasis on streamlining the organizational structure and coordinating the activities of state authorities and institutions responsible for policy-making and policy implementation in these two fields. The development of the *National Energy Strategy 2020*, the *National Strategy for Sustainable Development*, the *Strategy for Energy Efficiency*, and the *Strategy and Law for the Development of Renewable Energy Sources* should be coordinated and executed simultaneously.

In a number of Member States, such as Spain, the Netherlands, and Italy, good coordination has been achieved by means of **specially established inter-ministerial bodies** synchronizing policies and actions of related institutions with respect to climate change: environment, energy, industry, housing policy, agriculture, technology development, local self-government, and forestry. This is a logical step, since sustainable development and effective energy sector governance are likely to affect a number of sectors and all levels of government. Only the coordinated actions of various government bodies and a functioning control system can result in achieving the country's energy goals. It should be noted that the latest draft of the energy strategy Concept, envisions a considerably **higher degree of interconnectedness between energy, environmental, and technological factors** in the development of the energy sector than previous strategic documents.

1.2. ENERGY LEGISLATION

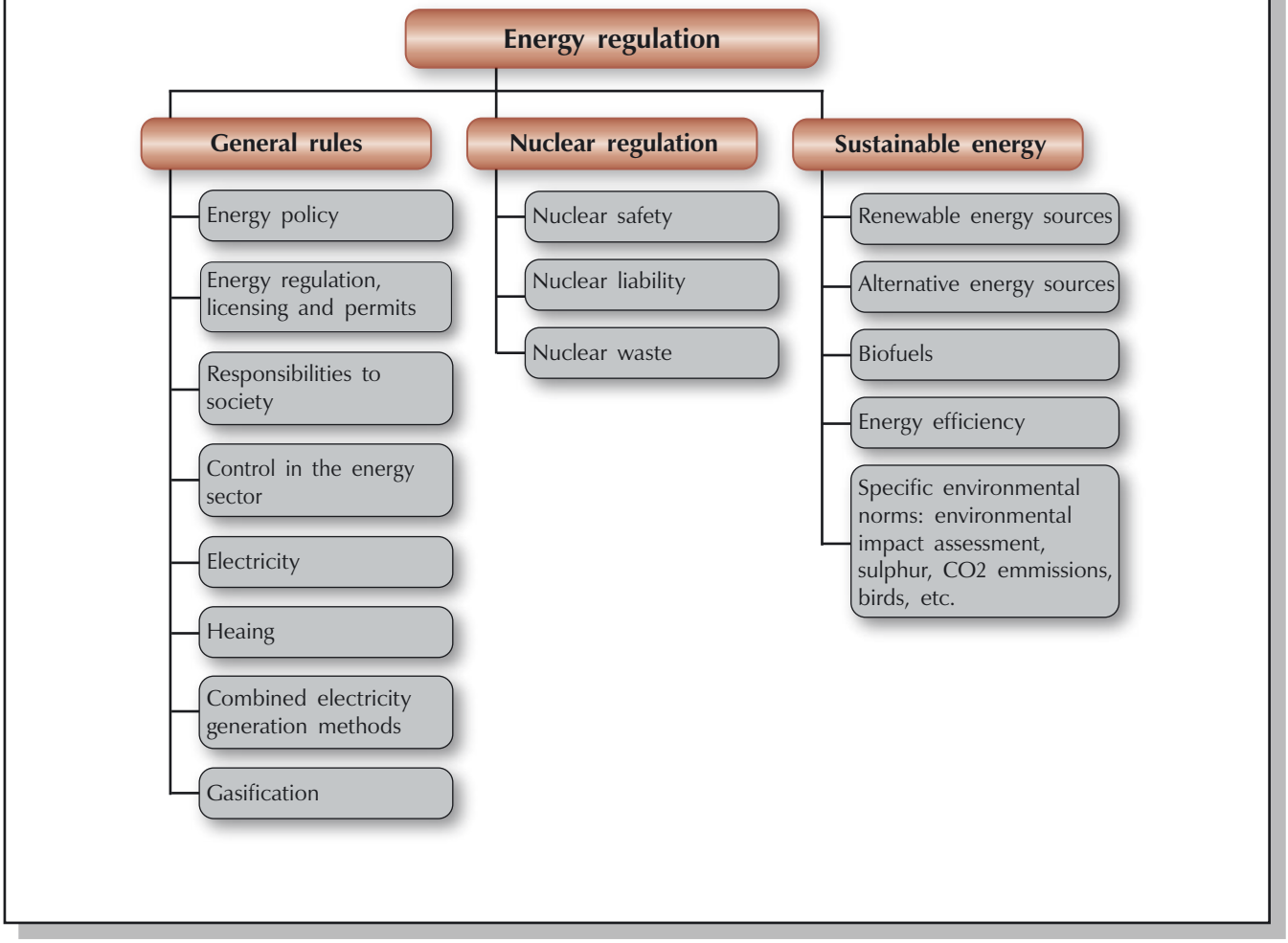
The Bulgarian energy sector is regulated by several laws and more than fifty pieces of secondary legislation. There are **three relatively differentiated regulatory subsystems**: (1) general sector regulation provided by the *Law on Energy 2003*[8] (LA); (2) nuclear energy and nuclear safety regulations; and (3) sustainable energy regulations – energy efficiency, RES, and bio-fuels.

The three subsystems have evolved in parallel over time, with occasional intersections. A differentiating factor for each subsystem is the varying degree of exposure to and influence of external factors. While the general sector regulation has developed relatively independently, nuclear regulation is entirely based on a series of international treaties and agreements to which Bulgaria is a party. These have been duly ratified and have become an integral part of the domestic law. What distinguishes the third regulatory subsystem – energy efficiency, RES, and bio-fuels – from the other two, is the strong influence of Community Law on its development since 2006. The regulatory framework for sustainable energy is based on joint directives of the European Parliament and the Council of the European Union.

[8] Prom., SG, No 107 of 9.12.2003; Am., No 18 of 2004; Am., No 18 of 2005; Am., No 95 of 2005, No 30 of 2006; Am., No 5 of 2006, No 74 of 2006; Am., No 49 of 2007; Am., No 55 of 2007; Am., No 9 of 2007, No 36 of 2008; Am., No 3 of 2008; Am., No 98 of 2008; Am., No 35 of 2009; Am., No 41 of 2009, No 42 of 2009; Am., No 82 of 16.10.2008, Am. SG No 103 of 29 December 2009, Am. SG No54 of 16 July 2010.

The bulk of the Bulgarian energy legislation has been transposed from the market and system regulations of more advanced countries. These transposed regulations, together with relatively little national experience with their implementation, result in substantial discrepancies between practice and legislation, while also providing ample opportunities for (powerful) corporate interests to capture the (weak) public administration in the energy sector. The Bulgarian government needs to make sizable investments in strengthening the regulatory and governance capacity in the country to overcome the above-mentioned tendencies. Otherwise, there is a real danger that the transposed good regulations, such as reference purchase prices for green energy, become conducive to abuse, incl. **to penetration of questionable capital and to misappropriation of government and European funds**.

Figure 2. Scope of Energy Regulation[9]



Source: Center for the Study of Democracy, 2010.

[9] A more detailed examination of the three areas of Bulgarian energy legislation is provided in Annex 1.

Mining remains outside the scope of energy regulation, since it serves to a varying degree not only the energy sector, but also other extractive industries. The Law on the Obligatory Reserves of Oil and Oil Products[10] passed in 2003 is also of importance to the maintenance of the country's energy balance although its scope is limited and by definition excludes natural gas.

Problems in the Bulgarian Energy Legislation

The dynamic political and economic development in Bulgaria, the new realities imposed by the global financial crisis and the deficiencies in the existing legal framework call for amendments to the energy legislation and, above all, the Law on Energy. The other two sub-systems – nuclear legislation and the sustainable development laws – are less sensitive to domestic political priorities and depend on the will of the international community and the EU institutions. Bulgarian energy legislation faces the following main challenges:

Transposition

Typically, the process of transposition and implementation of the legislation of the European Union, poses **new challenges to national legislation, which require further legislative action**.

Inconsistency

The development of the Bulgarian energy legislation has often been marred by loopholes, which allow for unexplained **digressions from publicly stated principles and commitments**, including such laid out in EU's legislation. Most notably, these include unjustified restriction of competition, reducing the scope of independent energy regulation, and extending hidden state aid.

Box 1. Draft Amendments of the Law on Energy (LE)

A few days after the promulgation of the *Law on Energy* at the end of 2009,[11] two new draft amendments and addenda were introduced by the Council of Ministers and by MPs, demonstrating starkly legislation inconsistency. One was aimed at removing the consequences of an open procedure for establishing the infringement of Bulgaria's obligations regarding the conditions for access to the cross-border electricity transmission network (laid out in *Regulation (EC)* No 1228/2003). The other draft law concerned the procedures and competences in developing and adopting the country's energy strategy. It proposed restoring the role of the National Assembly in the final adoption of the Energy Strategy of Bulgaria. Both changes, were produced in reaction to a specific problem, rather than being an outcome of a strategic vision for the sector's development.

[10] Prom., SG, No 9 of 31.01.2003; Am., No 107 of 2003, No 95 of 2005; Am., No 105 of 2005, No 30 of 2006, No 82 of 2006; Am., No 109 of 20.12.2007; Am., No 69 of 2008, No 102 of 2008, No 12 of 2009 – in force since 01.01.2010; Am., No 82 of 16.10.2009.

[11] *Law on Amendment and Addenda to the Law on Energy* (Prom. SG, No 82 of 16.10.2009).

Unstable Strategic Framework

Bulgarian energy legislation must unconditionally adhere to the country's energy strategy and the stated government policies. The Bulgarian Parliament continues adopting amendments to energy laws without a valid national energy strategy. Since the four-year legislative cycle overlaps with the period for updating the energy strategic framework, stability of legislation can hardly be expected, yet, it is possible to at least ensure coherence between strategic intentions and legislative initiatives.

It normally takes two to five years to adopt a legislative act, such as the *Law on Energy*, to create the respective institutional framework, and to harmonize implementation. This implies that the main elements of the energy strategy need to remain unchanged for at least 5 years to ensure stability of the legislative framework. Achieving such stability requires **a long-term agreement among the main political parties, institutions, and the civil society** on the energy strategy and on the specific domestic and foreign energy policies that consecutive governments will pursue. The task may sound unrealistic but it is feasible provided the existence of an adequate procedure for consulting stakeholders, such as the one organized for the latest review of the energy strategy concept in June 2010. In this way energy sector investors and stakeholders can familiarize themselves with each others' positions and can prepare better in the event of political changes.

Energy Legislation, Judicial System, and Public Consultations

The constitutional and administrative court cases resulting from complaints against specific energy legal norms are of particular importance for preserving public interests. **So far, the Constitutional Court has never ruled to repeal any act of energy legislation**. The practice of the Supreme Administrative Court in the energy area has been very limited, but the Court has set a precedent by repealing certain regulations concerning the implementation of the *Law on Energy* provisions.

The absence of structured public consultations on major government legislative and investment initiatives poses a serious obstacle to the development of energy legislation in Bulgaria due to the lack of corrective feedback. Publicity requirements for the law-making process are merely formally observed.[12] The low level of citizens' participation and the absence of independent public expertise on the energy issues under consideration exacerbate the problems. All too often the same experts are engaged as consultants to lawmakers, to private investors, and as participants in public discussions, which raises legitimate doubts for conflicts of interest.

[12] Indeed, art. 26, para. 2 of the *Law on Regulatory Acts* stipulates that prior to introducing a draft regulatory act for adoption by the competent authority, the initiator must post the draft on the website of the respective institution together with the motives and related report, and stakeholders must be given a minimum of 14 days to submit proposals and opinions on the draft. The provided minimum timeframe is quite unrealistic, especially when it comes to subjects of such complexity that require special knowledge.

Box 2. Time Frames for Public Consultations of Regulatory Initiatives

Announcing draft legislation in the public domain, such as the website of the respective administration that drafted the bill, at least 14 days before the deadline for public consultations runs counter to the principles of openness and coherence laid out in Art. 26, Para. 1 of the *Law on Regulatory Acts*. In essence, the administration can take advantage of the minimum time frame and treat it as a maximum period for comments. In this way stakeholders are often deprived of the opportunity to get informed about the respective legislative initiative and to react in a timely manner.

1.3 MANAGEMENT OF THE ENERGY SECTOR

It is difficult to carry out a comprehensive analysis of the functioning of each and every government unit for coordination and management of the energy sector in Bulgaria. Yet, even a general overview shows the need for strategic review and reform of the operations of these units and the respective legal and regulatory norms that guide them:

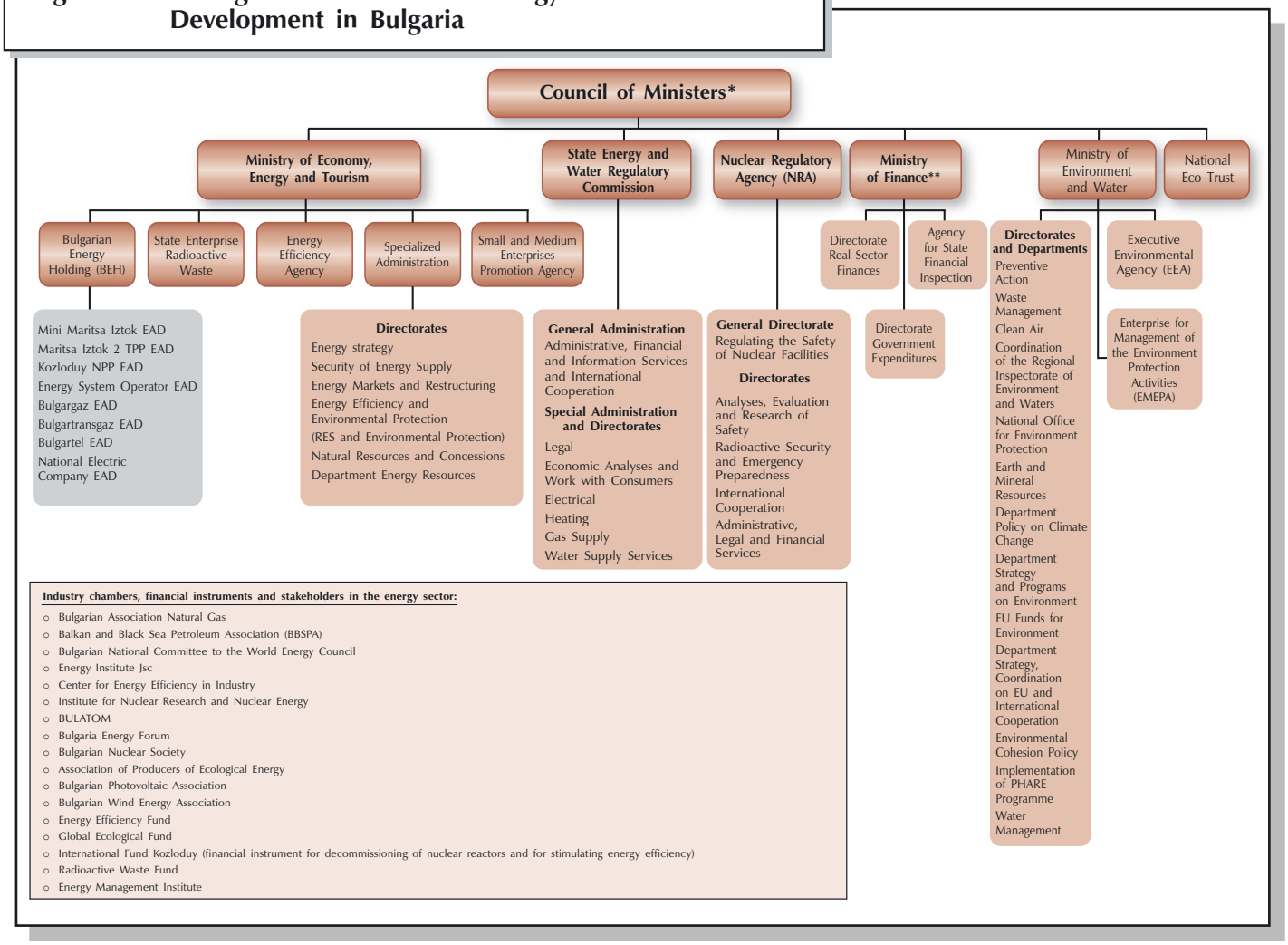
- **Energy governance in Bulgaria remains focused on state-owned companies rather than policies**, which makes it is hard to separate the public from the private, lobbyist interests;

- Although the sector remains largely state-owned and consists mainly of natural (geographic) monopolies, **state assets management remains fragmented** – each state-owned enterprise acts as if it were not a part of a system but an independent unit;

- In response to the fragmentation of management of state-owned companies and to compensate for the vertical integration that existed in the past, the government has created **additional management layers**, such as the Bulgarian Energy Holding (BEH). In effect, BEH duplicates many of the functions of the Ministry of the Economy, Energy and Tourism. Despite the presence of BEH, the Ministry remains engaged in the daily operational management of the companies, particularly the larger ones such as Kozloduy NPP and the National Electric Company (NEK).

The management of the energy sector has been entrusted to various ministries, agencies, directorates, and state-owned companies, with frequently overlapping responsibilities and conflicting interests. Changes in the management structure of the Bulgarian energy sector are most commonly the result of external pressures. For example, the unbundling of generation, transmission, distribution and supply of gas and electricity seems to be driven by a formal compliance with the directives of the EU's Third Liberalization Package, rather than the logic of national specifics. The establishment of the Bulgarian Energy Holding in 2008 by mechanistically pooling the assets of a number of state-owned companies created the impression that the government aimed to actually reduce transparency and find alternative approaches for the implementation of resource-intensive infrastructure

Figure 3. Management Structure of Energy and Sustainable Development in Bulgaria



Notes:

* *Other participants in the sector: Ministry of Regional Development and Public Works (permits for construction of new energy units), Ministry of Health (specialized control) and Ministry of Environment and Water (Environmental Impact Assessment, etc.).*

** *Regarding the Ministry of Finance, it is difficult for all the departments, relevant to energy policies to be identified from the publicly available information.*

Source: Center for the Study of Democracy, 2010

projects in the energy sector, rather than secure strategic advantages. A strategic review of the management structure in the energy sector should clearly map out the responsibilities of each management level and should lay out mechanisms for better interaction between them. The following aspects should be taken into particular consideration:[13]

- Distribute the management responsibilities for crafting climate change policies (energy efficiency and RES development) and a Bulgarian strategy for sustainable development between the Ministry of the Economy, Energy, and Tourism (MEET) and the Ministry of the Environment and Waters (MEW). Determine

[13] Energy Strategy of Bulgaria 2020: Commentary and Proposals for Improved Governance, Policy Brief No 19, Center for the Study of Democracy, November 2009.

the type of activities and the level of coordination between the two ministries, as well as the leading management authority in the green energy sector. Differentiate between MEET and Ministry of Finances' control functions over state-owned energy enterprises. Energy projects take up billions from the national budget in the form of direct investments and government guarantees, yet **at government level it is not clear who is ultimately responsible for making the investment decisions** and how those decisions are taken, who collects and archives the financial information of the state-owned energy sector, and/or who decides on how state-owned enterprises' finances should be run in order to ensure their financial stability;

- **Reinforce the role of the National Assembly in strategic decision-making in the energy sector**. The National Assembly endorses the country's energy strategy. It is necessary to also boost its role and involvement in large-scale infrastructure energy projects, when the latter involve explicit or implicit national budget guarantees (e.g. through long-term agreements for purchasing electricity at fixed prices) or when such projects are implemented through joint ventures with companies that are over 50 % state-owned. For example, in 2008 NEK undertook financial obligations under the contract for the construction of Belene NPP amounting to nearly EUR 4 billion. This amount constituted more than 80 % of the entire state debt as of the end of the same year and should have been subject to parliamentary endorsement similar to the procedure for increasing the government debt level;

- Delineate more clearly responsibilities between the regulator – the State Energy and Water Regulatory Commission (SEWRC), the ministries in charge of policy – MEET and MEW, and the management of state-owned enterprises. In 2010 SEWRC conducted and announced publicly audits of private electricity distribution companies under pressure from the Prime Minister, while no similar audit was carried out for upstream state-owned enterprises. The manner, in which the audits were carried out raised legitimate **concerns about the independence of the regulator** and the impartiality in evaluating the performance of state-owned vs. private companies in the sector. It would seem that, instead of striving to raise efficiency and reduce the price of energy for end users, most of the state management units actually enter into implicit agreements to reinforce the monopoly positions of the enterprises from the sector.

As a result of the fragmentation of management functions and structures across the sector, authority and responsibility get blurred. There is no platform for inter-institutional and/or civic control and checks and balances of the functioning of the multitude of agencies, directorates, and enterprises in the energy sector in Bulgaria. There is a lack of transparency and public information about the activities of and the results from state management of the energy sector. An additional problem is the quality and impartiality of management selection in the state-owned energy sector and **the use of term limits to cement political appointees at important positions**. The lack of national experience in independent regulation is conducive to a revolving door practice: experts switch back and forth between positions in the regulator and in regulated enterprises. There are no publicly available guidelines or codes of ethics in state-owned or private energy enterprises or the energy regulator for preventing of conflicts of interest.

Table 1. Vulnerability to Corruption: Government Policies

Activity	Areas vulnerable to corruption	Red flags
Estimates of the additional capacity required to meet demand	Manipulation of the estimates	No or inadequate analysis of demand No public consultation Lack of transparency in demand forecasting
Norms and procedures for licensing	Alteration of licensing criteria to favor particular interests	Ad hoc revisions or exceptions made to criteria Nontransparent process for revising norms
Statutory and other clearances	Dilatory and repetitive procedures with no time limit for final decision	Vague procedures Authorities with overlapping jurisdictions
Sale of the energy generated	Restrictions on who may buy the energy and the price payable	Noncompetitive procurement of independent power producers (IPPs)
Acquisition of land and rehabilitation of project-affected persons	Payment of compensation to landowners Payment to and resettlement of project-affected people	High level of activity in land transactions before government notification of zoning or land acquisition A few transactions registered at inflated prices to raise the benchmark for rates of compensation Opaque procedures for payment of compensation Several partial payments
Subsidies to specified consumer groups	Administration of subsidy, including selection of beneficiaries	Unmetered supply Absence or weak linkage with means criteria
Selection of regulators and top management of utilities	Manipulating selection criteria Corruption in appointments	Undue delay in appointments Lack of transparency in the selection process

Source: Gulati, Mohinder and Rao, M.Y. Corruption in the Electricity Sector: A Pervasive Scourge, in The Many Faces of Corruption: Tackling Vulnerabilities at the Sector Level Washington, The World Bank, 2007.

1.4 MANAGEMENT OF STATE-OWNED ENTERPRISES

A number of **organizational changes have been made to the state energy sector** in Bulgaria during the past decade. Yet, these changes are characterized by **conflicting goals and results**, as they were seeking to meet multiple aims, such as secure revenues from privatization, meet the provisions of European legislation, or attract investments. Furthermore, the dynamically changing

external environment, the development of new technologies for conventional energy sources, and the market penetration of renewable energy sources are all factors that imposed changes on the sector. The results of these divergent restructuring efforts in Bulgaria can be summarized as follows:

- **Decentralization and privatization:** in 2000 NEK was separated into 15 companies for generation, transmission, and distribution of electricity. The stated aim was to privatize distribution and to ensure greater competition in and liberalization of electricity supply. In continuation of this policy and in an attempt to meet EU goals for market liberalization, the electricity and gas distribution were privatized and transmission system operators were established;

- **Reverse integration:** in 2008 the largest state-owned energy companies were pooled into the Bulgarian Energy Holding with the stated purpose of creating a national energy champion likely to have better access to financial resources and capable of investing in the regional and European energy markets.

Yet another restructuring is forthcoming in 2011 in order to meet the requirements of the EU Third Liberalization Package concerning the separation of transmission from supply and distribution of gas and electricity. This calls for a transformation of BEH and a reinforcement of the functions of the State Energy and Water Regulatory Commission. The process of restructuring, however, is being delayed and meanwhile **problems within state-owned companies are accumulating**:

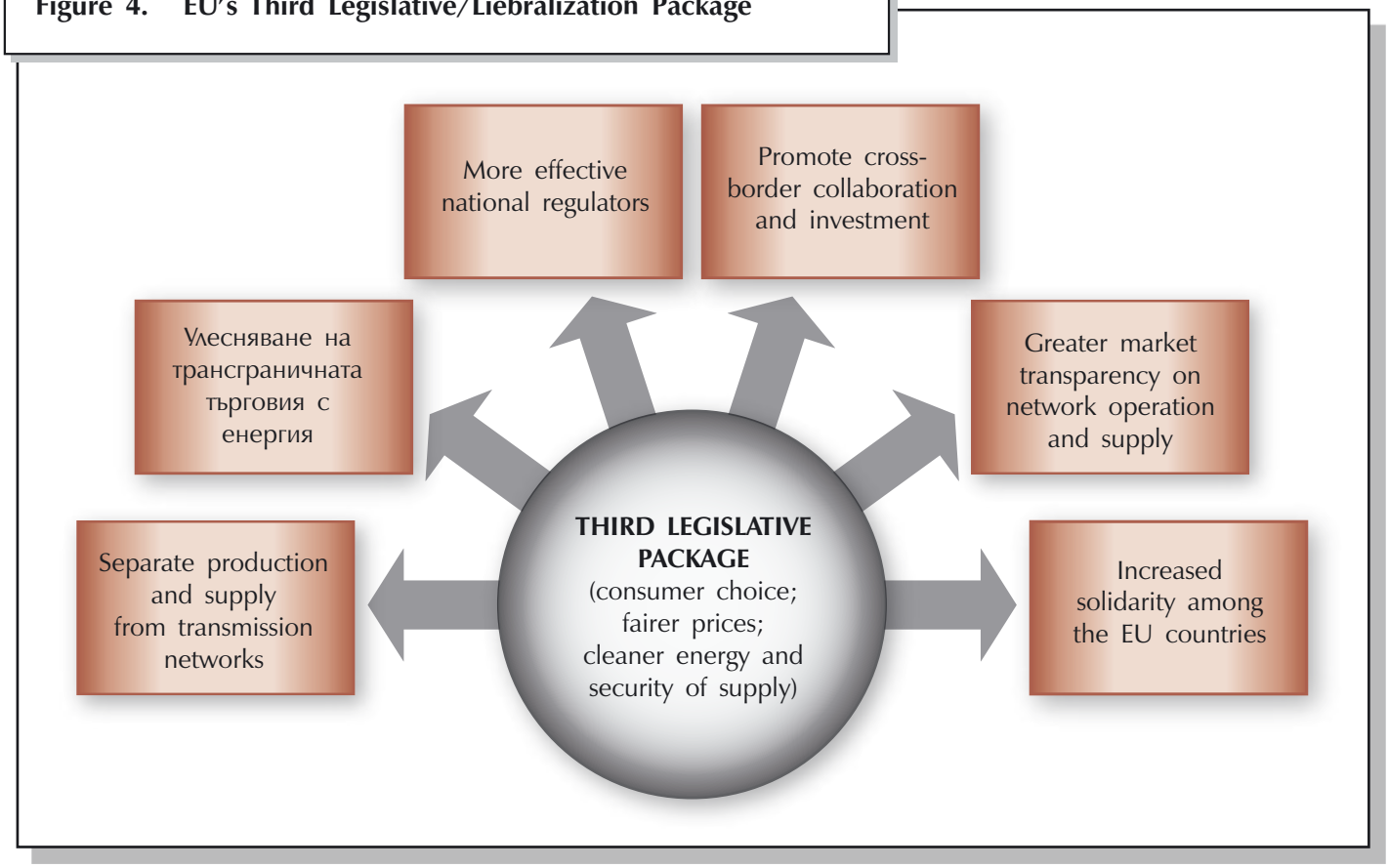
- **The central heating companies are seriously indebted,** which results in a relapse of the financial condition of the public gas supplier and a deterioration of important central-heating infrastructure. Failure to resolve this problem would affect roughly 2 million customers;

- **The financial condition of the state-owned companies is unclear**. The Ministry of Finance is tasked with collecting quarterly financial reports from state-owned enterprises with a majority government stake.[14] The release of the quarterly financial reports of state-owned enterprises on the web page of the Ministry of Finance since the beginning of 2010 has improved public access to information about the condition of the companies. This commendable first step should be followed by the adoption of **uniform financial accounting and reporting standards** for all state-owned enterprises. The publicly available quarterly reports are still of low quality. In this sense, the aim should be to achieve a level of public accountability comparable to the accountability of publicly traded companies. It would be worthwhile to improve the data usability for external users by entering the information into an accessible database;

- **There are no adequate criteria for choosing Bulgarian state-owned partners in investment projects**. For example, some gas interconnection projects are implemented by BEH, while others by Bulgartransgaz. It would

[14] Council of Ministers Decree No 114 of June 10, 2010 on monitoring and control of the financial condition of state-owned enterprises and companies with a majority government stake and the companies under their control (Former CM Decree No 87 of 7 May, 2008).

Figure 4. EU's Third Legislative/Liebralization Package



Source: Center for the Study of Democracy, 2010.

seem that the decisions about the involvement of Bulgarian state-owned companies in such projects are random, which is hardly recommended in light of the long-term commitments under these projects;

- **The added value of the BEH and NEK holding structures is unclear**. This has become particularly obvious in the management of government funding for Belene NPP: the then Ministry of Economy and Energy transferred funds to BEH, which in turn transferred them to NEK, which invested the money on behalf of Belene NPP project, yet, assuming the investment risk. In this way responsibilities were blurred, and the financial liabilities remained with NEK, while its management did not have the operational freedom and means to manage its investments;

- **The responsibilities and the authority of the executive and the regulator have not been clearly delineated.** The Prime Minister's intervention in the audits of the electricity distribution companies in 2010 demonstrated the absence of a guarantee for the independence of the energy regulator on the one hand, and the inadequate control over the regulator's performance by the Bulgarian parliament, on the other;

- **Relations between state-owned enterprises and their private counterparts**. In a number of publicized cases signed contracts between state-owned energy companies and their private partners proved to be detrimental to public

finances.[15] This prompts an analogy with the schemes for siphoning state-owned enterprises' resources by their management in the beginning of transition in Bulgaria through installing phony private contractors on the companies' entry and exit. For example, intermediaries handle the import of gas despite the presence of a single import pipeline. Similarly, the export of electricity produced by state-owned enterprises is entrusted to private companies in the absence of any notable gains in efficiency or profitability. While state-owned companies are in a dire financial state, their private counterparts in the energy sector are amongst the most profitable.[16]

The lack of a strategic vision for the development of state-owned enterprises in the energy sector places them in an extremely vulnerable position and under the **risk of covert privatization**, incl. through the entry of foreign hostile interests. On the one hand, state-owned enterprises are burdened with a number of government infrastructure projects and social functions limiting their investment capacity. On the other hand, private interests are pushing state-owned enterprises out of the profitable market segments. Such a governance model is not sustainable and calls for development in two directions: (1) gradual privatization through placing government's shares on the stock market, while retaining control over key companies such as NPPs, transmission system operators, etc; and/or (2) development of national champion companies capable of penetrating the regional and European markets. The imminent restructuring of BEH announced by the Bulgarian government in 2010 could serve as the starting point for this process.

1.5. RESTRUCTURING OF THE BULGARIAN ENERGY HOLDING[17]

The Bulgarian Energy Holding has failed to achieve its stated goals – improving the financial and economic performance of the companies within it. The holding group has not developed internal organizational cohesion and has remained a perfunctory collection of companies with disparate areas of activity (coal, electricity, natural gas, telecommunications). BEH's aspirations to operate as a financial holding structure streamlining the financial management of individual companies has also not been realized. The holding company receives payments from its constituent companies for services that they themselves continue to perform, i.e. there is a duplication of efforts. BEH is in fact turning into a separate auxiliary structure in the state-owned energy sector, acting as a clearinghouse, taking on claims and liabilities and redirecting financial flows between its subsidiaries.[18] Owing to the administrative restrictions imposed by BEH, a large share of the production-related, technical, and/or

[15] For a more detailed discussion of specific examples, see the section Energy Policy Instruments: Public Procurement in the present Report.

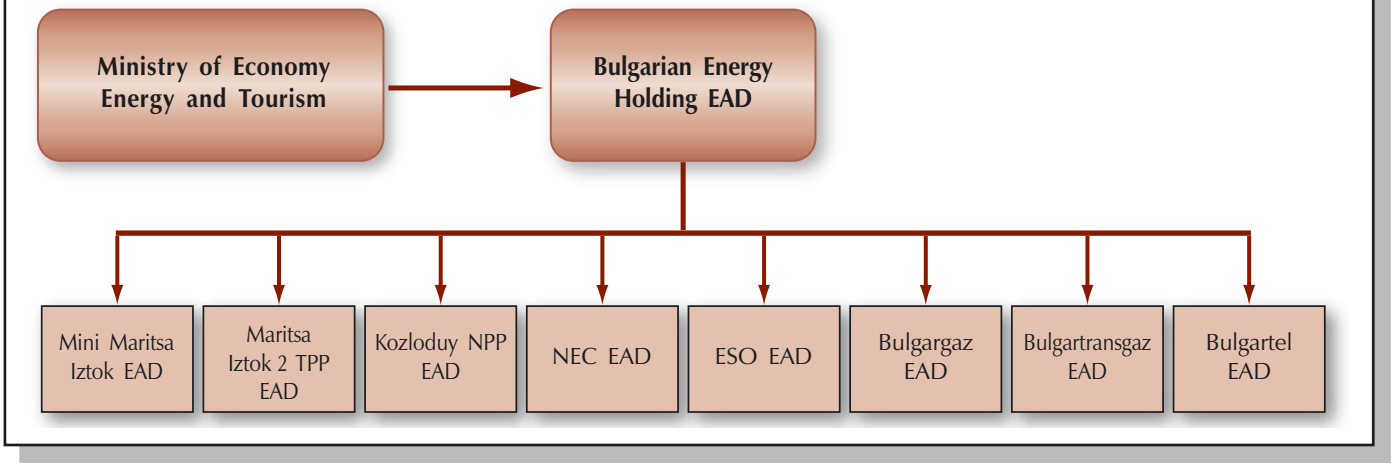
[16] The Energy Sector in Bulgaria: Main Governance Problems, Center for the Study of Democracy, 2010.

[17] The Bulgarian Energy Holding EAD was established on September 18, 2008.

[18] Bulgarian Energy Holding AD, Financial Report for the nine-month period ending on September 30, 2010. Last accessed on 23.11.2010 and accessible at the website of the Ministry of Finance <http://www.minfin.bg/bg/page/605>.

financial decisions in the subsidiaries have to go through a number of bureaucratic procedures, which delays their implementation. Common accounting and reporting standards have not been adopted within the holding group. There are no mechanisms for pooling procurement for similar goods and services that would reduce their unit costs. No analytical reporting is in place to enhance the transparency of the holding group.

Figure 5. Organizational Structure of the Bulgarian Energy Holding



Source: BEH, 2010.

The main problems for BEH's management are:

- **The indebtedness of subsidiaries.** This is particularly alarming in the cases of the two former holding structures, namely NEK AD and Bulgargaz AD. Their liabilities might be transferred over mechanically to BEH, which would relieve temporarily their burden but would hardly resolve the problem. In September 2010, BEH capitalized its receivables and took on liabilities from the two companies amounting to more than BGN 400 million.[19] In 2010, there was a general improvement in the financial condition of the companies within BEH (with the exception of Bulgargaz) owing to the more favorable market conditions, the efforts of MEET to cut costs in all companies, and the forced delay of payments on infrastructure projects, supplies, and other contracts. Nevertheless, NEK and Bulgargaz face decapitalization. By September 30, 2010, both companies were in a liquidity crisis:

  ◊ **NEK is in violation of all of its contracts with credit institutions.** Its obligations under these contracts have in fact become immediately payable upon request, which would result in the company's bankruptcy. **Investment expenditures are financed by operating capital.** The unforeseen rise in capital investments in the construction of the Tsankov Kamak hydro power plant have hindered planned investments in grid development. In 2010 there were practically no expenditures on the Belene NPP

[19] Reports of BEH AD and the companies within the holding group for the period January-September 2010. Last accessed on 23.11.2010 and accessible at the website of the Ministry of Finance <http://www.minfin.bg/bg/page/605>.

project.[20] The poor financial condition of NEK is beginning to affect other companies in BEH due to delayed payments. For instance, Kozloduy NPP cites its accumulated claims on NEK, amounting to BGN 140 million, as a major risk to the sound operation of the company;[21]

◊ **Bulgargaz is the company that has incurred the largest loss within BEH in 2010.** In addition to the low regulated gas prices on the domestic market, which the company is forced to take, it is burdened with obligations under contracts with monopoly suppliers from Russia. As of September 2010, the company had unpaid liabilities under gas import contracts amounting to USD 80 million;

- A large portion of the loans of BEH companies is backed by **government guarantees or entails government aid**. The analysis of the financial condition of the companies as of 2010 shows they are unable to secure, either independently or as a holding group, the implementation of large infrastructure projects without implicit government guarantees. Therefore, the companies' poor financial condition should be perceived as a direct threat of **exposure of the national budget to the risk of incurring liabilities under these projects**. To ensure sound financial discipline, the obligations of BEH or its constituent companies with respect to large infrastructure projects should always be considered to imply government guarantees and be treated accordingly;

- **The equity structure of BEH subsidiaries is unjustified from an economic point of view**. One possibility for dealing with the high levels of indebtedness of BEH companies and raising additional investment funds is to list all or part of their equity on the stock market. In this respect the size and structure of equity is of utmost importance. Optimizing the equity structure of BEH could maximize shareholders' value. The actual equity of the holding group is several times higher than the statutory (or authorized) share capital. This is economically unsound and does not reflect the actual government stake in these companies. **It is feasible and it is recommended that the government increases the share capital of each state-owned energy company in BEH at least twice** prior to its listing on the stock market. Optimizing the equity structure would ensure more adequate protection of the government's stake, it would boost the company's credit rating, and it could lead to a significant increase in revenues from sold shares.

Due to the failure to achieve the goals set with the establishment of BEH, in April 2010 the Government of Bulgaria announced its intention to break up BEH and restructure the management of state-owned enterprises. Although there is as yet no final decision on the restructuring, several **alternatives for the regrouping of the holding group** have been publicly announced, such as:

- Dividing BEH on a **sectoral basis**: (a) creating two new holding groups that would control electric and gas companies, respectively; (b) keeping BEH but with a merger between NEK, Kozloduy NPP, and Maritsa Iztok 2 TPP;

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[20] NEK EAD Activity Report for January-September 2010. Last accessed on 23.11.2010 and accessible at the website of the Ministry of Finance <http://www.minfin.bg/bg/page/605>.

[21] Financial analysis and assessment of the state of NPP Kozloduy EAD as of 30.09.2010. Last accessed on 23.11.2010 at the Ministry of Finance webpage <http://www.minfin.bg/bg/page/605>.

- Dividing BEH on a **functional basis**, with one company controlling the transmission operators (Electric System Operator and Bulgartransgaz) and a second one controlling the remaining production and supply companies.

Table 2. EU Models for Unbundling Transmission System Operators (TSO) as per the Third Liberalization Package[22]

Model	Ownership Unbundling – Separate TSO	Independent System Operator (ISO)	Independent Transmission Operator (ITO)
Model features (all models must ensure effective separation of transmission from generation and/or supply)	Separate legal entity assumes ownership and operation of the transmission system. Vertically integrated company (BEH/successor) may retain only a minority stake, without voting rights in the operator. Control (exercise of property rights, etc.) is entrusted to a public authority other than the authority controlling the vertically integrated company (MEET).	Vertically integrated company (BEH/successor) retains ownership of the transmission system. The regulator certifies an independent system operator, which must be legally separate from the vertically integrated company (BEH/successor) and be under the control of a public authority other than MEET.	Vertically integrated company (BEH/successor) transfers the assets and management of the transmission network to an operator who can be part of the group but a separate legal entity with guaranteed autonomy of management (a separate building, IT systems, audit, administration, etc.). MEET/BEH can participate in the supervisory body of the ITO.

Source: Center for the Study of Democracy, 2010.

Before proceeding with the restructuring of BEH, the Bulgarian government needs to carefully assess the needs for restructuring, define clearly its goals, and analyze the costs and benefits of changing and/or preserving any management structures. **Mergers and acquisitions are among the most complex and time-consuming processes in managing enterprises**, often ending in failure owing to the lack of clear strategy and goals. Best practices in company strategies for mergers and/or restructuring show that they take at least 18 months to implement and should **pursue at least one of the following goals:**[23]

- Expansion of market share and/or increase in market power;
- Diversification into a new sector or industry;
- Protection from takeover and/or penetration of market competitors;
- Internal restructuring: increasing revenues, reducing costs, tax benefits, reducing the cost of capital;
- Penetration of new geographic markets;
- Access to skills and/or technologies.

[22] Commission staff working paper, Interpretative note on Directive 2009/72/EC concerning common rules for the internal market in electricity and Directive 2009/73/EC concerning common rules for the internal market in natural gas: the unbundling regime, European Commission, January 22, 2010.

[23] Jackson, Tim and Liza Spence, Hearts and Minds: the Keys to Successful Mergers, Booz Allen Hamilton, 2004.

The Bulgarian government should implement the provisions of the EU's Third Liberalization Package[24] regarding the separation of energy and natural gas transmission from generation and supply by March 3, 2012. By that date the government should have also accomplished the restructuring of BEH. The transmission system operators (ESO and Bulgartransgaz) must be effectively separated from BEH, and ownership rights control should be transferred to a public authority other than MEET. Bulgaria will have to choose between one of the three models proposed by the EU for the effective separation of transmission of gas and electricity from generation and supply.[25] The approach may differ for the various operators, and Bulgaria has already taken steps to implement the selected models in the two sub-sectors:

- **Bulgartransgaz** has the basic characteristics of a separate TSO (ownership unbundling model) and/or an ITO (having ownership of the grid). Since Bulgaria is still an **isolated market** in terms of the EU liberalization directives, i.e. it is not linked to another Member State through an interconnected system and has only one major external supplier of gas, it would make sense to choose a model that would preserve the shareholding structure of the operator and would guarantee its independence – the ITO model**.** Although the country may request derogation from the provisions for effective unbundling, it would be better for the selected operator to deny access to third parties, other than the public supplier Bulgargaz, until the interconnectors with neighboring countries (Romania and Greece) have been constructed. This would safeguard the position of Bulgargaz as a public supplier, while guaranteeing *de jure* the effective implementation of the provisions of the European gas liberalization directive. **A clear-cut time frame for building the interconnectors should be set** in order to start planning for the *de facto* liberalization of the market;

- **The Electricity System Operator** possesses some of the characteristics of an ISO (it currently does not own the grid). A possible transfer of ownership of the grid from NEK to ESO would bring the latter closer to the Bulgartransgaz model. Undertaking such a step may, however, lead to destabilizing the financial standing of the electric company. This could be offset by a merger between NEK, Kozloduy NPP and Maritsa Iztok 2 TPP, but should be well justified by clear long-term goals and specific implementation steps.

The implementation of the Third Liberalization Package will increase pressures to improve the management structure of state-owned enterprises in the energy sector and will place the issue of restructuring and/or dismantling BEH on the agenda. The Package also entails a significant strengthening of the authority and the functions of the independent regulator – the State Energy and Water Regulatory Commission. The latter calls for enhancing the existing, and generating new, technical and regulatory expertise of this institution. The restructuring of BEH, and particularly the formation of new entities, should not be an aim in and of itself, but the result of careful analysis and assessment of the alternatives, incl. preserving elements of the status quo and/or disbanding the holding company.

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[24] The Package includes the following five documents: Directive 2009/72/EO; Directive 2009/73/EO; Regulation (EO) No713/2009; Regulation (EO) No714/2009; and Regulation (EO) No715/2009.

[25] The provisions of the directives should be transposed to Bulgarian legislation by March 3, 2011.

2. THE LARGE ENERGY INFRASTRUCTURE PROJECTS: EXAMPLES OF MANAGEMENT DEFICIENCIES

The construction of new energy generating capacities is among the areas most affected by corruption worldwide.[26] A major reason for this is the high complexity of contracts for the construction of new infrastructure, which leaves more opportunities for corrupt behavior. Several **notable problems in the management of large energy infrastructure projects** need to be pointed out:[27]

- Such projects involve a number of contractors, subcontractors, suppliers, consultants, and other participants, each of whom may engage in corrupt practices. In some instances the main contractor may not even be aware of ongoing corruption practices and find out only in the event of project failure;

- **Poor performance and output quality is easily covered up** in the mesh of multiple contracts – a typical practice, for example, is to deliver lower than contracted quantities of a raw material, with the buyer and supplier sharing the proceeds from the remainder;

- Big energy companies are used to operating in **countries with high levels of corruption**, thus being under no pressure to adhere to ethical standards. This is particularly the case in countries where anti-corruption legislation is weak, or with companies that are unlikely to be scrutinized at home;

The Bulgarian energy sector and the planned infrastructure projects are fully exposed to all of the above corruption risks. The Bulgarian economy is characterized by high corruption, and the rate of corruption among private contractors is comparable to that in public procurement.[28] There are a number of governance deficiencies and inefficient and wasteful use of resources across all segments of the sector – electricity, thermal power, and fuels. **The instability of the energy sector places Bulgaria among the countries with the lowest energy indicators in the European Union.**[29] This multitude of problems is due not only to the shortage of financial resources or to technical constraints, such as outdated technical capacity and/or infrastructure, but is also related to other factors like economically unsound planning, corruption,[30] lobbying, gray economy, and

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[26] Ruth, M., Corruption and the Energy Sector, MSI, USAID, November 2002.

[27] The Future of Global Infrastructure, Unweaving a Tangled Web, Michael Peel, Financial Times, June 8, 2010.

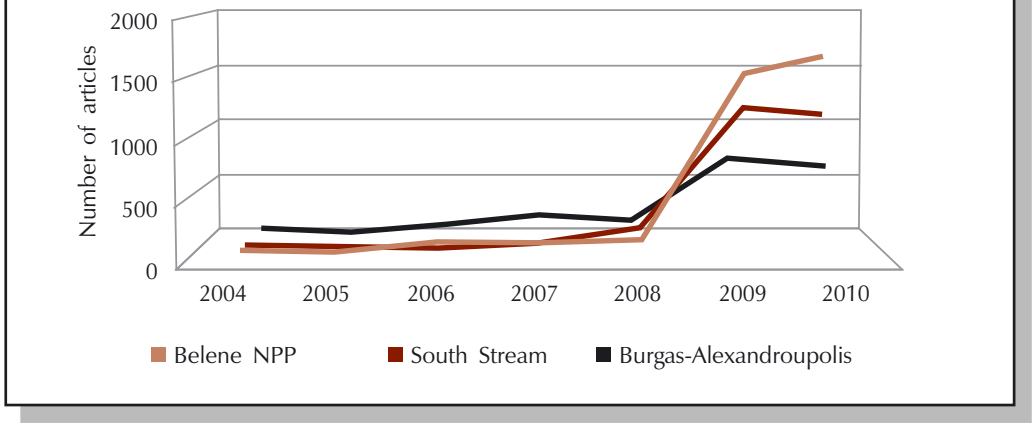
[28] Anti-corruption reforms in Bulgaria, Center for the Study of Democracy, Sofia, 2004.

[29] For a more detailed overview of the condition and challenges before the Bulgarian energy sector, see Bulgaria's Energy Sector, Policy Brief No 22, Center for the Study of Democracy, Atlantic Council of the United States, May 2010.

[30] For a detailed analysis of corrupt practices and government resource management, see Crime Without Punishment and Countering Corruption and Organized Crime in Bulgaria, Center for the Study of Democracy, 2009; Organized Crime Threat Assessment: Methodological Issues and Global Experience, Center for the Study of Democracy, 2010; Examining the Links between Organized Crime and Corruption, Center for the Study of Democracy, 2010.

misappropriation of resources. The lack of broad and active public debate concerning large-scale energy infrastructure projects allows significant government spending without adequate public awareness.

Figure 6. Number of Articles on Large Infrastructure Projects in the Bulgarian Press by Year and Topic



Note: Data are as of 16th of November, 2010.
Source: Ciela.net, 2010.

Analyzing the process of implementation of large-scale energy infrastructure projects is of great importance for the long-term sustainability and security of the sector and of the economy as a whole. The scope of the projects allows for a holistic overview of the structure, activities, and processes in the energy sector.[31] The current report reviews the Belene NPP project in greater detail, as it is the largest undertaking of all energy infrastructure projects and involves all levels of governance. Furthermore, the report provides a brief overview of the South Stream, Burgas-Alexandroupolis, and Nabucco projects. All of these projects share similar characteristics and problems:

- The projects **exceed the country's economic and technical capacity** for infrastructure management. The financial scope of Belene NPP exceeded the volume of the entire public procurement market in Bulgaria in 2006;[32]

- The projects involve **excessive consultancy fees** paid out prior to the actual project launch. As a general rule consultancy fees are poorly accounted for, and are the most commonly used instrument of political corruption. These fees have spawned a sizeable expert lobby, which has overwhelmed public debates with biased assessments, while not disclosing their conflicts of interest. The lobby has poisoned public debate and has obstructed any independent and objective analysis of problematic issues related to project implementation;

[31] For a more detailed overview of the Bulgarian energy sector, see The Energy Sector in Bulgaria: Major Governance Issues, Center for the Study of Democracy, 2010.
[32] Corruption in Public Procurement: Risks and Counteraction, Center for the Study of Democracy, Sofia, 2007.

Table 3. Corruption Vulnerability of the Different Stages of Project Development

Activity	Areas vulnerable to corruption	Red flags
Project formulation	Techno-economic studies to establish feasibility and viability Surveys and site investigations Estimation of costs and implementation schedules Statutory and other clearances Land acquisition for the plant Rights-of-way for transmission lines Rehabilitation of persons affected by the project	A perfunctory study (or no study at all) Omitting surveys and site investigations or leaving them to be done later by the contractor Estimation of costs Vagueness about procedure for obtaining clearances Not allocating sufficient resources for paying compensation to project-affected persons
Project implementation	Procedure for selection of contractor Type of contract (works, labor, turn-key) and contract documents Monitoring and supervision of contractor's work Purchase and supply of plant, machinery, and materials Stage payments to contractors Completion and commissioning	Procedure not spelled out in bid documents Lack of specificity in the contracts Failure to designate supervisors with clear responsibilities Not allocating sufficient funds for payment, leading to disputes and claims of escalation of costs
Project operation	Performance of plant and machinery during initial guarantee stage Execution of operations and maintenance (in-house or outsourced) Emergency repairs Purchase and use of materials, stores, and consumables Emergency purchases Payments to contractors, suppliers, and vendors Employee-related issues, such as promotion, transfer, payment of employees' dues such as provident funds, various allowances, and reimbursement of expenses Adherence to relevant codes and licensing conditions	Failure to specify the performance parameters and methodology of verification Failure to spell out clear procedures for routine as well as emergency purchases Requiring multiple certifications (thus diluting individual responsibility) before payments can be made Absence of codified and transparent procedures Failure to specify responsibilities of individual officers to ensure compliance with license conditions

Source: Gulati, Mohinder and Rao, M.Y. Corruption in the Electricity Sector: A Pervasive Scourge, in The Many Faces of Corruption: Tackling Vulnerabilities at the Sector Level Washington, The World Bank, 2007.

- Contracts for large infrastructure projects have been concluded on a bilateral basis with **countries where the corruption risk is higher than in Bulgaria**[33] or with companies that adhere to no international ethical standards.[34]

2.1. THE BELENE NPP PROJECT

The growing concerns over climate change, the decline in fossil fuel reserves, and the related increase in their prices, have led to the **resurgence of nuclear energy worldwide, but in particular in emerging markets**. Additional factors include the ever-increasing energy consumption needs of major emerging economies, such as China and India, and the approaching ends of the production lifecycles of a number of nuclear reactors in developed countries. Most long-term forecasts project an increase in the demand for all types of energy. In the process the estimated share of nuclear energy may reach 8 % by 2035 from 6 % in 2010.[35] Nevertheless, the reasons for halting the construction of new nuclear reactors in the developed countries in the 1980s remain unresolved and continue to polarize public opinion – namely, **the enormous potential negative consequences of nuclear accidents and the lack of viable solutions for long-term storage of nuclear waste**. In Europe, there is a clear division of public opinion into a pro-nuclear (France, Czech Republic, Great Britain, Sweden, Bulgaria) and an anti-nuclear camp (Austria, Germany, Slovenia).[36] In this relation, debates in Germany have attracted the most attention. In 2010, contrary to the prevailing public opinion, the German government extended the lives of its nuclear reactors by an average of twelve years beyond the originally set phase-out date of 2022.

Bulgaria is one of the countries in the European Union with relatively large share of nuclear energy in final energy consumption. The long-term viability of this segment of the energy sector is an **important cornerstone for ensuring the country's energy security**. There is a **strong nuclear lobby** in the country, bringing together energy experts, politicians, and a number of private companies. The Bulgarian nuclear program development has been characterized by lack of transparency and accountability masked by claims of technical complexity. As a result, though the majority of the population is in favor of nuclear energy, **Bulgarians are among the least informed citizens in the EU about nuclear energy facts and risks.** At the same time, the liability fund for nuclear damage in Bulgaria is limited to BGN 96 million (EUR 49 million), which is among the lowest in Europe.[37]

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[33] According to the Corruption Perception Index, Russia has a score of 2.1 versus 3.6 for Bulgaria. A higer score denotes less corruption.

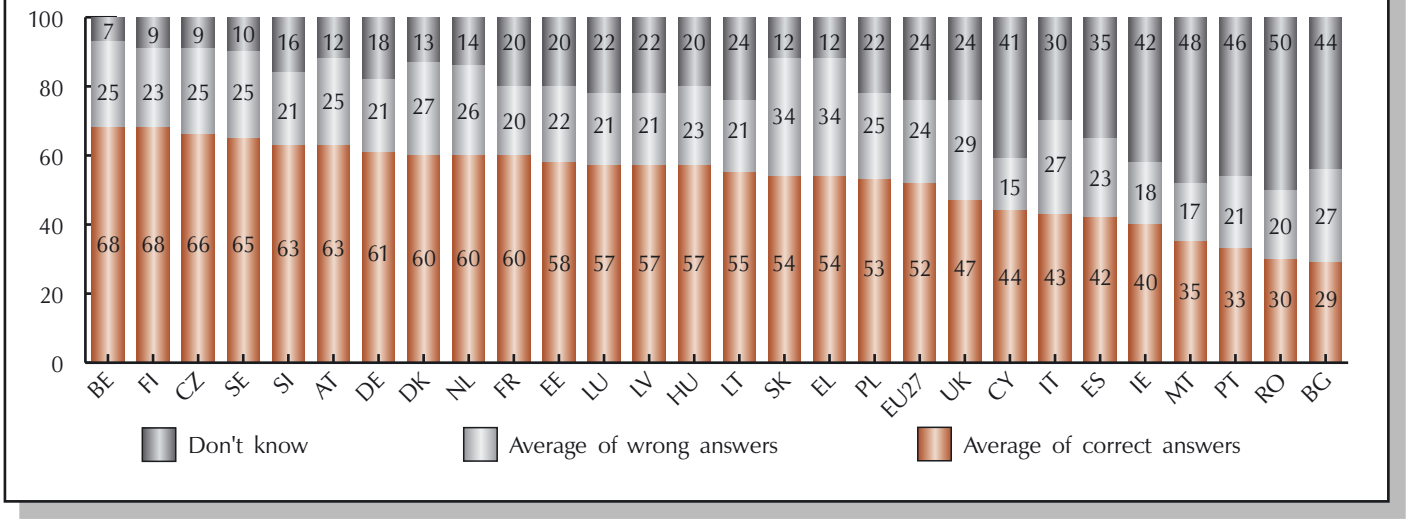
[34] Anticorruption Reforms in Bulgaria: Main Outcomes and Risks, Center for the Study of Democracy, Sofia, 2008.

[35] World Energy Outlook 2020, International Energy Agency, November 2010.

[36] Europeans and Nuclear Safety, Special Eurobarometer 324, European Commission, March 2010.

[37] The Vienna Convention on Civil Liability for Nuclear Damage (2004).

Figure 7. Level of Awareness of Nuclear Energy Issues among Europeans (responses to nuclear energy questions)



Source: Europeans and Nuclear Safety, Special Eurobarometer 324, 2010.

Nuclear energy management is one of the most difficult tasks in the sector due to a number of specific characteristics of this particular type of energy, such as: the large initial investment; the high level of technical expertise needed; the very long operation and post-operation periods; the high environmental cost with potentially catastrophic consequences in cases of accidents; and the lack of long-term solutions for the storage of spent nuclear fuel. Due to these factors, nuclear energy policy is extremely complex and the withdrawal of the government from the sector and adherence to solely market principles is impractical.[38] In this context **the restart of the construction of Belene NPP after 2002 has been marked by all of the bad practices observed in the energy sector and in the management of state-owned enterprises in Bulgaria over the past 20 years**, such as:

- **Manipulated expression of interest procedure**, which has restricted technological and market choices and has increased costs and the long-term dependency on the selected manufacturer**;**

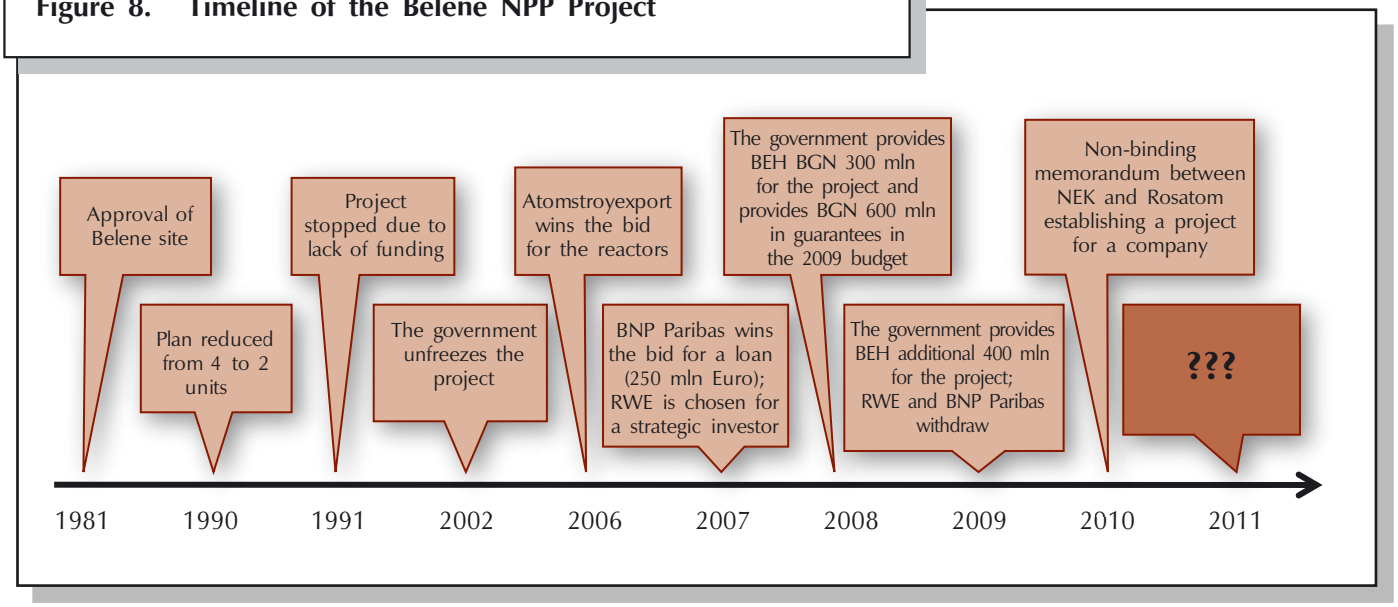
- **Poor project management** after choosing the contractor, with ambiguous responsibilities and obligations regarding state guarantees, unclear budget and private sources of financing, unjustified increases in consultancy fees, and, ultimately, the withdrawal of the selected financing bank and strategic investor. Additionally, independent control and monitoring by government institutions and the public have been restricted, regulations have been only formally met, and referring to trade secrets has been used as an excuse for not disclosing information to which the general public should have had access;

[38] Nuclear Power's Role in Generating Electricity, Congressional Budget Office Study, May 2008.

- Although funds from the national budget earmarked for the project have been spent, the **declared objectives have not been met** as regards the establishment of a joint venture company with a strategic investor. Moreover, the project's implementation was suspended in 2009. So far, EUR 396 million have been spent on project implementation. In addition, contractual obligations on equipment orders and project management fees amount to at least another EUR 674 million, thus adding to a total of approximately EUR 1,070 million (or 27 % of the total value of the main contract, of EUR 3,997 million).

Following an interruption of more than a year, negotiations on the implementation of Belene NPP were resumed in late 2010. The initial steps – the signing of a memorandum on the establishment of a joint venture company, which is to implement the project, seem promising in terms of improving project management. Nevertheless, building Belene NPP will only entrench the energy dependence of Bulgaria on a single source. This concerns the delivery of nuclear fuel, but also the provision of spare parts and engineering services, the long-term storage of the spent nuclear fuel, and extending the life of nuclear reactors in Kozloduy NPP (Units 5 and 6). Essentially, the **project is in disagreement with the highest priority** laid out in EU and national strategic documents: namely, **energy security though diversification**. Poor management at the outset of the project and the lack of any pressing economic or energy-related need for its implementation make its successful continuation extremely difficult.

Figure 8. Timeline of the Belene NPP Project



Source: Center for the Study of Democracy, 2010.

The Belene NPP Project from an Energy Perspective: the Missing Rationale

In order to convince the general public of the need to construct Belene NPP during the 2003-2005 period various official figures in the energy sector advanced the argument that without the project, the country would experience a shortage of electricity as early as 2009-2010. In 2003, NEK developed a *Plan for the Development of the Electric Energy Sector of the Republic of Bulgaria*, using minimum

cost estimates, for the 2004-2020 period.[39] According to the Plan, without Belene NPP, there would be a shortage of at least 1,000 MW in Bulgaria by 2010. The architect-engineer of the project also presented overstated forecasts in support of the need to implement the project.

The optimistic (from the point of view of project development) **forecasts have been misleading** because, due to negligence or intentionally, they have failed to take into account the following factors:

- Declining household electricity consumption due to the country's gasification and, in the long run, because of Bulgaria's negative population growth;
- Energy efficiency and energy saving solutions – Bulgaria is the most energy intensive economy in the EU;
- Electricity generated from RES: Bulgaria has committed to 16 % of gross final energy consumption from renewable energy sources (RES) by 2020;[40]
- The construction of thermal power plant generation capacities. By 2003 AES already had plans to build two 670 MW units at the site of Maritsa Iztok 1; this plant is scheduled to start operation in 2011;
- No cost-benefit analysis of the project has been conducted;
- Possibilities for importing electricity, the effects of market liberalization and Bulgaria's inclusion in the EU energy system.

As of 2010, the country does not suffer from any shortages of electricity. On the contrary – it has surplus capacity allowing for substantial energy exports.[41] In July 2004, NEK forecasted that in 2020 the total final energy consumption in Bulgaria would range between 48.9 and 54.2 billion kWh. The State Energy and Water Regulatory Commission upheld this optimistic anticipation of growing demand in the National Energy Report to the European Commission as recently as the summer of 2009.[42] By the end of 2009, the forecasts[43] were revised down to an expected consumption of 43.8 – 46.7 billion kWh, and an independent team[44] estimated the maximum level of consumption at 43.4 billion kWh. In 2010, the Electricity System Operator (ESO) calculated the range of estimated gross electricity consumption over a ten-year period to be between 36,617 GWh (min) and 42,090 GWh (max).[45] These data suggest that the **construction of Belene NPP cannot be justified by arguments of dynamic rise in the domestic demand for electricity**. The elaboration and presentation of NEK forecasts

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39 Technical and economic analysis in support of the construction of Belene NPP, July 2004.

40 Directive 2009/28/EC.

41 Electric energy market analysis in the Balkan Region, SEWRC, September 2009.

42 National Report to the European Commission, July 2009, State Energy and Water Regulatory Commission, Bulgaria. Accessible through the website of European Energy Regulators on 19.11.2010 <http://www.energy-regulators.eu/portal/page/portal/EER_HOME/EER_PUBLICATIONS/NATIONAL_REPORTS/National%20Reporting%202009>.

43 Projected Balance Sheets of Generating Capacities in the Electric-Energy System, NEK, September 2009.

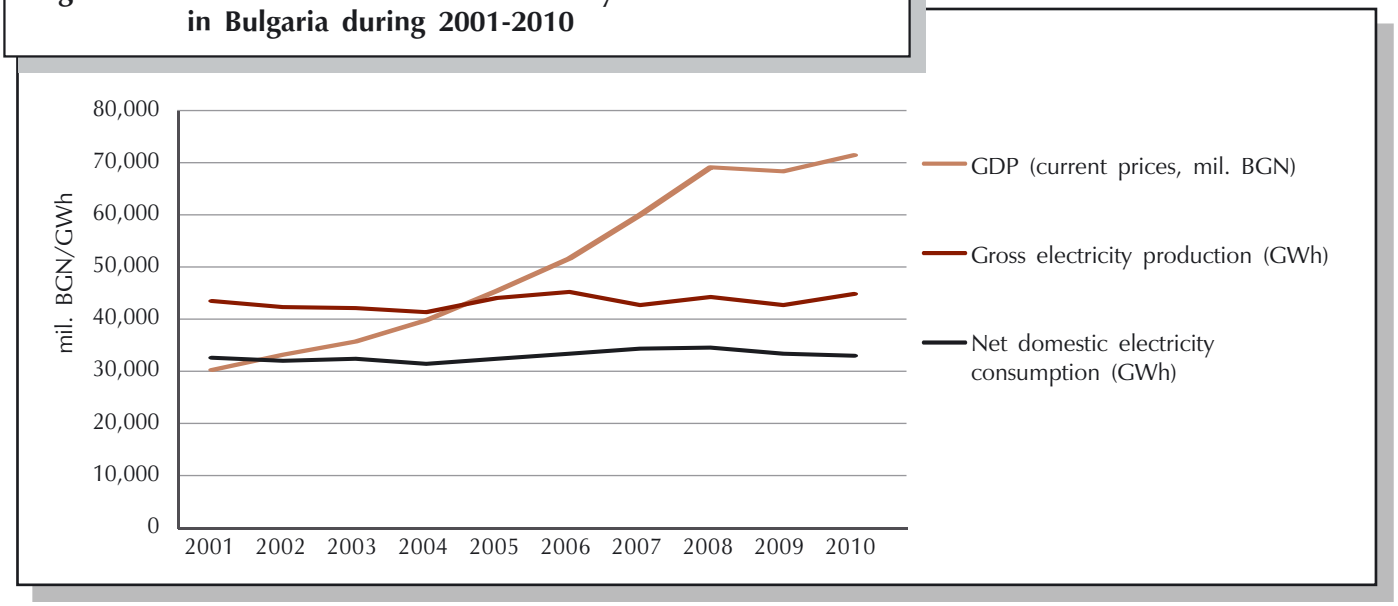
44 Project No 518294 SES6, CASES Cost Assessment of Sustainable Energy Systems, Electricity scenario for Bulgaria, 2007 <http://www.feem-project.net/cases/downloads_deliverables.php>.

45 Ten-year development plan for the national electric-energy system, ESO, Bulgarian Energy Sector Day, June 17-18, 2010.

appears to ignore the principles of market supply and demand and is not based on the available data.

Over the past decade, Bulgaria's GDP in current prices has doubled and real GDP has increased by about 44 %, whereas net domestic electricity consumption increased by a mere 1.5 % during the same period. In view of the financial and economic crisis of 2009-2010 and the shrinking industrial production, as well as the accelerated efforts to improve energy efficiency in the context of rising electricity prices, there is hardly any reason to expect notable increases in electricity consumption over the next decade. ESO estimates that by 2015 Bulgaria will have lost about 1,000 MW of its current generation capacity, as a result of the decommissioning of some existing facilities. However, these estimates do not take into account the energy generated from RES, which is posed to more than offset decommissioned capacity.

Figure 9. Economic Growth and Electricity Demand in Bulgaria during 2001-2010



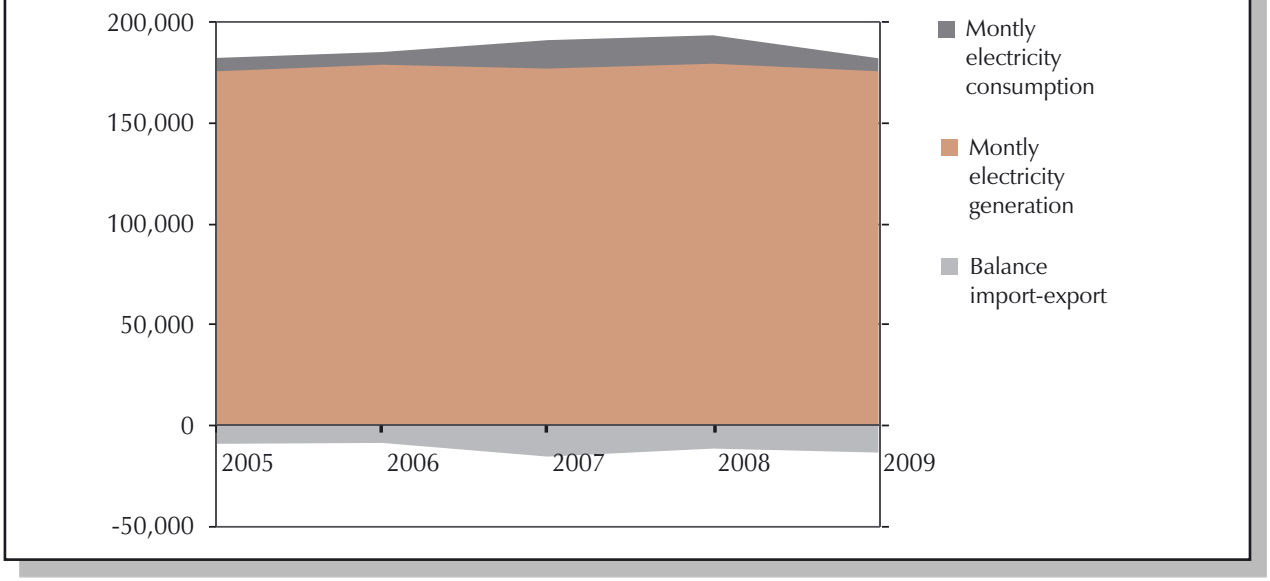
Source: Center for the Study of Democracy, based on NSI data, 2010.

The Export of Electricity Fallacy

One often cited alternative use for the electricity generated by Belene NPP and rationale for its construction has been the export to neighboring countries. However, using base load nuclear capacity to satisfy potential needs on the regional electricity market is debatable. The possible devastating environmental consequences of a nuclear plant accident, however unlikely, would affect primarily Bulgaria and Romania, whereas the demand for electricity is expected to be highest in Serbia, Greece, and Turkey. It would hardly be a sign of good environmental governance to meet the potential demand of neighboring countries while bearing all risks at home. The region is experiencing electricity shortages, and is likely to do so in the future, yet forecasts of regional market development are very uncertain. All countries in Southeast Europe are building new generating capacities, and there is serious potential for competition form producers in

Russia and Ukraine. The latter may enter the region more aggressively upon the liberalization of the European market in 2012 – 2015. Furthermore, in a consumer market situation of abundant base load supply Bulgaria could be forced to supply electricity at prices lower than prevailing market rates as it could be unable to shut down its reactors to react to market conditions.

Figure 10. Monthly Consumption of Electricity and Net Export: All Balkan Countries, except Bulgaria and Albania (GWh)



Source: Balkan Energy News, 2010.

The Belene NPP Project from a Financial-and-Economic Perspective

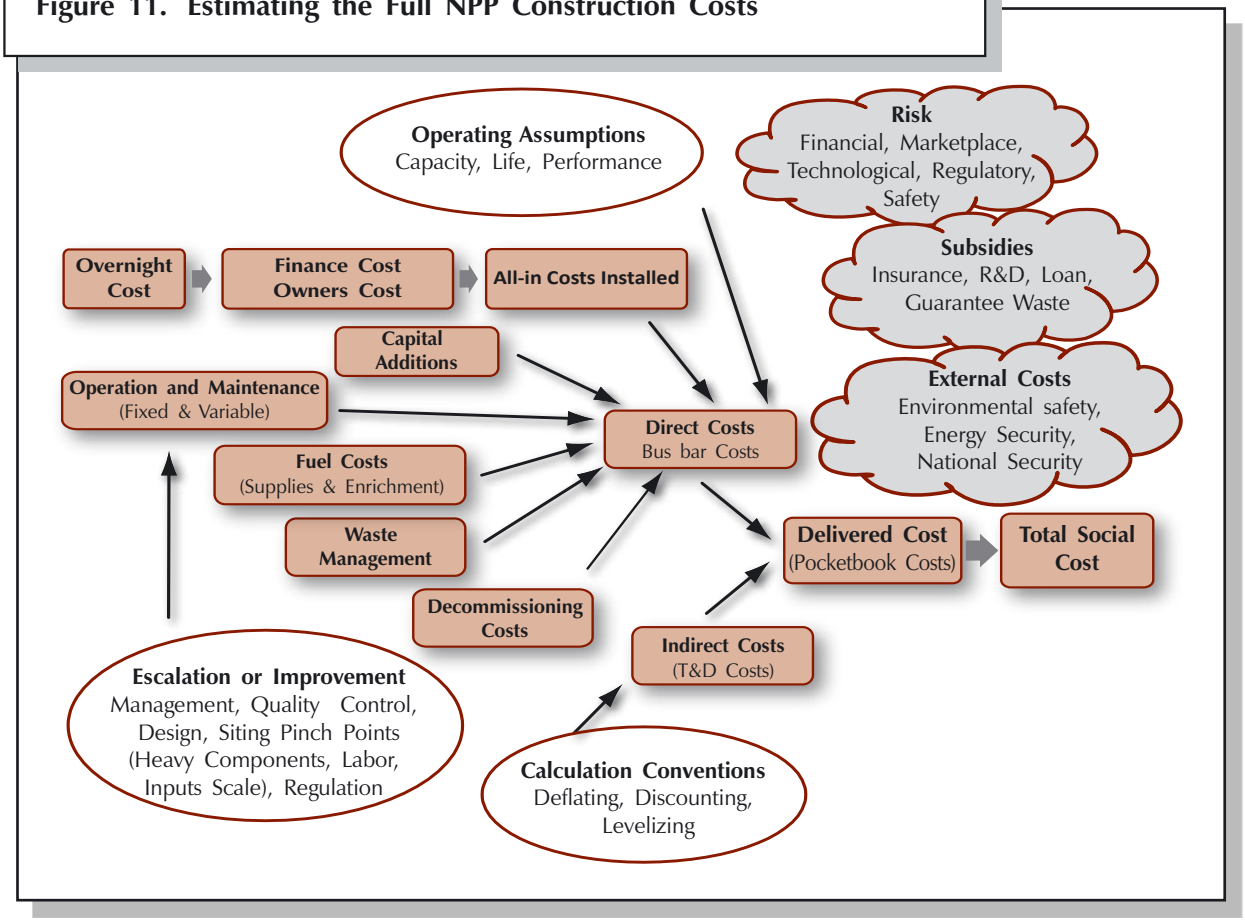
The construction of a nuclear power plant involves very high initial costs. Historically, approximately 75-80 % of the price of the electricity generated by NPPs is determined by the size of the initial investment.[46] The size of this initial investment is most sensitive to the duration of the construction period and the prevailing interest rates. All of the new reactors currently under construction in the EU are behind schedule. For example, the delayed construction of a new reactor in the French Flamanville led to a cost increase from EUR 3.3 billion to EUR 6 billion. In Finland, the construction of the Olkiluoto NPP was delayed by four years with a similar effect on costs. That is why the return-on-investment (ROI) timeframe is 25-40 years – a period during which significant changes to the market may occur. Although electricity generated by nuclear energy remains among the cheapest, due to its long lifespan for exploitation and its low running costs, the **initial costs are a serious financial risk for the investor, which calls for some form of government guarantee or incentive**. In a monopoly market the ROI timeframe is relatively easy to calculate, but **with the prospective liberalization of the European market, the selling price and volumes of Belene NPP electricity become extremely difficult to estimate**.[47]

[46] The Economics of Nuclear Power, World Nuclear Association, July 2010.

[47] Hidden Costs of Energy: Non-priced Consequences of Energy Production and Use, National Research Council, 2010.

In addition to the direct and relatively predictable expenditures, the nuclear power sector is also characterized by certain indirect costs, which may significantly alter the economic assumptions related to a NPP project. These include the costs for management and storage of spent nuclear fuel and radioactive waste. **The storage of the high-level radioactive nuclear waste** is probably the greatest concern regarding NPP, which has not yet been resolved on an international level. According to the latest legislative proposals of the European Commission, nuclear waste from a Member State should only be stored within the EU.[48] If this approach is adopted, the costs to Bulgaria will increase. Other important indirect costs are the potential changes to NPP regulation, which typically depend on external factors (especially true for small countries). Bulgaria is one of a number of countries that has already incurred such indirect costs, with the closure of the first four reactors of Kozloduy NPP due to changes in the political and regulatory environment.

Figure 11. Estimating the Full NPP Construction Costs



Source: Cooper, M., The Economics of Nuclear Reactors: Renaissance or Relapse?, June 2009.

According to the initial energy lobby reassurances (2002-2004), the Belene NPP Project would cost USD 1-2 billion and financing would be covered entirely by private companies. In 2005-2006, the price tag was recalculated to be EUR 2-4 billion. In January 2008, NEK signed a contract with Atomstroyexport in the amount of nearly EUR 4 billion, which was revised by

[48] Proposal for a COUNCIL DIRECTIVE on the management of spent fuel and radioactive waste, Brussels, 3.11.2010 COM(2010) 618 final.

Atomstroyexport in 2010 to EUR 6.3 billion. The initial amount of EUR 3.997 billion is the so-called **overnight cost** – the price that would have been paid if no interest were incurred during the construction period and the project were completed overnight. Some additional costs, which have not yet been taken into account, include:

- Costs to the owner for the exploration and preparation of the site (currently exceeding EUR 250 million for Belene NPP);

- Inflation costs, higher prices of raw materials, goods and services – the indexation of the project value which, according to the Russian authorities, by 2010 is approximating EUR 2.3 billion (an almost 50 % increase from the initially agreed price);

- Loan servicing costs. For instance, if 50 % (EUR 6 billion) of the Belene NPP project are financed by a loan at six-month EURIBOR + 3.5 % interest (similar to the loans under the Tsankov Kamak hydro power plant project), and if an increase of 3 percentage points in the interest rate is assumed (as was the case in 2005-2008, compared to the previous three years), the interest payments would increase by EUR 180 million per year, which would pose a serious threat to the financial health of the main investor – NEK. Coping with such a situation might require state intervention or putting off other needed company investments.

In order to obtain the end cost, or so-called **direct cost** of an NPP – the cost of the project until the point when it can start feeding electricity into the system, it is necessary to add:

- **The cost of energy infrastructure around the nuclear site.** At present, only one electric transmission line of small capacity connects the Belene NPP site to the national grid. In order to properly connect the site to the electric power system (EPS), it is necessary to install approximately 600 km of transmission lines and one or two substations, with the cost likely to exceed EUR 1 billion;

- The costs for protection and safety of the reactor active zone, nuclear fuel and sinks (EUR 300-400 million);

- The costs of project consultants (EUR 300-400 million), salaries for the Russian specialists, operation, and maintenance (salaries, fuel, chemicals, raw materials, etc); security costs;

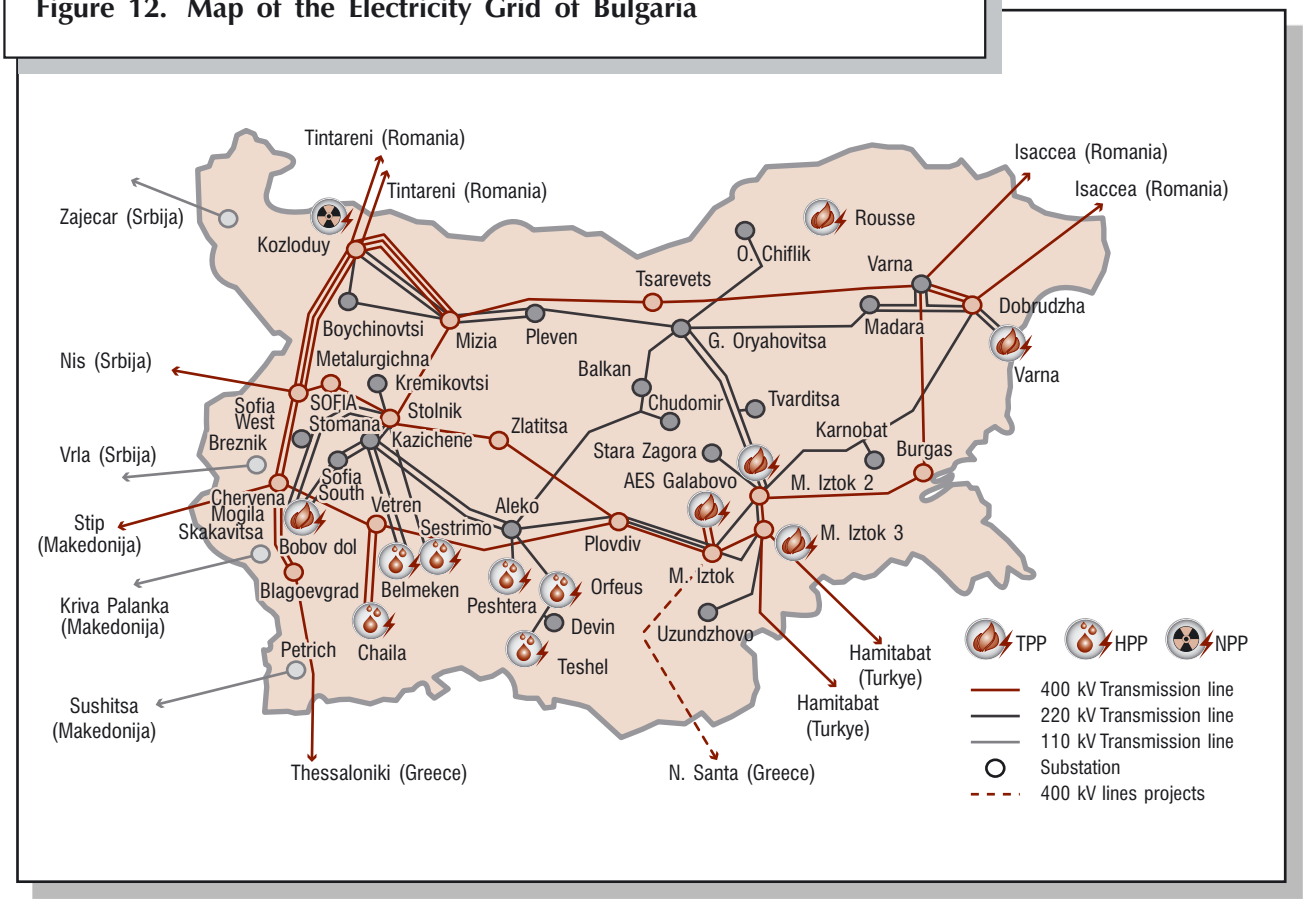
- The cost of financial guarantees or insurance for nuclear damage;

- The management of radioactive waste and spent nuclear fuel; decommissioning costs, etc.

Taking as a reference the costs of nuclear power plants under construction in the EU (Finland and France) as of 2010 and those planned in Turkey, it is reasonable to expect that the direct cost of Belene NPP will amount to approximately EUR 10-12 billion.[49] A number of statements by Bulgarian officials seem to support this estimate. In early 2010, the Minister of Economy, Energy

[49] Кто кого? Why Bulgaria should abandon NPP Belene, Candole Research, November 2010.

Figure 12. Map of the Electricity Grid of Bulgaria



Source: ESO, 2010.

and Tourism and the Belene NPP consultant Deloitte, announced an anticipated cost of EUR 8-10 billion. In June 2010, the Bulgarian Prime Minister estimated the probable cost of the plant at EUR 13 billion.[50] This makes the Belene NPP project larger in scale than all of the financing allocated to Bulgaria under EU funds for the 2007 – 2013 period. Considering the serious difficulties in absorbing EU funds that the country is experiencing and the delays in all major infrastructure projects, it can reasonably be expected that the implementation of a project of such proportions may pose a **long-term threat to the financial stability of the country**. It should further be noted that these huge costs come with relatively few direct benefits to the Bulgarian economy (mainly in the construction sector). A substantial portion of funds invested in the NPP construction will in fact flow to the Russian economy and to EU economies, since Bulgaria manufactures neither electrical nor nuclear equipment.

The escalating cost for constructing Belene NPP will lead to an increase in the cost of electricity produced from the site. This will, in turn, affect the ROI timeframe. In the years between 2002 and 2010, the estimated cost per kWh increased from 2.5 to 6.5 Eurocents. The price can be expected to increase further to 8-10 Eurocents, though it will likely remain one of the cheapest alternatives to fossil fuels.

[50] Meeting between the Prime Minister and EU member-state ambassadors in Sofia of June 11, 2010.

The Poor Management and Corruption Risks of Belene NPP

The absence of immediate energy-related and/or financial and economic need for building Belene NPP raises a number of questions with respect to the rationale of project-related decision-making. From its onset, the project has been characterized by a **lack of transparency and economically unprofitable decisions**. The responsibility for these decisions is blurred within the complex institutional scheme for management of the energy sector in Bulgaria. In this context, a number of **questions and concerns about the expediency of the decisions made in the process of project implementation** arise:

- **Lower-cost alternatives were not considered**, e.g., using the site of Kozloduy NPP, where the related electricity transmission infrastructure is already in place and seismic risk is lower;

- The Government and the related state institutions were not active in attracting interest from the widest possible circle of participants and technologies in the call for tenders for the construction of the NPP. **Competition was restricted** by selection criteria, such as the use of the existing infrastructure and equipment on the site. Subsequently, these requirements were violated and the existing nuclear reactor bed on the Belene site was dismantled, while the equipment was sold to the main contractor at a price lower than its valuation. The consequences were higher project costs to the detriment of NEK and Bulgarian taxpayers;

- The choice of architect-engineer followed the same **discriminatory criteria**, incl. prior experience in the Bulgarian nuclear energy sector. The deadline for submitting bids was 45 calendar days. After the conclusion of the contract with the architect-engineer, its value was increased nearly threefold through annexes without justification and before any real progress on the NPP construction had been made;

- **The government guarantee** for the project was appropriated by BEH and NEK and the allocated funds were spent, incl. for extraneous purposes, yet the principal objective set by the Council of Ministers before the Minister of the Economy and Energy for disbursing the funds – the establishment of a joint venture company with the selected strategic investor RWE – was not achieved. Moreover, even before the approval of the technical project of the NPP by the regulator, the Bulgarian side commissioned extremely costly equipment with long production lead time without securing the financing for it or calculating the payment schedule and financing options over the following years;

- In violation of the *Law on Energy*, the public procurement procedure for the construction was assigned to NEK, rather than to the State Energy and Water Regulatory Commission. Project development was also assigned to NEK, even though it did not hold a license for nuclear electricity production. **NEK did not have the financial stability to implement the project**, yet spent significant government funds before the establishment of a joint-venture company with the strategic investor;

- The Environmental Impact Assessment (EIA) Report was produced on the basis of limited general information provided by five companies[51] in seven different draft proposals for three types of reactors.[52] The **EIA Report was developed in five months**, which is too short a period for quality assessment of a site of such crucial importance to the environment;

- The Ministry of Environment and Water approved the construction of two light-water reactors; yet, NEK only conducted a tender for reactors of the VVER type (Russian pressurized water reactors). NEK developed a project for 2,120 MW in violation of the maximum of 2,000 MW authorized by MEW.

It can be concluded that the Bulgarian Government decided to resume the Belene NPP project without a solid energy-related or economic rationale. The restriction of competition when choosing the contractor for the Belene NPP placed the development of the Bulgarian energy sector in a position of complete dependence on a single country. As a result of the poor management of the project, eight years after it was resumed, **the declared objectives are still not met, while the government funds allocated for this purpose have been spent**. The project does not have a strategic investor, financing bank, or a financing schedule.

Towards Improved Management of Belene NPP

The excessive expenditures and the mismanagement and malpractice in the implementation of the Belene NPP project call for **taking administrative and legal action against the government, administration and company officials** responsible for the decision-making and execution of the project. It is possible to significantly improve the project management of Belene NPP and in general in the energy sector through the following actions:

- The project should be **structured and implemented by a separate company**, which includes all shareholders, is registered in Bulgaria, and takes on the existing obligations and assets. The Bulgarian government has already taken steps towards the implementation of such an approach. The **strategic investor** should be a company with proven experience in the construction of nuclear facilities. The choice of an investor associated with the selected contractor should be avoided in order to prevent potential conflicts of interest and compromises on security and safety;

- **Priority setting** should be based on proven needs of the domestic market. Bulgaria does not need additional nuclear generating capacity before the units of Kozloduy NPP are closed down. The Bulgarian government should first ensure the extension of the life of units 5 and 6 at Kozloduy NPP. Only then should the decision to proceed with building Belene NPP be taken;

- **Alternative sites** for the construction of new nuclear facilities in the country **should be reconsidered**. The infrastructure already in place at Kozloduy NPP

[51] EIA Report on the Construction of Belene NPP, Non-Technical Summary, National Electric Company, March 2004.

[52] In the accessible version (the non-technical summary) the main attention is on the description of the characteristics of the region. General information is provided on 7 different projects for three types of reactors with capacity ranging from 728 MW to 1500 MW.

and its lower seismic risks make it a more attractive location for new nuclear capacities. The equipment already commissioned for Belene NPP may be re-sold in order to reduce the incurred costs, or installed at the Kozloduy NPP site;

- **All contracts with subcontractors** under the project must be announced in advance, documented in a special register, and monitored by the Public Procurement Agency. It should be noted that the main reason for the escalating costs of Belene NPP and other energy projects (e.g., the Tsankov Kamak hydro power plant) is not inflation indexation itself but the manner in which it is calculated and applied, and the concluding of a number of subcontracts of uncertain expediency and with unclear responsibilities.

Proceeding with the Belene NPP project calls first and foremost for **conducting a more adequate risk assessment and taking preventive measures with respect to a number of risks** that have not yet been considered:

- **Seismic risk.** As early as June 1983, Russian scientists recommended abandoning the Belene site on account of the high seismic activity in the region and seeking a different location for the construction site;

- **New technology risk**. The execution of all new nuclear projects in Europe involving untested technology is marred by significant increase in the period and costs of construction. The same applies to the technology chosen for the construction of Belene NPP (AES 92) – it is new and unfamiliar both to the manufacturer and to the regulatory bodies in Bulgaria and in Europe. This may considerably delay the plant's start of operation, incl. due to possible defects and malfunctions. Two units of the earlier modification – AES-91 – installed in Tianwan, China, have shown defects in a number of basic components.[53] In view of the novelty of the technology, Bulgaria will hardly be able to ensure adequate quality control of the manufactured equipment;

- **Belene NPP quality of construction works risk**. The project envisions assigning roughly 30 % of the work, mainly in the construction phase, to local contractors. Considering the very limited experience of Bulgarian companies in building sites of such proportion over the past twenty years, there is a high risk of failure to achieve the desired quality of the construction works. This may lead to reduced involvement of Bulgarian companies in the project implementation;

- **Long-term environmental risks**. It is necessary to take adequate measures and plan the costs for:

  ◊ Spent nuclear fuel and radioactive waste management;

  ◊ Decommissioning nuclear facilities. Reports of the European Commission have pointed to the failure of Bulgarian authorities to meet deadlines and requirements for securing financing for closing down the last two units of Kozloduy NPP. It is estimated that, out of the necessary BGN 5.2 billion, the plant has currently secured only half of the funds;[54]

[53] Nucleonics Week, September 29, 2005, Nucleonics Week, April 13, 2006.

[54] Comparison of Different Decommissioning Fund Methodologies for Nuclear Installations, Country Report Bulgaria, 2007.

◊ Civil liability for nuclear damage. The standard amount of civil liability in Western European countries is set at EUR 570 million.[55] Amendments were proposed in 2004 (still not in force) stating that the amount of the required coverage by NPPs may reach as much as EUR 1.5 billion. In Germany, for example, liability is unlimited, with each operator obliged to ensure coverage for EUR 2.5 billion. Liability for nuclear damage in Bulgaria is limited to BGN 96 million[56] (EUR 49 million) and is among the lowest in Europe. The involvement of foreign companies in Belene NPP would require increasing the nuclear damage liability;

- **Risk for the stability of the electric system.** Bringing into operation a nuclear power plant with installed capacity totaling 2,120 MW, and potential net annual production of 15 billion kWh, would run against Bulgaria's binding goals for renewable energy generation under international and EU agreements. This affects the construction of RES capacity of 1,100 MW (with 2,200 hours of operation per year), in order to meet Bulgaria's commitment of 16 % of end-use consumption from RES by 2020. The simultaneous entry into operation of all of these generating facilities would create additional problems in terms of the safety and stability of the electricity system.

2.2. NABUCCO, SOUTH STREAM, AND BURGAS-ALEXANDROUPOLIS

The large infrastructure projects in the oil and gas sectors duplicate many of the characteristics and risks of Belene NPP. The considerably earlier stages of execution of these projects allows for correcting some of the mistakes made in the planning and implementation of Belene NPP. To do so, it is necessary to adhere to several **basic rules for good governance** of this type of projects:

- **Consistency with national and EU strategic documents** and commitments. Implementation of the highest priority projects only;

- **Structuring the projects into separate companies** and mandatory preliminary approval by the National Assembly of Bulgaria's participation when it involves a state-owned company and/or government guarantees, incl. the amount of the guarantee;

- Operating the energy grid infrastructure should remain with the national grid operators so that **equal access for all participants is guaranteed**.

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[55] World Nuclear Association, Civil Liability for Nuclear Damage, November 2009 <http://www.world-nuclear.org>. The liability is regulated by two instruments – the Vienna Convention on Civil Liability for Nuclear Damage and the Paris Convention on Third Party Liability in the Field of Nuclear Energy.

[56] *Law on the Safe Use of Nuclear Energy*, Chapter 10, Article 132, para. 1.

A growing concern about climate change is putting ever-increasing pressure on fossil fuels through the rising prices of coal, oil, and gas. Nevertheless, it is expected that even in 2050 fossil fuels will provide most of the energy consumed worldwide, with the newly emerging markets (incl. China and India) being the main engines of rising demand. Natural gas, however, is the only fuel expected to be in greater demand in 2035, as compared to 2008, largely due to its less harmful effects on the environment and the increasing demand from Europe and China.[57] The development of technologies for liquefied and compressed natural gas (LNG and CNG) and the extraction of shale gas would make natural gas supply more flexible and marketable. Meeting the demand for gas is one of the main priorities of the European Commission and the Member States. The goal is to make the European gas systems interconnected and to liberalize the market in order to reduce the monopoly power of the main importer in Europe – Russia. In this international context, Bulgaria is an important transit country for two of the major competing gas projects in Europe – the South Stream and Nabucco gas pipelines. Compared to the transit volumes, the country's domestic market is insignificant but it is expected to grow. Household gasification in Bulgaria is at a level far lower than in Europe in general.

Considering the limited resources of the national economy, Bulgaria needs to prioritize the order and importance of implementation of the main alternatives for securing natural gas supplies and for obtaining maximum gains from the planned transit corridors. The combined goals of maximizing energy security at the lowest possible price give Bulgaria a clear **strategic course and priorities**, according to which gas projects should be implemented:

- **Development of its own national reserves** in the Black Sea shelf and exploring shale gas. This option would provide the highest level of energy security and is relatively cheap in view of the possibility to easily attract private investors;

- Connecting the national gas system to that of neighboring countries through **gas interconnectors –** this would allow for diversification of supply routes and sources of natural gas, while a significant portion of the financing could be secured by EU funds;

- **The Nabucco project** allows for a diversification of both supply sources and routes, with a large portion of the financing secured through the EU budget;

- **The South Stream project** allows for a diversification of supply routes only, but likely at a higher price than in the case of the Nabucco project, considering the expected increase in costs due to its underwater segment;

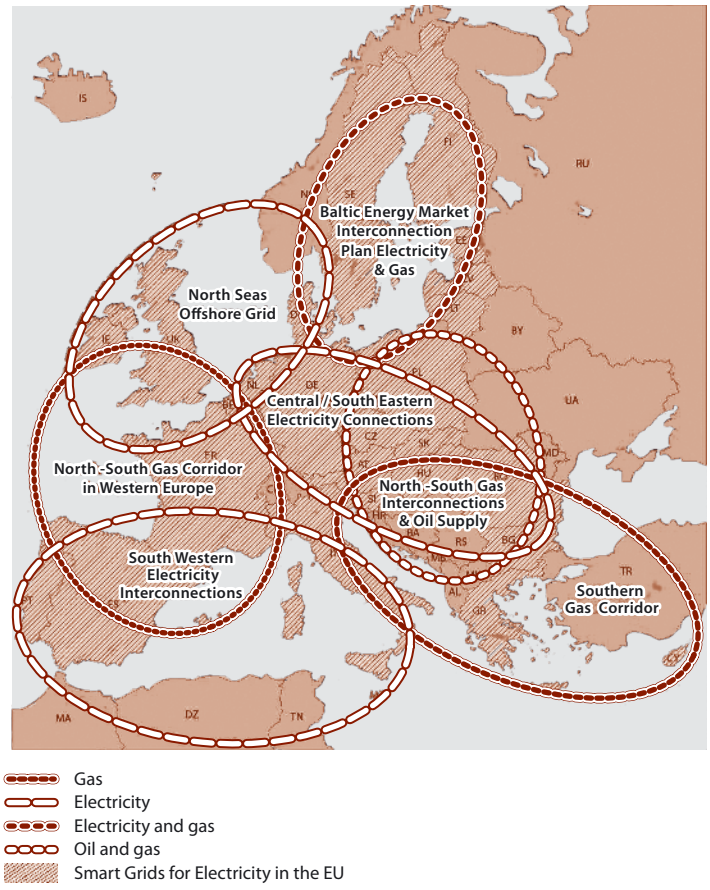
- Building a **LNG terminal** at the Black Sea, or jointly with Greece and/or Turkey at the Aegean Sea; the first option would be more beneficial in terms of the country's energy security, yet the second would involve lower costs, incl. environmental ones.

[57] World Energy Outlook 2010, International Energy Agency, 2010.

The Burgas-Alexandroupolis oil pipeline project does not fit into the strategic development of the Bulgarian energy sector, nor is associated with any potential financial and economic benefits to the country's economy.

The *Concept for National Energy Strategy 2020* reflects the priorities outlined above but does not clearly specify the national policies for their realization. The Bulgarian government's policies during the period 2006-2008 for implementing the South Stream and Burgas-Alexandroupolis projects, as well as Belene NPP, ran counter to good practices in strategic governance and **sound cost-benefit analysis with regards to energy security**. Launching projects that are not of top strategic priority and that lack a clear business plan would entail considerable risks for the country's energy as well as financial and economic security, and is conducive to mismanagement and corruption in the sector.

Figure 13. Priorities in European Energy Infrastructure for Electricity, Gas and Oil



Source: European Union, DG Energy, 2010.

The latest available data and the strategic documents adopted at the EU level suggest that **the European Commission perceives South Stream and Nabucco projects as strategic competitors**. The demand for gas, incl. for gas imports

to Europe, is now expected to be significantly lower than previously estimated owing to the wide penetration of renewable energy sources, nuclear energy, and improved energy efficiency.[58] These forecasts may prove inaccurate and, over the long term, Europe may actually need gas volumes that would justify the viability of both projects.[59] In the short term, however, the two projects are competing in terms of gas supply and market demand. They both target the natural gas resources in the Caspian Sea region and European customers. Whoever succeeds in making a better offer to the Caspian exporter countries would gain an important strategic advantage.[60] In its plans for the development of an integrated European energy network, the European Commission clearly expresses its support for the Nabucco project as an important priority in terms of reducing European gas dependence and preventing a recurrence of the 2009 gas crisis.[61]

Considering Bulgaria's limited public financial resources in the context of the economic crisis, the two gas projects will be competing for scarce government funds (from the national budget or state-owned companies) and can hardly be implemented simultaneously. The governance structure of the Nabucco project is clearer and subject to a uniform regulatory framework – that of the EU, which allows for greater transparency of Bulgaria's commitments. The South Stream project is based on a number of bilateral treaties and joint ventures between Russia (Gasprom, respectively) and the individual partner countries (as represented by their national gas companies). This leads to a fragmentation of ownership and imbalance in the relations between the partners with potential negative consequences in terms of project transparency. In addition, the planned **South Stream project** pipeline **remains currently inaccessible to third parties, which runs counter to the precepts of the EU Third Liberalization Package.**[62]

The Nabucco Project

The Nabucco project envisions the construction of a transcontinental pipeline for the transportation of natural gas from the Caspian Sea region and the Middle East to Central and Western Europe. The project's goal is to secure **an alternative gas supply corridor in the South, thus reducing the dependency of European gas supplies on Russia**. The project is said to guarantee reliable gas supplies to Europe, enable the diversification of supply routes, and enhance the energy independence of EU Member States (including Bulgaria).

The pipeline runs from the eastern border of Turkey to Austria's Baumgarten gas hub. Its total length is 3,400 km, including 1,935 km on Turkish territory, 400 km on Bulgarian territory, 495 km on Romanian, 519 km in Hungary, and 46 km in Austria. The construction work was scheduled to start at the end of

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58 EU Energy Trends to 2030, DG Energy, 2010. According to the report, the need for gas imports in EU-27 will increase by about 10 % to 318 Mtoe by 2030, indicating substantially reduced dependence on gas compared to previous scenarios.

59 According to forecasts of the European Commission and the International Energy Agency of 2007-2008, the total additional demand for imported gas in Europe is likely to reach 100 billion cubic meters.

60 According to World Energy Outlook 2010 of the International Energy Agency, the Caspian Basin is expected to emerge as one of the largest oil and gas producers over the next two decades.

61 Energy Infrastructure Priorities for 2020 and beyond – a blueprint for an integrated European energy network, COM(2010) 677/4.

62 Should the Nabucco pipeline project be shelved?, Centre for European Reform, 2010.

2010 or the beginning of 2011, yet it is likely that this deadline will not be met due to implementation delays. According to the plan, the pipeline segment between Ankara (Turkey) and Baumgarten (Austria) will be ready by 2014, having a carrying capacity of 8 billion cubic meters (m^3) per year, and gradually increasing its capacity (through the construction and use of compressor stations) to 15.7 billion m^3 per year by 2015, 25.5 billion m^3 by 2018, and 31 billion m^3 per year by 2020. It is also envisioned that by 2015 the construction of the pipeline connection between Ankara and the eastern border of Turkey (about 1,300 km) will be completed either by extending the existing gas transmission network in Turkey, or by building a separate, new gas pipeline.

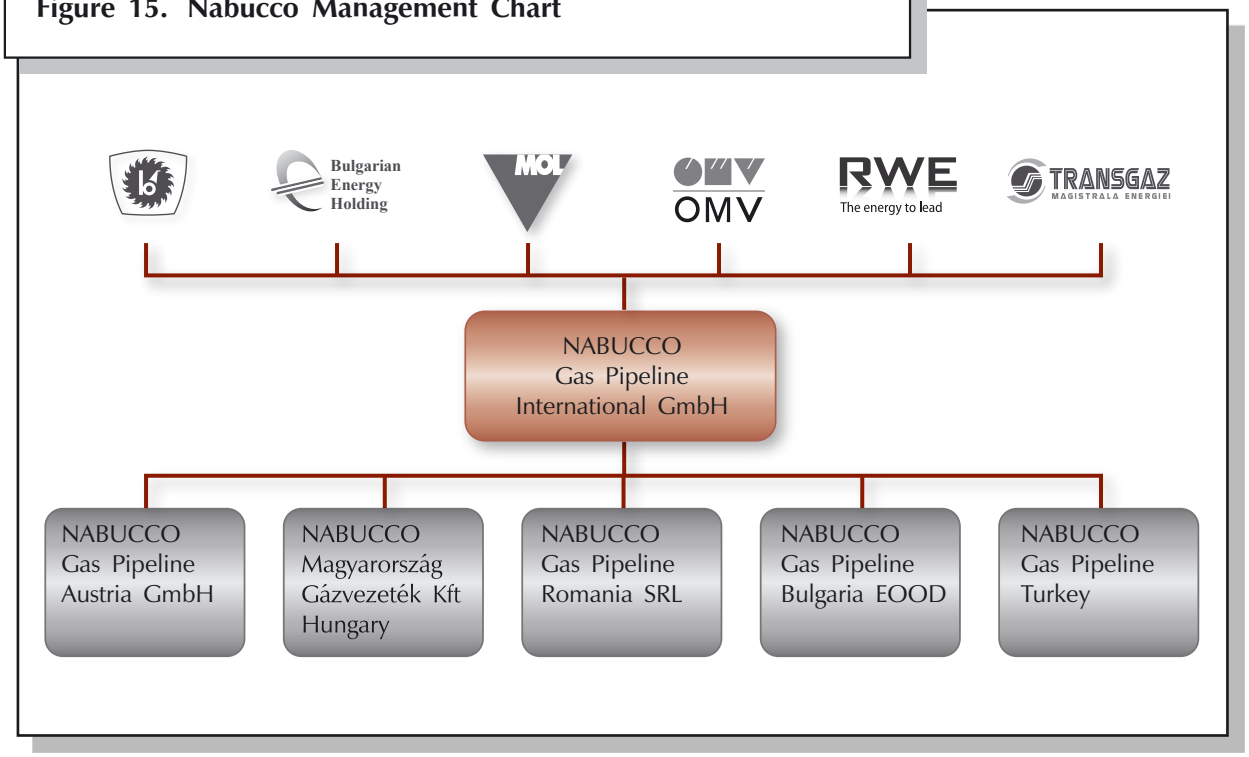
Figure 14. Map of the Nabucco Project

Source: Nabucco Gas Pipeline International.

National Nabucco companies, 100 % owned by the international Nabucco company, have been established and registered in all five transit countries. In Bulgaria, the respective company is Nabucco Gas Pipeline Bulgaria EOOD. The main document regulating the relations of partner companies is the Cooperation Agreement. The total cost of the project is estimated at about EUR 8 billion, 70 % of which are to be provided by the international Nabucco company, while 30 % are provided by the national shareholders. The **Bulgarian share of EUR 400 million is payable in 2011**, yet it remains unclear whether this amount has been included in the country's budget for 2011. Bulgaria's participation in the Nabucco project is managed by the Bulgarian Energy Holding (BEH) through the Holding's managing directors. Bulgaria also has a representative in the international Nabucco company.

The fact that BEH is managing both the Nabucco and South Stream gas pipeline projects is **an additional source of conflicts and competition**. It could lead

Figure 15. Nabucco Management Chart



Source: Nabucco Gas Pipeline International.

to a serious political pressure on BEH's management for supporting either one or the other. It could also lead to a confrontation between members at managerial positions at the expense of the long-term development of the Holding. It is thus necessary that the executive directors of BEH have a clear framework for action at their disposal, based on the National Energy Strategy and the policies set by political leaders for the sector. **The absence of such benchmarks has led to a decline in Bulgarian participation in the Nabucco project during the past year**. While BEH is the smallest participant in the project (in terms of company size), thus not likely to have a leading role in the project's development, it is necessary to ensure that Bulgaria's interests are well represented within the international Nabucco company.

Box 3. The Nabucco Project: Potential Synergies

On Bulgarian territory, 166 km (41 %) of the Nabucco gas pipeline would be built alongside already existing gas pipelines, while 239 km (51 %) would be built separately. Additionally, the pipeline crosses the Danube at about 40 km away from the existing Chiren underground gas storage facility and 7 km away from Kozloduy NPP. These are useful preconditions for adding the Chiren gas storage facility to the Nabucco gas transmission system, and/or for restarting NPP Kozloduy's electricity generators 1-4 (currently out of service) with natural gas.

The Nabucco Project Management: Advantages and Bottlenecks

As the parties in the Nabucco project are equal transit countries with common interests (i.e. the highest possible gas transit fee), project negotiations or transit fee negotiations will be easy. In accordance with existing EU rules for natural gas supply and transit, Nabucco Gas Pipeline International will secure free access, subject to capacity,[63] for every seller or owner of natural gas willing to use the Nabucco pipeline. **The lack of secured gas supply sources is the major shortcoming of the project**. Possibilities include supplying natural gas from the Caspian region and/or the Middle East, yet, gas supply remains uncertain due to a number of strategic (relations between Russia and Turkmenistan), political (Turkey's accession into the EU), and security factors (the Kurdish question in Northern Iraq). In the shorter run, Azerbaijan is the only viable source of gas supply, and both Nabucco and South Stream are competing for this resource. Therefore, the timely implementation of the Nabucco project is considered as a crucial competitive advantage. Still, Nabucco is currently an infrastructure project rather than a gas supply project as neither it or its shareholders have their own gas reserves.

A major advantage of the Nabucco project is its EU dimension. Nabucco is commonly seen as a symbol of European solidarity and will for collaborative action in the energy sector. A potential failure of the project could be seen as a fundamental problem for European integration. The European Commission uses various financial support schemes to assist the Nabucco project. The Commission used a grant scheme to finance 50 % of the project feasibility study and, in 2010, provided about EUR 200 million via the European Economic Recovery Plan for the project implementation. It is also expected that the European Bank for Reconstruction and Development and the European Investment Bank will provide additional project financing. Despite that, **the Nabucco project still lacks critical mass in terms of political support**, most notably from large European consumer countries such as Germany. Moreover, **Germany's position on the project remains ambiguous**, while the country insists that the private sector take over a the larger share of the project's financing.

The **major advantages** for Bulgaria stemming from its participation in the Nabucco project are:

- Securing **a new alternative route and source of natural gas supplies** to the country, which would significantly improve the security and reliability of supply to consumers and ensure competition between suppliers within the country;

- Offering **new employment opportunities**, such as in construction in the short term and the exploitation of the pipeline in the longer run (over the next 40 to 50 years);

- The possibility for attracting **foreign investments** to finance the pipeline's construction;

- Securing **additional revenues** for the Bulgarian partner and the state budget;

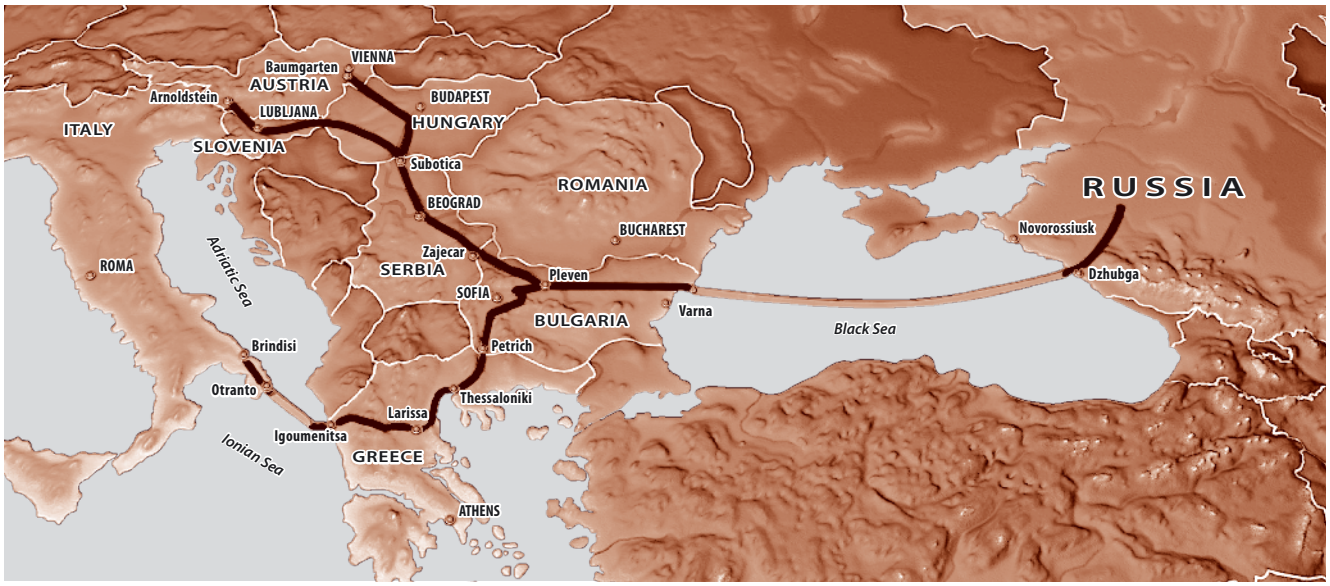
[63] It is expected that, initially, the participants in the pipeline project will secure about 50 % of the total carrying capacity through contracts.

- Introducing **new technologies and innovative management techniques** and know-how in the process of construction and exploitation of the pipeline.

The South Stream Project

The South Stream project envisions the construction of a transcontinental pipeline for the transportation of natural gas from Russia to Italy and Central Europe. According to the plan, the total length of the pipeline would be approximately 3,000 km, including 900 km of underground pipelines beneath the Black Sea starting at Dzhubga (Russia) and ending at Varna (Bulgaria).[64] The total carrying capacity is planned at 63 billion m^3 per year and should be reached by 2018. The gas pipeline would run through Bulgaria, where it would split in two: one of the bifurcated pipelines would pass through Greece and the Ionian Sea to South Italy, while the other would pass through Serbia, Hungary, and Slovenia and end in Austria and Northern Italy. The total project costs (prior to completing the project feasibility study and the technical planning) are estimated at about EUR 25 billion. By mid 2010 Russia had signed bilateral agreements with Greece, Bulgaria, Serbia, Austria, Hungary, and Slovenia. An additional agreement between Russia and Turkey was signed so that the gas pipeline can bypass the Ukrainian waters segment of the Black Sea. The underwater segment of the pipeline would be built by Russia's Gazprom and the Italian ENI.

Figure 16. Map of South Stream Project



Source: South-stream.info

[64] The pipe's point of entry into Bulgaria can be changed following the project feasibility study.

Bulgaria's participation in the South Stream project was agreed upon on the January 12, 2008. The agreement between the governments of Bulgaria and the Russian Federation stipulates the implementation of a joint project for building a pipeline for natural gas transit through Bulgarian territory. In line with the agreement, on November 13, 2010, BEH and Gazprom agreed on and signed the statutes of the South Stream – Bulgaria AD Joint Venture Company. The company is to be headquartered in Sofia and is entrusted with the planning, financing, building, and exploiting the gas pipeline. BEH and Gazprom each hold 50 % of the company's shares.

The South Stream Project Management: Bottlenecks

Bulgaria is faced with several problems in the process of planning and implementing the South Stream project. These issues necessitate further clarification from and action on the part of the Bulgarian government in order to maximize gains from the project implementation and minimize the risks associated with poor project management. Virtually all details of the project's implementation are currently unspecified, while sensitive issues among the shareholders have not been resolved and are potential points of conflict likely to affect Bulgaria.

The signed intergovernmental agreement (18.01.2008) **needs to be amended to comply with the rules of EU legislation** and, more specifically, the *Directive Concerning Common Rules for the Internal Market in Natural Gas.*[65] The European Commission has already voiced its concern that some of the clauses of the agreement may contradict provisions of EU energy legislation, thus requesting that the Bulgarian government changes the contract agreement. The EC has also insisted that the agreement should guarantee equal access to the gas pipeline for European energy companies.

It is also necessary that **the statutes of the joint company** clearly and explicitly define the competencies and relations between the two shareholders (BEH and Gazprom) in terms of hiring personnel, preparation of the annual budget, decision making mechanisms, rules on dispute settlement, etc. It should be pointed out that introducing a decision-making mechanism based on consensus would aid accountability, yet would slow down the operational performance of the company.

Ensuring transparency and better project planning and implementation require the use of an **open tendering procedure for choosing an independent international company with extensive experience for preparing the feasibility study** and technical project of the pipeline. There are already **examples of poor project management** of South Stream on the Bulgarian side. The procedure for choosing a contractor to carry out the feasibility study preceded the signing of the statutes of the joint project company, thus blurring the separation of management responsibilities of the shareholders and the joint venture. The joint venture should be responsible for all financial and organizational costs related to the choice of feasibility study contractor. The feasibility study deadline for applications has been extended a number of times, and the last extension was for mere several hours. The latter is indicative of poor organiza-

[65] Directive 2009/73/EO of the European Parliament and the Council of the European Union Concerning Common Rules for the Internal Market in Natural Gas and Repealing Directive 2003/55/EO from July 13, 2009.

tion at best and/or of tailoring the call for tenders to the interests of a specific applicant. Moreover, providing only six working days for applications for a contract of such magnitude and levels of technical detail is clearly inadequate, especially in the absence of a prior indicative announcement. This practice is among the most commonly used methods of limiting competition in public procurement in Bulgaria. The implementation of the South Stream project on the Bulgarian side lacks consistency – the establishment of the joint company and the completion of the feasibility study are being conducted simultaneously. This is likely due to the need to formally adhere to the agreed with Gazprom deadlines for carrying out the feasibility study within eighteen months from the establishment of the joint company.

Transit Fees

Transit fees should be significantly increased from their current values (determined by the current contract with Gazprom) and updated annually in line with gas prices and inflation in the EU. The interests of the South Stream shareholders are entirely opposing – Bulgaria would benefit solely from the transit fees, while Russia's interests are in selling gas at competitive prices, hence its incentives lie with lowering transit fees.

The **transit fees should be paid in Euros** in light of Bulgaria's future accession to the Eurozone. The **contract for gas transit must include the so-called "transit or pay" clause**[66] (as is the case with the existing Gazprom gas transit contract for Bulgaria), so that returns on investment are guaranteed. The transit fees should be based on the carrying capacity of the gas pipeline (63 billion m^3), and not on the actual amount of natural gas running through the pipeline, as the investments in the project are made on the stated maximum of carrying capacity.

There are reasonable doubts that South Stream is a political project[67] that is not economically justifiable. The preliminary assessment of the project's costs makes it the most expensive venture in the gas energy sector ever. The latter is a real threat to the project's competitiveness and returns on investments. Hence, Bulgaria must insist on timely commitments from Russia to meet its obligations under the project and on possible compensation in case the project is not completed. Moreover, **an exact date for reaching the maximum carrying capacity of the pipeline should be set**.

To address the above issues, when signing agreements on South Stream, Bulgaria should also rely on the Energy Charter adopted by all EU-27 Member States.

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[66] Such a clause would stipulate that the whole volume of the gas pipeline should be used for transit, or otherwise penalties would apply.

[67] Security Aspects of the South-Stream Project, Briefing Paper, DG External Policies of the Union, European Parliament, October 2008.

Additional Issues

When the carrying capacity of the South Stream pipeline is reached (at 63 billion m^3 per year), it is likely that the transit of natural gas through the existing pipelines in Ukraine, Romania and Bulgaria to Turkey, Greece, and Macedonia (currently 17.7 billion m^3) would cease. This raises two issues associated with the transit of gas to the above-mentioned Balkan countries. First, the new EU legislation on the liberalization of the gas market stipulates that **South Stream should sign a contract with and pay for the services of Bulgartransgaz –** the gas transmission system operator for the transmission of Russian natural gas to Turkey, Greece, and Macedonia. Second, **Bulgaria should be compensated for the lost revenues** from not using the compressor stations and gas pipelines in the case the transit of gas through them stops. Gazprom is obligated to use the existing gas transit pipeline system in Bulgaria at its maximum carrying capacity until 2030, as per the memorandum signed on December 18, 2006, and the additional agreements to the gas transit contract dating back to 1998. On average, for the period between 2011 and 2030, the revenues from the transit of gas according to the existing contracts wit Gazprom will be about USD 35 million per every 100 km of the pipeline on Bulgarian territory. That amounts to a total of USD 700 million for the next 20 years per every 100 km of pipeline.

The Burgas – Alexandroupolis Project

The Burgas-Alexandroupolis oil pipeline is an international project for the transportation of Russian and Caspian oil from the terminal at Novorossiysk (Russia) to the port of Burgas (Bulgaria), where a pipeline would transport the oil to the port of Alexandroupolis (Greece). The project's aim is to serve as an alternative to the oil route through the Bosporus and Dardanelles straits. As such, Burgas-Alexandroupolis would emerge as **a new transit corridor for Russian oil to the European petroleum markets**.

Figure 17. Map of the Burgas-Alexandroupolis Project

Source: Wikipedia.

It is estimated that the Burgas-Alexandroupolis project will transport 30-35 million tons of oil per year. The project company – Trans-Balkan Pipeline B.V was registered in February, 2008, in Amsterdam (Netherlands). Fifty-one percent of the company's capital is owned by three Russian companies: Rosneft, Transneft, and Gazprom Neft. Greece and Bulgaria each own 24.5 % of the capital via the Hellenic Petroleum and Traki consortium and (23.5 %), the Greek state (1 %), and Technoexportstroy (24.5 %) respectively. The total cost of the oil pipeline (prior to completing the project feasibility study) is estimated at EUR 1-1.2 billion. Thus, the Bulgarian share in financing the project is expected to be between EUR 240 and 300 million.

A closer look at the project's parameters demonstrates that it is unlikely that the Bulgarian state-owned company will recover its investments. Upon adding the interest rate and loan guarantees, the estimated participation of the Bulgarian shareholder in the project would reach EUR 340 to 400 million. Considering the (preliminarily) estimated transport fee of USD 1 per ton of oil transported through the pipeline, the total revenues of the international company would be in the range of USD 30 to 35 million annually. Thus, the Bulgarian share of 24.5 % would bring at most revenues of USD 7.35 to 8.75 million annually. This amount could not cover either the annual depreciation costs, or interest, nor the operational costs of the Bulgarian company.

Despite the obvious strategic and economic irrationality of the project from a Bulgarian standpoint, Bulgaria's participation in Burgas-Alexandroupolis was withdrawn only after the completion of an environmental impact assessment. Meanwhile, the Bulgarian government continues spending resources to support the country's participation in the project. In light of the above it would be best if **Bulgaria's participation in the project company be discontinued as soon as possible, and the company and its assets be liquidated**.

There are certain **common shortcomings** in the management of the three largest energy infrastructure projects of the past decade in Bulgaria described above. These shortcomings should be clearly pointed out so as to develop effective measures for overcoming them:

- The **lack of clearly defined strategic priorities** and the relation of each project to these priorities;

- The **deviation from the principles of good corporate governance and transparency** during the decision-making process and the project implementation;

- The **absence of quality standards for managing public procurement**, which leads to unforeseen increases in project costs and the risk of poor quality of implementation.

The following section of the report discusses the issues related to public procurement in the energy sector.

3. ENERGY POLICY INSTRUMENTS: PUBLIC PROCUREMENT

Public procurement is the most crucial instrument of energy policy, both at the national and international levels. Public procurement plays a substantial role in a number of activities related to energy – from building new power stations worth billions of euros and purchasing materials and consumables to awarding consultancy and financial services.[68] Awarding public procurement is also a means of redistributing national income. A total of 15,431 public procurement contracts were awarded in 2009 for a total of BGN 10.3 billion.[69] In comparison, in 2010 there has been a substantial decrease in public procurement contracts: 14,017 contracts totalling BGN 3.6 billion have been awarded in 2010.[70] Further analysis would be necessary to determine whether this decrease is attributable to the general economic crisis or to enhanced public procurement efficiency.

The Center for the Study of Democracy discussed various issues related to public procurement in the energy sector in 2006/2007.[71] **The high concentration of public funds in this particular instrument generates a persistent risk of corruption, fraud and abuse of public financial resources.** The major problems analysed then keep reoccurring and are even being exacerbated. Most big energy projects like Belene NPP, Tsankov Kamak HPP and the rehabilitation of facilities can serve as examples of the misuse of public procurement mechanisms. The **major factors contributing to heightened corruption risks** in the energy sector can be summarized as follows:

- **Insufficiently detailed legal regulation** regarding the status and functions of the specialised anti-corruption unit at the Ministry of Economy, Energy and Tourism (MEET);

- **Considerable economic interests at stake and substantial financial resources involved** in the energy sector;

- **Privatisation** of electric distribution companies;

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68 For a detailed review of public procurement in the field of energy in Europe in general, and Norway and Bulgaria in particular, see Andvig, J., Public Procurement: Corruption and Cartelization Issues, Center for the Study of Democracy and Norwegian Institute of International Affairs.

69 The overall number of contracts in the Public Procurement Agency database is actually higher. Only those listed under a particular type of public procurement (e.g. public works, supply and service) have been considered here. The public procurement contracts over the reporting period were awarded in four different currencies: BGN, EUR, USD and GBP. The BGN equivalent of contracts awarded in foreign currency was calculated using the fixed BGN/EUR rate and the average monthly and daily rate of the Bulgarian National Bank for the other currencies.

70 Data of the Public Procurement Agency as of the end of November 2010.

71 Corruption in Public Procurement: Risks and Reform Policies, Center for the Study of Democracy, 2007; Crime without Punishment: Countering Corruption and Organized Crime in Bulgaria, Center for the Study of Democracy, 2009.

- **Lack of genuine competition** and strong monopolization of individual segments in the energy sector;
- Large investment projects in terms of both number and value;
- High volume of energy exported via intermediaries;
- **Lack of transparency, public awareness and independent expert assessment**; restricted access to information on national security grounds;
- The technical complexity of the energy sector;
- The pressing need to strengthen the inspectorates' capacity;
- The need to introduce anti-corruption training of personnel;
- The need to elaborate a policy for increasing employee remuneration as a means of reducing corruption risk.

It is due to these high risks that public procurement as an energy policy instrument directly affects good governance and is the focus of this report.

3.1. LEGAL REGULATION AND GENERAL PRINCIPLES OF PUBLIC PROCUREMENT

The national regulation of public procurement was substantially modified prior to Bulgaria's accession to the EU. As of July 1, 2006[72] the *Law on Public Procurement* (LPP) has been harmonised with the two most important applicable EU directives,[73] and shortly afterwards the respective bylaws were amended: the *Regulation on Small-Scale Public Procurement (RSSPP)*,[74] the *Regulation on Special Public Procurement (RSPP)*[75] and the *Law on Public Procurement Implementing Rules*.[76]

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[72] Law Amending and Supplementing the Law on Public Procurement (promulgated in State Gazette issue 37 of 5 May 2006).

[73] Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts and Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors.

[74] Adopted with a Council of Ministers Ordinance No. 249 of 17 September 2004 (promulgated in the State Gazette issue 84 of 27 September 2004; corrected SG 94/2004; amended and supplemented SG 59/2005, SG 53/2006, SG 83/2007, SG 3/2009; amended SG 34 of 8 May 2009).

[75] Adopted with a Council of Ministers Ordinance No. 233 of 3 September 2004 (title amended by SG 7/2007; promulgated SG 80 of 14 September 2004; amended SG 78/2005; amended and supplemented SG 7/2007, SG 83/2008; amended SG 93 of 24 November 2009).

[76] Adopted with a Council of Ministers Ordinance No. 150 of 21 June 2006 (promulgated SG issue 53 of 30 June 2006; amended SG 84/2007; amended and supplemented SG 3/2009; amended SG 93 of 24 November 2009).

In public procurement energy enterprises act as contracting authorities in two cases: when they are public undertakings, i.e. when they are controlled by state authorities, or when they operate on the basis of special or exclusive rights related to natural gas, heat and energy, with a number of exceptions.[77] In both cases they are considered to be **sectoral contracting authorities**.[78]

The Law on Public Procurement sets forth certain requirements for contracting authorities in the energy sector. The reason is that their activity may be exempted from the scope of application of public procurement procedures where the activity in question is open to competition and consent has been granted by the European Commission to that end.[79]

Box 4. Interpreting the Obligation for Public Undertakings to Award Contracts: the Case of the Bulgarian Energy Holding

The case of the Bulgarian Energy Holding EAD (BEH) is particularly interesting. Being the successor of Bulgargaz Holding, it has been considered a contracting authority only retrospectively in relation to already concluded inspections of tendered contracts prior to its establishment. A 2009 report of the Public Financial Inspection Agency (PFIA)[80] established that the holding was no longer a contracting authority since its activities did not fall under any of the categories set forth by the *Law on Public Procurement*.[81] Indeed, BEH does not carry out any of the activities referred to in the act, namely activities relating to natural gas, heat or electricity, drinking water, public transport, universal postal service or exploitation of a geographical area. In this sense the holding is **not a sectoral contracting authority**. It remains unclear however whether or not it is **a body governed by public law** as defined by the *Law on Public Procurement*,[82] namely a body having a managerial or supervisory board, more than half of whose members are appointed by: 'bodies of state authority', 'other institutions of State established by a statutory instrument' or other bodies governed by public law.

The same procurement thresholds as set forth by the LPP and RSSPP apply to both sectoral and institutional contracting authorities.[83] The difference concerns the applicable procedures. Sectoral contracting authorities may only award contracts following an open procedure, a restricted procedure or a negotiated procedure, with or without the publication of a contract notice. The law also provides for a design contest and a **preliminary selection of contractors**.

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77 Article 7, items 5 and 6 read in combination with Article 7a of the *Law on Public Procurement*.

78 The reasons why special procedures for the award of contracts apply to these entities are set forth in paras 2 and 3 of the preamble of Directive 2004/17/EC and fall in two groups: (a) the variety of ways in which national authorities can influence the behavior of these entities, including participation in their capital and representation in the entities' administrative, managerial or supervisory bodies and (b) the closed nature of the markets in which they operate, due to the existence of special or exclusive rights granted by the Member States concerning the supply to, provision or operation of networks for providing the service concerned.

79 See Article 118b of the Law on Public Procurement.

80 Report of the PFIA No. ФИ5СФ-0059 of 12 November 2009 obtained pursuant to the *Law on Access to Public Information*.

81 The activities referred to in Articles 7a to 7e.

82 Pursuant to § 1, item 21 of the Additional Provisions of the *Law on Public Procurement*.

83 See Annex 2: Procurement thresholds for sectoral contracting authorities.

3.2. PUBLIC PROCUREMENT DYNAMICS IN THE ENERGY SECTOR

Investment projects in the energy sector are by default of high value. Given the scale of their projects, **big energy companies are among the top contracting authorities in Bulgaria**. According to Public Procurement Agency data, for the 2007 – 2010 period the top contracting authorities in terms of value of the awarded contracts are as follows: Maritsa Iztok 2 TPP EAD; EVN Bulgaria Electric Distribution AD, Plovdiv; Kozloduy NPP EAD; Mini Maritsa Iztok EAD, Radnevo; Enel Maritsa Iztok 3 AD; Electricity System Operator EAD; National Electric Company (NEK) EAD and Bulgargaz EAD. Of the top ten contracting authorities in terms of EUR and the top twenty in BGN, five are energy companies. Should the amounts be aggregated, **six of the top ten sectoral contracting authorities in the country are energy companies**.[84] The same energy companies appear regularly in previous years' rankings, as compared to the sporadic presence of other companies among the top ten contracting authorities. In 2010 these energy companies awarded 918 contracts. In 2009, the awarded contracts were worth over BGN 568 million.

Table 4. The Biggest Contracting Authorities for 2009 in Terms of Value of Contracts

Name of the contracting authority	Total BGN
Metropoliten EAD Sofia	173,065,926
Kozloduy NPP EAD	154,999,501
Maritsa Iztok 2 TPP EAD	133,867,475
Mini Maritsa Iztok EAD, Radnevo	120,164,085
National Railway Infrastructure Company	107,222,720
National Electric Company (NEK) EAD	84,477,102
Sofiyska Voda AD	84,459,629
EVN Bulgaria Electric Distribution AD, Plovdiv (former name Electric Distribution Plovdiv AD)	72,068,374
Sofia Airport EAD	12,673,150
ENEL Maritsa Iztok 3	2,515,800

Source: Public Procurement Agency, 2010.

Energy enterprises hold roughly one-third of the top ten positions of the biggest awarded contracts. **Over the past two years they have awarded contracts worth more than BGN 1.7 billion**, or approximately 10 % of all awarded contracts over the period (some BGN 17.6 billion).[85] Contracting authorities in the

[84] See Annex 3 Public Procurement in the Energy Sector for 2008 – 2009.

[85] The data refers to the period 2008 – 2009. No conclusive data for 2010 is available but the provisional data shows that there is no significant difference compared to the 2008 – 2009 period. For previous years, see Corruption in Public Procurement: Risks and Reform Policies, Center for the Study of Democracy, 2007.

energy sector are of structural significance to the public procurement sector and have at their disposal **mechanisms to influence the market of certain supplies, services and construction works**.

It is important to underscore the fact that the available data only refers to contracts awarded following procedures under the LPP and the RSSPP. Both national and EU law **excludes certain contracts from the scope of public procurement**. For example, pursuant to Article 4 of the LPP, six types of contracts are excluded from public procurement; some of these may be worth substantial amounts, like those for financial services, scientific research and experimental development and real estate transactions. That is why the total **volume of contracts, which should be awarded through public procurement, is significantly higher**.

Table 5. Number of Contracts Awarded by the Biggest Contracting Authorities in the Energy Sector[86]

Contracting authority	2006		2007		2008		2009	
	Position	No. of awarded contracts	Position	No. of awarded contracts	Position	No. of awarded contracts	Position	No. of awarded contracts
Maritsa Iztok 2 TPP EAD	2	212	8	186	6	306	6	227
EVN Bulgaria Electric Distribution AD, Plovdiv	-	-	11	168	13	154	7	190
Kozloduy NPP EAD	4	185	5	241	7	248	8	177
Mini Maritsa Iztok EAD, Radnevo	14	107	7	187	10	212	10	137
ENEL Maritsa Iztok 3 AD	6	166	9	185	14	150	17	119
Electricity System Operator EAD	-	-	24	83	16	145	21	112
National Electric Company (NEK) EAD	8	141	16	126	-	118	-	55
Bulgargaz EAD	22	76	-	-	-	-	-	-

Source: Public Procurement Agency, 2010.

[86] The table illustrates the position that energy enterprises hold in the ranking of the 30 top contracting authorities in terms of number of awarded contracts.

Table 6. Data on Public Procurement Awarded by Ccontracting Authorities in the Energy Sector

Period		2008	2009
Number of public procurements – 2,445, incl.:		1,537	908
	Construction works	228	144
	Supplies	823	424
	Services	485	340
	Design contests	1	0
Period		**2008**	**2009**
Number of awarded contracts – 3,577, incl.:		2,035	1,542
	Construction works	371	295
	Supplies	994	767
	Services	669	480
	Design contests	1	0
Period		**2008**	**2009**
Total amount of awarded contracts, incl.:			
	BGN	808,290,429	530,129,337
	EUR	114,004,651	98,017,535
	USD	3,662,000	1,797,000
Construction works	BGN	218,614,289	187,939,037
	EUR	5,414,040	1,941,027
Supplies	BGN	357,886,159	226,710,123
	EUR	94,233,499	35,323,660
	USD	2,050,000	1,797,000
Services	BGN	231,789,980	115,480,177
	EUR	14,357,112	60,752,848
	USD	1,612,000	
Design contests	BGN	0	0

Note: The table refers to contracts awarded during the respective year.

Source: Public Procurement Agency, 2010.

3.3. MAJOR PROBLEMS IN PUBLIC PROCUREMENT IN THE ENERGY SECTOR

Several problems stand out in public procurement in the energy sector:

- Guaranteeing competitive conditions in the award of public procurement contracts;
- Ensuring publicity of awarded contracts and their particular conditions;
- Conducting negotiations without following specific guidelines or set procedures, negotiating strategic partnerships outside the scope of the LPP and having recourse to the so-called special procurements;
- Unclear and/or inadequate control procedures and mechanisms, in particular with regards to the expediency and practical utility of public procurements.

The **major types of violations** in pubic procurement in the energy sector are as follows:

- Initiating an inexpedient (not in line with the public needs) public procurement procedure with a view to spending out available funds or to someone's personal benefit;
- Selecting a non-qualified team and/or opting for negotiations where there is a possibility for choosing a more competitive procedure;
- Deliberately manipulating procedures and related documentation, for example by making them excessively complex or riddled with ambiguities;
- Deliberately manipulating eligibility criteria for candidates, for example by establishing inadequate qualifications and certification criteria and technical requirements;
- Exerting administrative or political pressure, for example with a view to hiring a particular subcontractor or influencing the contracting authority's decision-making;
- Exerting pressure over a supplier, contractor or service provider of the public procurement by manipulating payment schedules;
- Deliberately creating unequal treatment or prerequisites for inequality or unfair competition among the bidders;
- Breach of trust and undue disclosure of information.[87]

Even where some public procurement procedures formally comply with the letter of the law, they carry alongside risks for substantial damages that are ultimately compensated through **raising the fees for the provision of the respective services to consumers and end users**. The analysis of 13 inspec-

[87] Relations of trust often occur in the public procurement sphere on the basis of information protected by law. The excessive expansion or restriction of the requirements to the documentation in this connection could lead to abuse to the detriment of the contractor.

tions[88] of energy enterprises carried out by the Public Financial Inspection Agency over a period of four years shows that 39 violations were found in 41 cases. For 12 of these violations no citations have been issued, partly due to expired statutes of limitations. Several conclusions can therefore be made: (1) the number of inspections is relatively small compared to the large volume of public procurements in the sector; (2) the share of violations is quite high and is indicative of a systemic problem; (3) inspections should be carried out without delay to prevent statute of limitations expirations, and (4) **a detailed review of the financial control system for state-owned energy companies is necessary**.

Avoiding Supply Competition

In terms of competition among the bidders, the procedures for the award of public procurement contracts vary considerably. They **fall into three major categories**:

- **Highly competitive procedures** where all interested parties may submit a tender. Open procedures under the LPP, open contests under the RSSPP, commodity exchange transactions and to some extent design contests fall under this category;

- **Partly competitive procedures** where a limited number of interested parties may submit a tender, i.e. only those explicitly invited by the contracting authorities (the restricted procedure under the LPP);

- **Non-competitive procedures** where a limited number of interested parties may submit a tender and thereafter negotiations are conducted. This category includes the negotiated procedure with and without publication of a contract notice under the LPP, the competitive dialogue, and the negotiated procedure following an invitation, as well as the selection among three submitted tenders, both under the RSSPP fall under this category.

The specific nature of Bulgaria's energy sector is conducive to the bypassing of highly competitive procedures. To this contribute the exceptional criteria for access to and safety of nuclear energy sites,[89] the effective technology monopoly at the micro level for a number of supplies, the ambiguous legal nature of energy export transactions, the lack of effective in-house financial audits, and the lack of monitoring and control with respect to public procurement efficiency exercised by the State Energy and Water Regulatory Commission or any other control body.

The **share of open procedures** (open contests under the RSSPP) where a **single tender** has been submitted is **indicative of the progressive establishment**

[88] Reports of the Public Financial Inspection Agency for the period 2006 – 2009 obtained pursuant to the *Law on Access to Public Information*.

[89] For example, Article 3, para 2 of the *Law on the Safe Use of Nuclear Energy* reads that 'in the use of nuclear energy and ionizing radiation and in the radioactive waste management: 1. nuclear safety and radiation protection shall have priority over any other aspect of these activities; and 2. exposure of the personnel and the general public to ionizing radiation shall be kept at the lowest feasible level. Item 1 understandably attributes highest priority to safety, but this also means priority to considerations relating to public procurement procedures.

of discriminatory specifications. Open procedures in principle attract broad interest and the number of submitted tenders would typically be as high as possible. In the energy sector however preference is consistently given to non-competitive procedures for the awarding of public procurement contracts.

Approximately **56 % of all procedures for the awarding of public procurement contracts in the energy sector are non-competitive**, encompassing the various negotiated procedures with or without the publication of a contract notice under the LPP, and negotiated procedures following an invitation under the RSSPP. If the contracts awarded without a public procurement procedure are added to this number, it becomes apparent that **avoiding market competition is the rule rather than the exception in the energy sector**. For instance, in the 2008 – 2009 period, not a single public tender under the RSSPP was announced.

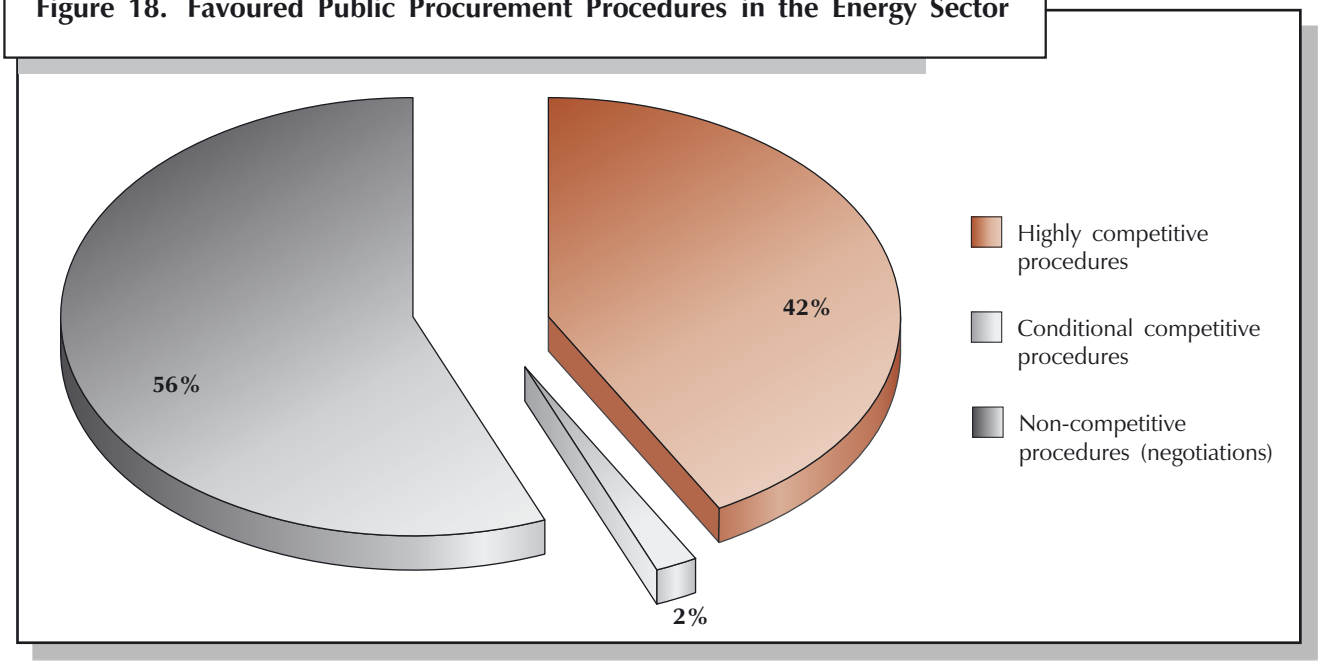
Table 7. Types of Procedures Followed in the Energy Sector

TYPES OF PROCEDURES	2008	2009
Open procedure under the LPP	578	348
Restricted procedure under the LPP	74	38
Negotiated procedure with the publication of a contract notice under the LPP	856	534
Negotiated procedure without the publication of a contract notice under the LPP	580	464
Open contest under the RSSPP	782	354
Public tender under the RSSPP	0	0
Negotiated procedure following an invitation under the RSSPP	204	84
Stock exchange transaction	0	0
Competitive dialogue	0	0
Design contest	2	0
TOTAL NUMBER OF AWARDED PUBLIC PROCUREMENT CONTRACTS	3,076	1,822

Source: Public Procurement Agency, 2010.

Sometimes the choice of negotiated procedures is not made in compliance with the law. Most frequently recourse is made to arguments referring to the **limited number of suppliers of the respective service or goods**. In many cases public procurement contracts are awarded following the negotiated procedure without the publication of a contract notice because the supplied good constitutes special equipment purchased directly from the producer. This is the case with **nuclear fuel supplies**, which also require securing storage facilities for nuclear waste. Other frequent types of cases involve **the supply of spare parts by the producer of the main equipment**, or supplemental increase in procurement volumes through contract annexes. In these cases it is **difficult to establish the cost-effectiveness of the supplies for the contracting authority**, i.e. whether the supplies are made in adherence to market principles or not.

Figure 18. Favoured Public Procurement Procedures in the Energy Sector



Source: Public Procurement Agency, 2010.

A major deviation from best practices is the **manipulation of technical specifications in a way to fit a 'favoured' potential candidate or bidder**. According to the general rule, technical specifications should not discriminate in any way nor restrict competition. Due to their complexity, technical specifications in the energy sector are for the most part inscrutable for the control bodies and usually only an in-house assessment as to their expediency can be made.

The transparency and effectiveness of public procurement are further impaired by the **lack of well-structured control and sanctioning mechanisms for large-scale procurements**. In practice sanctions for serious and for minor violations are not sufficiently differentiated. Fines for violating the contracting authority's integrity vary from BGN 5,000 to 10,000, which is not enough to produce a deterring effect for officials in charge of large financial transactions generating high corruption risks.

The control bodies under the LPP are the **National Audit Office and the Public Financial Inspection Agency (PFIA), both of which lack a sufficient number of highly qualified experts in the energy sector**. Where violations in drafting the technical specifications are established, these bodies must impose fines ranging from BGN 2,000 to BGN 7,000. In view of the supposedly high corruption pressure however, these fines can hardly serve as deterrents, all the more so since imposing them involves in-depth specialized technical analysis and expertise.

There are a limited number of cases in public procurement where the initially forecasted value of the procurement has been exceeded so grossly as to **cross the respective threshold and place the procurement in a different category, eventually rendering it illegal**. In such cases the procedure must be terminated and a new one launched. Instead the contracting authorities have on occasion awarded the procurement contract in violation of the law and to the detriment of the contracting authority's integrity.

Box 5. Award of Public Procurement Contracts Above the Thresholds Prescribed by the RSSPP at the Mini Maritsa Iztok EAD

The financial inspections conducted by the PFIA[90] established that five of the nine inspected public procurement procedures of Mini Maritsa Iztok EAD were awarded under the RSSPP in violation of the applicable thresholds. It was further established that the company management should have terminated the procedures after it had established that all submitted tenders exceeded the values set in the thresholds and should have followed instead the procedures under the LPP. These findings are further aggravated by the fact that in some cases negotiated procedures following an invitation under the RSSPP were launched, which, regardless of the arguments in favour of these procedures, restrict competition and hence make contract values difficult to forecast.

Some **best practices have nevertheless been introduced in the energy sector**. An example is the **tendering system for energy exports**, although it formally falls outside the scope of public procurement. Under this system tenders are held directly by large-scale producers like Kozloduy NPP EAD and Maritsa Iztok 2 TPP EAD. The system has been instrumental in **discrediting arguments regarding the positive role played by intermediaries in exports** (who have been selected without any competition) for guaranteeing the stability of sales. For quite some time opponents of such an arrangement have held that tenders entail the risk of cartelization and that intermediaries could guarantee more vigorous competition, and subsequently more favourable terms than under open market transactions.

Energy supplies account for a major share of public procurements in the energy sector. Most energy supplies can be purchased at local and foreign **commodity exchanges**. **This procedure however is consistently avoided** despite its detailed regulation in the law that rules out any doubts as to its legality. Not a single commodity exchange transaction was made over the 2008 – 2009 period[91] compared to 16 such transactions (out of a total of 2,139 procurements or 0.7 % of all procurements) over the period from October 1, 2004 to June 30, 2006.

Data regarding direct negotiation procedures should be interpreted with care. Some of the procurements for example have been awarded under previously concluded framework agreements with several potential contractors. The practice of concluding framework agreements resolves a number of issues regarding procurements of high importance and urgency,[92] but it entails certain risks as well. For example, the **law permits the conclusion of a single framework agreement with a sole potential contractor**. Thus the framework agreement may be concluded following a non-competitive procedure, for example negotiation following an invitation.

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[90] Reports Nos. ФИ4С3-0001 of January 12, 2007 and ФИ4С3-0020 of October 19, 2009 covering the period 2006 – 2009. The reports have been obtained pursuant to the *Law on Access to Public Information*.

[91] The analysis of transactions per contractor shows that commodity exchange transactions are being made but for various reasons they are registered and reported as negotiations.

[92] The framework agreements used to be a good practice in Bulgargas EAD, the BEH EAD predecessor. Some of the agreements however were concluded through a negotiated procedure with a publication of a contract notice (see PFIA Report No. ФИ5СФ-0008 of February 24, 2009), which could arouse public distrust as regards the selection of potential contractors.

A **considerably large number of negotiated procedures without the publication of a contract notice** in the energy sector are justified on account of the need for additional supplies that have not been envisaged in advance, for carrying out extra construction works or even purchasing spare parts from the main equipment producer. Such circumstances cannot justify resorting to direct negotiations. A number of further requirements that are set out in detail in the law should be met as well. These stipulations however are set as blanket requirements, which call for further precision and heightened control where such procedures are followed. Of **particular interest** in this respect are the **consultancy services where often the deliverables are not quantifiable**. Some projects like the construction of Belene NPP involve multiple consultancy services related to project management, research and design work.

Transparency of Public Procurement Contracts

Although public procurement contracts affect the interests of virtually everyone in the country, the texts of many of them are still not publicly accessible. Excuses usually refer to the **principles of trade secrets, fair competition and the protection of contractors' trade rights and interests**. Contracts in the energy sector practically affect all energy consumers and the public interest in them overrates even the interest in contracts concluded by conventional contracting authorities. It should be broadly acknowledged that the *Law on Public Procurement* **favours the protection of trade secrets in only four cases**:

- Where it allows the tenderer to designate at the time of submitting the tender which part of said tender is of a confidential nature.[93] In such cases the contracting authority may not disclose any information designated as confidential or constituting technical or trade secrets, with the exception of registration of data regarding concluded contracts;

- Where it prescribes obligations for the contracting authorities to preserve the integrity and confidentiality of tender applications and bids;[94]

- Where it allows the contracting authority to refuse candidates or bidders access to data contained in the memorandum where the disclosure of said data conflicts with a statutory instrument or prevents, restricts or distorts competition;[95]

- Where it allows sectoral contracting authorities not to indicate the object of or quantities related to awarded research and development activities, should the disclosure of such data violate a trade secret. In those cases the contracting authorities however are under the obligation to provide data concerning all aspects of the publication.[96]

Access to trade information in the awarding of public procurement contracts by sectoral contracting authorities is subject to certain specificities. It is usually restricted to prevent any unfair competition among potential contractors.[97] At the same time however the **status of sectoral contracting authority is conferred in**

93 Article 33, paras 4 and 5 of the LPP.
94 Article 58a, para 3 of the LPP.
95 Article 73, para 4 of the LPP.
96 Article 118a, para 1 of the LPP.
97 Argument by Article 33, paras 3 and 4 and Article 73, para 4 of the LPP.

conditions of absence of competition on the supply market. It is because of the presumption of natural monopoly with regard to activities relating to natural gas, heat and electricity that the LPP defines the respective energy suppliers as sectoral contracting authorities.[98] The lack of competition in the respective market renders unfair competition impossible by default. Thus, should an operator be conferred the status of sectoral contracting authority, protection against disclosure of information in the award of public procurements is excluded since there is no competition to start with. This serves as a **legitimate ground to do away with the legal protection of trade data and to ensure transparency of public procurement contracts should there be public interest therein**. The presumption of public interest is justified since the rights and obligations assumed by the contractor affect a broad range of natural and legal persons. This applies in particular to sectoral contracting authorities whose acts and omissions affect directly or indirectly prices in the provision of public utility services through fixed networks.

Currently there is no rule to allow or prohibit the publication of public procurement contracts and annexes thereto. This data is not disclosed to the general public in the same way that trade data in a typically competitive environment is protected. This lack of transparency is a substantial flaw of the Bulgarian regulatory framework and does not contribute to strengthening the trust in public utilities. **In many cases the contracting authorities do not publicly announce the awarded contracts as required by the LPP or do so following prolonged delays and then only provide partial information**. Such delays impede the effective supervision of contracts and give rise to doubts as to their transparency.

Special Public Procurements

Another group of problems in public procurement relates to the **lack of public control over the implementation of the Regulation on Special Public Procurement (RSPP)**. Within the meaning of the LPP and the Regulation, special procurements fall under any of the following three categories:

- Public procurements relating to national defence and national security which are subject to classified information constituting a state secret;
- Where carrying out the public procurement must be accompanied by special security measures in accordance with legislation currently in force; or
- Public procurements associated with the production of and trade in arms, ammunition and military equipment.

In principle, **sectoral contracting authorities cannot award special public procurements**. Public procurements under the third category are apparently irrelevant for contracting authorities in the energy sector but for the other two categories loopholes in the legislation permit bypassing the law. **Speculations abound regarding such special public procurements in the energy sector.**

[98] This is also the logic of Directive 2004/17/EC of the European Parliament and the Council coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors.

Limited or no access to official data however renders any measures against such violations impossible.[99]

Box 6. National Security and Maritsa Iztok 2 TPP EAD

In 2008 Maritsa Iztok 2 TPP EAD launched a public procurement procedure under the RSSPP was regarding the provision of access to and ensuring the physical security of the premises, property and equipment of the enterprise. Two sets of reasons to follow this particular procedure were given by the contracting authority, namely:

(1) that with a decision of the government from 2004 the enterprise had been designated a 'strategic object of national importance', and

(2) that the procurement involved classified information and special security measures.

The procurement was awarded following negotiations with a potential contractor. The total value of the procurement for the whole five-year period (which exceeds the maximum duration of contracts under the LPP) was set at BGN 8,254,008 (VAT-free). The contract was awarded to the company that had been thus far in charge of the security of the enterprise.

Soon after that the contract was terminated due to security breaches whereby metal waste was disposed of on dates other than the ones fixed (violations of previously concluded agreements). The case was brought to court.[100]

3.4. JUSTIFYING PUBLIC BENEFIT

Traditional mistrust of public utilities operators directly affects public procurement efficiency, which is assessed by the expected final result and public resources involved. Relevant to this context is the issue of the so-called **unfavourable contracts** in their economic as well as legal aspects.

The lack of transparency regarding contracts and the lack of public mechanisms to monitor the award, content and performance of public procurements negatively affect public perceptions. These omissions cannot be justified by any significant technical, economic or other publicly significant factors. There is no institution to review and/or to assess the actual necessity of a particular service, supply or construction work. The **State Energy and Water Regulatory Commission could exercise such control** over large-scale public procurements **through the review of the annual business plans of large energy enterprises** and especially upon requests for tariff corrections and approval of business parameters. In addition, state-owned companies can introduce the practice to provide justification and financial forecasts for planned public procurements for the respective calendar year.

[99] Precise data may be obtained solely by the control bodies under the terms and procedures of the *Law on the Access to Public Information*, and only in specific cases.

[100] Source: PFIA Report No. ФИ4С3-0026 of 4 November 2008 on the financial inspection of Maritsa Iztok 2 TPP EAD, obtained under the *Law on the Access to Public Information*.

Efforts to enhance efficiency and control mechanisms in the public sector resulted in the adoption of two acts in 2006: The *Law on the Internal Audit in the Public Sector* and the *Law on the Financial Management and Control in the Public Sector*. Internal audit and internal financial control systems are thereby introduced as effective instruments for risk analysis and the prevention of practices whereby public procurements are awarded without being really necessary, or are performed inefficiently.

Box 7. Public Procurement in the Nuclear Sector

As one of the largest contracting authorities, the Bulgarian nuclear sector ranks traditionally high in terms of perceptions of **misuse of public funds and lack of openness in the awarding of contracts**. With respect to the public financing of the nuclear sector, uncertainties remain regarding the annual maintenance expenditures for Kozloduy NPP's decommissioned units 3 and 4, which in 2008 amounted to some BGN 40 million. The way these costs are forecasted and approved remains unclear.

The awarded contracts for the construction of Belene NPP are also of particular interest, specifically the high rates for consultancy services, exceeding several times European market prices. Yet another case in point is the site preparation works costing some EUR 100 million. These types of costs are outside the scope of public procurement governed by the LPP.

Non-transparent planning of and argumentation for upcoming public procurement in the energy sector continue to pose problems. Despite the logical need to integrate public procurements in the broader framework of annual public investments, **the available data indicates that energy procurements are rather made on a monthly basis**. PFIA inspections conducted under the LPP in major state-owned enterprises show consistently that argumentation precedes actual decision-making on public procurement by only three to four weeks.

Box 8. Planning of Public Procurement in the Energy Sector

The PFIA inspections of four public procurements launched by Maritsa Iztok 2 TPP EAD[101] show that in three of the four cases (the fourth being a special procurement, so no data is available) the assessment as to the necessity of the respective procurement was only made a few weeks prior to the decision-making, and in one of the cases it was even made the very same day. The decisions concerned public funds expenditures worth BGN 0.5, 0.9, 8.3, and 19 million, excl. VAT respectively. This clearly points to the **lack of sustainable annual public procurement planning** which impairs the economic and ethical rationale for the provision of argumentation.

[101] PFIA Reports Nos. ФИ4С3-0000001 of September 20, 2006, ФИ4С3-0001 of January 22, 2008, ФИ4С3-0026 of November 14, 2008 and ФИ4С3-0005 of April 2, 2009 obtained pursuant to the *Law on the Access to Public Information*.

Public benefit is not a circumstance that could be judicially controlled since it falls under discretionary rules conferred upon the contracting authorities. This alone is a serious argument in favour of introducing a **monitoring and** (both internal and external) **control system** with a view to ensuring the efficiency of public procurement awards and performance, and assessing their influence over the prices of consumer services.

3.5. CONTROL EFFICIENCY

Control over the implementation of the *Law on Public Procurement* is entrusted to two bodies: the National Audit Office is generally responsible for overseeing public contracting authorities, while the Public Financial Inspection Agency (PFIA) is responsible for the oversight of all entities, including sectoral contracting authorities. Although the PFIA only monitors the legality of the costs incurred, its financial inspections of sectoral contracting authorities reveal some interesting data and suggest certain **indirect conclusions as to the expediency of the contractors' decision-making**.

Box 9. Kozloduy NPP

NPP Kozloduy's inspection by PFIA over the period from 2003 to the beginning of 2009 covers fourteen procedures and contracts.[102] Some of the more important findings are as follows:

- All the way up to 2008 a number of public procurements were awarded without following any procedure, despite the explicit requirements to the contrary of the relevant laws and regulations. Some of these procurements concern the transportation of nuclear waste, the supply of nuclear waste equipment, and small-scale construction works;
- Opting for a less competitive procedure for the award of public procurements should in principle be well reasoned. The choice of the negotiated procedure with the publication of a contract notice has been justified by the contracting authority solely by reference to the LPP provision stating that '[C]ontracting authorities shall make a decision on the award of public procurements by open procedure, restricted procedure and negotiated procedure with publication of a contract notice whenever there are no conditions for conducting a negotiated procedure without publication of a contract notice'. This provision however refers to a legal argument and not a factual one. It may justify not following a negotiated procedure without a publication of a contract notice but it cannot underpin the choice of a particular procedure out of three possibilities;

[102] PFIA Report No. ФИ1Вр-0006 of April 14, 2009, obtained pursuant to the *Law on the Access to Public Information*.

Box 9. Kozloduy NPP (continued)

- Almost all inspected documents refer to the established need of certain supplies, services or construction works. As evidenced by all inspected transactions, between the establishment of the need and the board of directors' approval of the launch of a procedure there is a time span of four to five weeks.[103] In practice, the decisions for financial approvals of public procurements were taken at the first meeting of the management body after the one when the need of a particular procurement was established. This raises the question of the lack of an investment program or of an annual public procurement plan. The high values of most of the inspected procurements should also be taken into consideration, especially so as there were no extraordinary circumstances warranting them;
- A certain number of important supplies still remain outside the scope of the LPP, for example the supply of fresh nuclear fuel. The EU public procurement directive grants Member Sates the right not to apply the respective award procedures for supplies of energy or fuel for energy production where the contracting authorities supply electricity to fixed distribution networks which provide a service to the public. Supplies of nuclear fuel apparently fall outside the scope of application of both EU and national law. However it remains unclear what rules should be applied to such supplies and how the contractor must be selected, having in mind that this costs consumers more than EUR 18.7 million;
- In some cases awarded contracts already in progress have been terminated after failing to receive the control body's (the Nuclear Regulatory Agency) approval. However, this has been due to no fault in the performance since it is the contracting authority's obligation to request such an approval *a priori*. Ultimately, it would be consumers who would foot the bill for any losses incurred, without receiving any benefits;
- Irregularities in awarding and reporting contracts. A broad range of cases may serve as examples here: faulty ranking of tenders; failure to meet the deadlines set forth in the law for awarding contracts due to initiated proceedings before the Commission on the Protection of Competition; selecting a contractor who has failed to produce all required documents (e.g. such certifying no outstanding tax liabilities); failure to register, or delays in registering, awarded contracts with the Public Procurement Agency; inserting contract clauses which are not to be found in the tender documents; revising already awarded contracts despite the explicit prohibition of the LPP to that end.

In many cases the PFIA could not impose any sanctions because of expired statutes of limitations – yet another consideration with respect to the efficiency of the control systems in place.

More open procedures would render control and monitoring mechanisms more efficient. A number of **recommendations** can be made in this regard.

First, where contracts are awarded to consortiums of companies, only the respective names of the consortiums are entered in the Public Procurement Register. It would be useful instead to list all participants. In this way **various cases of bypassing legal and regulatory obligations via splitting procurements or the involvement of related persons, which stifle competition, may be established**.

[103] A similar conclusion may be drawn for other sectoral contracting authorities as well, for example Maritsa Iztok 2 TPP EAD, as evidenced in the PFIA reports on conducted inspections.

Second, **time limits of awarded contracts should be indicated as well** to allow for broader public control over the performance of the contract and a better assessment of the contract value with respect to the thresholds set forth in the law. Together with the contract value, time limits are another factor that determines which procedures must be followed according to the law. Furthermore, time limits have relevance to determining the amount of funding that would need to be secured. These problems can certainly be addressed radically by making the full content of the contracts public, as discussed above.

Last but not least, **the monitoring of subcontractors** is important. In many cases subcontractors perform more than 60 % of the contract. **In the energy sector this share frequently reaches 95 %, which means that in practice subcontractors perform the whole contract**.[104] It is inadmissible that **major contractors should serve as a mailing box**, while subcontractors who play a major role should be relieved of legal and public responsibility, all the more so where warranties and warranty periods are concerned during which major contractors may not generate any activity or funds. This impairs control options for the contractor and breeds persistent public mistrust in the efficiency of public procurement.

3.6. CONTROVERSIAL FINANCIAL SERVICES

The use of financial services – banking, insurance and intermediation services – remains a major problem in energy enterprises' asset management.

Box 10. Who Delivers Banking Services to the Bulgarian Energy Sector?

In May 2010, following an inquiry of the editors-in-chief of eleven printed media, official information was published regarding the banks where state-owned companies deposited their financial resources. The Minister of Finance confirmed the information subsequently. It appears that **three banks, whose combined market share is below 13 % hold almost 60 % of the cash deposits of large state-owned companies**. The first bank with a market share of approximately 6 % appears to manage 42 % of the deposits in question. The largest state-owned companies in principle act as sectoral contracting authorities under the *Law on Public Procurement*. Large energy enterprises make no exception, in view of their enormous financial turnovers. The data published indicates that energy enterprises' deposits are held for the most part by a single bank: BEH – 95 %; Maritsa Iztok 2 TPP – 82 %; Bulgartransgaz – 73 %; NEK – 63 %. The findings apply also to Kozloduy NPP and Bulgargaz. The information published also shows that energy enterprises keep with the same three banks more than two thirds of all funds deposited by large state-owned companies (more than BGN 450 million). The publication has caused extensive public discussion regarding the procedures and criteria applied by state-owned companies for the selection of servicing banks.

[104] See for example contracts nos. 00246-2008-19 and 00246-2008-20 under the Public Procurement Agency Register.

The *Law on Public Procurement* excludes from its scope the following services: the financial services in connection with the issue and transfer of securities or other financial instruments; the services provided by the Bulgarian National Bank; the services provided in relation to the management of government debt; the services provided for the asset management of the State Fund for Securing the National Pension System; the purchasing and certification of products; the approval of warehouses for storage and conducting sales auctions in the event of interventions on the market for agricultural products under the *Law on Agricultural Producers Support*.[105] In all other cases therefore **financial services are subject to public procurement rules**. This is reinforced by the fact that the law requires that financial services, namely insurance, banking and investment services should be awarded following open procedures, restricted procedures or negotiated procedures with the publication of a contract notice.[106] The EU public procurement directive only excludes from its scope the following financial services:

- contracts relating to the issue, purchase, sale or transfer of securities or other financial instruments;
- services provided by central banks;
- contracts relating to the acquisition or rental, by whatever financial means, of land, existing buildings or other immovable property or concerning rights thereto.[107]

The conclusion that **financial services, which are not explicitly excluded from the scope of the LPP application, are subject to public procurement rules** is further reinforced by a number of other legal texts. The *Law on Municipal Debt* for example explicitly requires that the selection of a financial institution or a financial intermediary should be made under the terms set forth in the *Law on Public Procurement*. The LPP itself also rules on how to calculate the contract value of financial services contracts. Amounts to be taken into account are 'fees, commissions, interest and other modes of remuneration'[108] as of the time the decision to launch a public procurement is taken. In this regard, state-owned energy enterprises seem to be well aware of their duties under the LPP. In its third 2010 quarterly report Bulgargaz for example refers to the requirement to apply the LPP to financial services as an impediment to managing the company's foreign currency risk.

Uncertainty and the lack of direct costs for the contracting authority are circumstances, which could justify recourse to the competitive dialogue procedure under the LPP. It is applied in cases of particularly complex procurement contracts where award through open or restricted procedures is precluded.[109] However, in the case of selecting banks for state-owned energy enterprises the

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[105] Article 4, para 3 of the LPP.

[106] Item 6 of Annex 2 to Article 5, para 1, item 1 of the LPP.

[107] Nevertheless, financial service contracts concluded at the same time as, before or after the contract of acquisition or rental, in whatever form, are subject to the law and directives.

[108] Article 15, para 2, item 6 of the LPP.

[109] Pursuant to Article 83a, paras 1 and 2 of the LPP, a public procurement is considered to be particularly complex 'where the contracting authority is objectively unable to define: 1. the technical specifications referred to in Article 30 herein, and/or 2. the financial or legal make-up of the procurement'.

financial and legal structure of the procurement is clear since all banks publish their interest rates and general banking terms.

The above-mentioned rules apply equally to financial services with certain costs incurred by the contracting authority, for example the acquisition of loans or the payment of commissions, insurance or other forms of remuneration. In those cases the contracting authority incurs direct public costs and their value may serve as grounds for competition on the financial services market. The situation is completely different in the case of financial services not involving costs, and producing benefits for the contracting authority, like bank deposit contracts. **Bank deposits are attractive for contracting authorities for two reasons: their high returns and low risks**. Unlike the case with typical procurement contracts, here the returns are directly related to the risk since often the two are in a reverse linear relationship. That is why the rules for the award of procurement contracts cannot be applied directly to this type of financial services and **special rules need be introduced**. Such practice was introduced in the past via

Box 11. Financial Services Regarding Deposits Rendered Outside the Scope of LPP over the Period 2005 – 2009

The review of registered public procurement contracts demonstrates that no financial services relating to bank deposits have been awarded by contracting authorities in the energy sector, with the exception of insurance services mostly related to motor vehicles. For example, since the beginning of 2007 Bulgartransgaz has awarded only one financial services contract, namely an independent financial audit through open procedure.[110] Since 2005 Bulgargaz has awarded one financial services contract to a rating agency for the award and maintenance of the company's credit rating through a negotiated procedure with the publication of a contract notice.[111] Kozloduy NPP has not registered any financial services procurement since 2008, while the National Electric Company has launched two bids for an independent financial auditor and one **negotiated procedure without the publication of a contract notice for consultancy services related to Belene NPP, and involving financial intermediation in external funding negotiations**.[112] Maritsa Iztok 2 TPP EAD has awarded six financial services contracts since 2006, among which:

- two overdrafts regarding 'securing funds for due payments';[113]
- two consultancy service contracts regarding 'Financial, legal and administrative services in relation to a security agreement to prevent currency fluctuation risks for Maritsa East 2 TPP EAD' and 'Financial, legal and administrative services and project co-ordination of sulphur waste installations for units 5 and 6 of Maritsa Iztok 2 TPP EAD';[114] and
- two one-year revolving credits for a total value of approximately BGN 814,000, excl. VAT.[115]

[110] No. 01351-2008-0090 in the Public Procurement Agency Register.
[111] No. 00428-2006-0033 in the Public Procurement Agency Register.
[112] Nos. 0026-2008-0040 and 0026-2009-0054. The procurement on Consultancy services regarding financial, economic and legal aspects of the NPP Belene is under No. 0026-2008-0101.
[113] Nos. 00246-2008-0235 and № 00246-2010-0010 in the Public Procurement Agency Register – both contracts were awarded through open procedures.
[114] Nos. 00246-2006-0074 andи 0075 in the Public Procurement Agency Register, awarded through negotiation following invitation on the basis of the pre-selection system.
[115] Nos. 00246-2007-0015 and 0016 in the Public Procurement Agency Register, awarded through negotiated procedure with a publication of a contract notice.

instructions of the Ministry of Finance directed at budget-spending units, but there has been no legislative confirmation or codification of the practice. No special rules have been introduced regarding state-owned companies in the water, energy, transportation and postal services sectors. **Special rules need to apply to all public utilities that constitute, according to the law, sectoral contracting authorities**.

Past experience convincingly demonstrates that opening deposit accounts with banks and other similar services are not considered by energy sector contracting authorities to be subject to public procurement rules. In this respect there is a **clear need for special rules** as energy sector contracting authorities control substantial funds, which will undoubtedly continue to be of particular interest to banks.

3.7. INDICATORS OF HEIGHTENED RISK IN PUBLIC PROCUREMENT

The above analysis clearly shows that **introducing mechanisms of public monitoring of public procurements in the energy sector is very much needed**. Such mechanisms would on the one hand enhance consumer confidence in the soundness of energy policy, and on the other would reduce losses in the sector incurred by means of inflated or unnecessary procurements. To this end, a **system of indicators of corruption risks** in the award and performance of public procurement contracts should be elaborated, and a permanent mechanism of public monitoring of the way public funds in the energy sector are spent should be introduced.

On the basis of the above analysis, the following could initially serve as such **indicators** in public procurement in the energy sector:

- **unwarranted increases in company costs** of energy producers and energy distribution companies over a certain period of time. Additional indicators for nuclear energy enterprises could be the higher exploitations costs compared to rates in similar NPPs operating in countries with open energy markets;

- **unwarranted decreases in company profits** accompanied by increased profitability of outsourcing or partners who have contractual relationships with these companies;

- **changes in management teams** following parliamentary elections without publicly stated and clearly defined arguments;

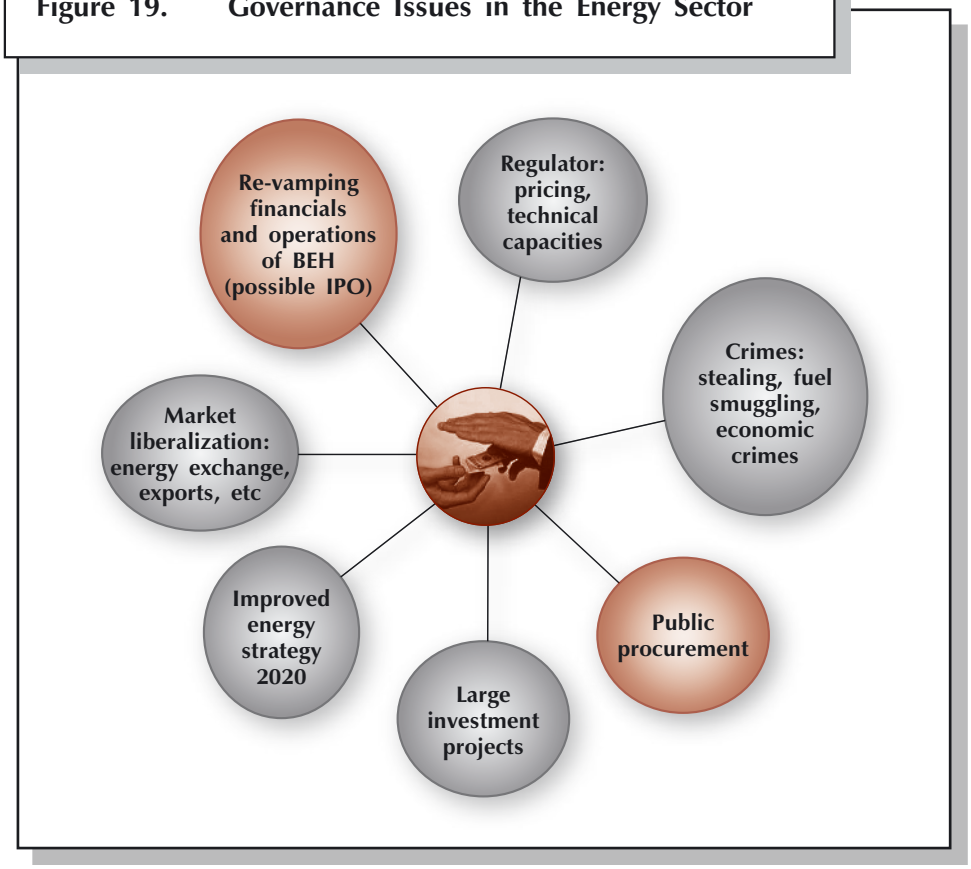
- **repetitive launching of public procurement procedures** for the award of identical services/supplies/construction works;

- **unwarranted termination of procedures** for the award of public procurements;
- **resorting to identical consultants** operating in different capacities in the consultancy services market;
- **persistent avoidance of commodity exchange transactions**;
- **interrelatedness of companies**, where one company is the consultant in an investment project, another company is the buyer or the consultant in a privatization procedure, while a third company is the contract partner of the energy producer or distribution company.

CONCLUSION: TOWARDS BETTER GOVERNANCE OF THE BULGARIAN ENERGY SECTOR

The governance of the energy sector in Bulgaria faces a number of problems of a technical, legal, and institutional nature. Resolving these issues is a major challenge for the Bulgarian government in the context of the 2008 – 2009 economic crisis and taking into account the complexities of the international environment.

Figure 19. Governance Issues in the Energy Sector



Source: Center for the Study of Democracy.

An analysis of the management of key energy projects, such as Belene NPP, the Tzankov Kamak HPP, Maritsa Iztok 2 TPP, Toplofikacia Sofia, etc. has revealed **complete disregard for even basic rules of good governance**, leading to skyrocketing project costs at the expense of taxpayers and consumers. The absence of good governance practices has resulted in poor accountability, has threatened the financial stability of state-owned enterprises, increasing the risk of losing state control over them (i.e. hidden privatization), and has jeopardized

the energy security of the country. This has exposed the **failure of the entire monitoring, regulatory and compliance control system**, including its political leadership, the internal control units of state-owned companies operating in the sector, as well as the independent regulator.

The failure of the checks and balances system, together with the mushrooming of project costs, raise **legitimate concerns of corrupt practices at all levels in the energy sector**, including the political leadership. Ultimately, the lawlessness and lack of controls in the implementation of energy projects provide significant grounds for **questioning the state's ability to manage large infrastructure projects worth over EUR 500 million**. This, in turn, raises doubts as to the benefit from developing such large projects at all.

Improving the functioning and management of state-owned energy companies entails, as a minimum, the implementation of the following actions requiring significant funding and at least 2 to 3 years to materialize:

- **The political leadership should reduce their direct involvement in the operational management of energy enterprises and instead focus on policy development**, the provision of public information, and control functions. The compliance with EU priorities and directives, and with the precepts of the *Concept for Energy Strategy of Bulgaria until 2020*, necessitates a shift in national energy policy away from its excessive focus on adding generating capacities towards ensuring the stability and security of energy supply (including from RES), reducing energy poverty, and improving energy efficiency. **The model of excess electricity production (large capital investments and centralized administration) creates strong incentives for wasteful investments and corruption at the expense of taxpayers and end users**. At the same time, such a model obstructs the establishment of market mechanisms and the introduction of new technologies;

- The Ministry of Economy, Energy and Tourism, the Ministry of Environment and Water, and the Ministry of Finance should **develop and launch a publically available website and online database** containing as a minimum: i) up-to-date information on the country's energy strategy, as well as energy and climate change policies; ii) systematic quarterly data on the financial performance of state-owned energy enterprises in an analyzable format, as well as semi-annual assessments of their condition and the risks to the financial stability of individual enterprises and the industry as a whole; iii) information on all upcoming, current, and completed public procurement procedures; and iv) information from the independent regulator concerning energy prices, market players, etc. To be comprehensive, the database should meet the following criteria:

  ◊ It should contain data from all relevant agencies, ministries, state-owned and private enterprises (e.g., the Public Procurement Agency, the Ministry of Economy, Energy and Tourism, the National Electric Company, etc.);

  ◊ It should be regularly and frequently updated;

  ◊ It should provide a non-conditional-on-registration access to the database free of charge;

- ◊ It should allow for quick and easy access and download of data in a usable format (e.g., Excel spreadsheets);
- ◊ It should provide tools for easy-to-use graphic analysis;
- ◊ It should be in compliance with established accounting, auditing and other relevant standards;
- ◊ It should provide access to contracts, environmental impact assessments, and other documents of public importance;

- The Bulgarian government should **develop a system for monitoring and control of energy sector governance**, including through the use of and membership in international organizations such as the Extractive Industries Transparency Initiative.[116] Membership in such initiatives would ensure higher levels of protection for consumers' and taxpayers' interests from monopolies, private interests, and non-transparent governance mechanisms. Such membership would serve as a guarantee for transparency and accountability. In addition, other instruments for the inclusion of stakeholders in the energy-related decision-making process should be utilized (e.g., enhanced civil society representation, public forums, etc.);

- A **system for financial control of the energy sector** should be developed and utilized. The internal control units of state-owned enterprises should fall under the authority of and report to the relevant minister who exercises the state's property rights in the companies. The operation of the control system of the energy sector should be reviewed by the Public Financial Inspection Agency at least once every two years, and by the National Audit Office every four years. The resulting recommendations should have a binding effect for the participants in the sector. Along with the implementation of a system of controls, there is a need to **audit the current financial situation of state-owned energy enterprises**, including as it relates to government guarantees, financial commitments under investment projects, inter-company debt and existing mortgages. Financial audits should be reconciled with quantitative audits. The audits should be supplemented by a four-way comparison between electricity generation, billing, revenues, and expenditures, based on accurate and frequent measurements of generation and transmission, and of transmission and distribution.[117] **A registry of public procurement contracts involving state-owned enterprises** should complete the financial control system. The registry should allow for online monitoring of the date each contract was signed, the dates of any changes to the contract, detailed information regarding the commitments undertaken, project end dates, financial documentation, etc. The registry's aggregated data by industry and sector should be publically available;

- **The extraneous expenses of state-owned enterprises should be limited** in order to optimize their finances. A number of irrelevant and redundant activities are typical for state-owned enterprises. For example, the maintenance of vacation homes and recreation facilities is suboptimal and fragmented. NEK

[116] For more information about this initiative, see Annex 4.

[117] Gulati, Mohinder and Rao, M.Y. Corruption in the Electricity Sector: A Pervasive Scourge, in The Many Faces of Corruption: Tackling Vulnerabilities at the Sector Level Washington, The World Bank, 2007, p. 36.

funds and issues a magazine on energy – an activity more suitable for the relevant ministry;

- The National Assembly should **carry out an annual energy policy review**. As a minimum, this annual review should include the following: i) an assessment of energy policy performance vis-a-vis the stated priorities for the year, the programming budget, and the strategic goals; ii) an evaluation of the financial state of state-owned energy enterprises and an identification of the risks to the sector's development, including required state guarantees and risks of hidden privatization; iii) an outline of the priority areas of development of the energy policy for the next year. The Ministry of Economy, Energy and Tourism, together with the Ministry of Finance and the independent regulator, could prepare the review in question and submit it to the National Assembly for approval. The review could be supplemented by regular surveys of consumers and businesses conducted by independent agencies, serving as a feedback regarding the quality of governance in the energy sector;

- **Decisions on key investment projects in the energy sector should be finalized** based on thorough, reliable, and transparent financial, economic, and environmental analysis and in line with national and European strategic priorities. The longer the delay of these decisions, the larger the sunk costs and the corruption, and the stronger the political pressure on the decision makers. It is therefore necessary that future large-scale energy projects be preceded not only by environmental and socio-economic impact assessments, but also by the enforcement of detailed **ethical standards for the operation of companies involved in such projects**.

Accomplishing the suggested strategic, legal, and structural reforms is not possible without **prosecuting and bringing to justice those responsible for abusing their positions and for the mismanagement of large energy projects and state-owned enterprises**. The absence of administrative and/or criminal proceedings, especially at senior management level in the energy sector, in spite of publicized information about unprecedented and unwarranted increases in project costs, mismanagement, and a variety of other types of bad practices, creates an environment of impunity and non-transparency. These circumstances, along with the problems that Bulgaria has in fighting corruption and organized crime, create preconditions for **the penetration of the energy sector by national and international criminal groups**. According to Europol, organized crime groups are already involved in the energy supply to EU Member States. Therefore, good governance in the energy sector has become a key element of the national security of EU Member States, as well as of the security of the Union as a whole.[118]

The following approaches represent global best practices, which implementation can ease the resolution of problematic issues in Bulgaria's energy sector governance:

- **Prioritizing** the issues, which resolution would be most beneficial in the medium term compared to the efforts involved (financial and managerial). Prioritization should be placed within the context of long-term sustainability;

[118] Organized Crime and Energy Supply: Scenarios to 2020, Europol, August 2010.

- **Using up-to-date and reliable data** to support informed decision-making, based on sound financial and economic analysis;

- **Utilizing cost-benefit analysis** and **sensitivity analysis** in developing multiple scenarios; careful consideration of the probability and feasibility of these scenarios in light of the latest global political and economic events;

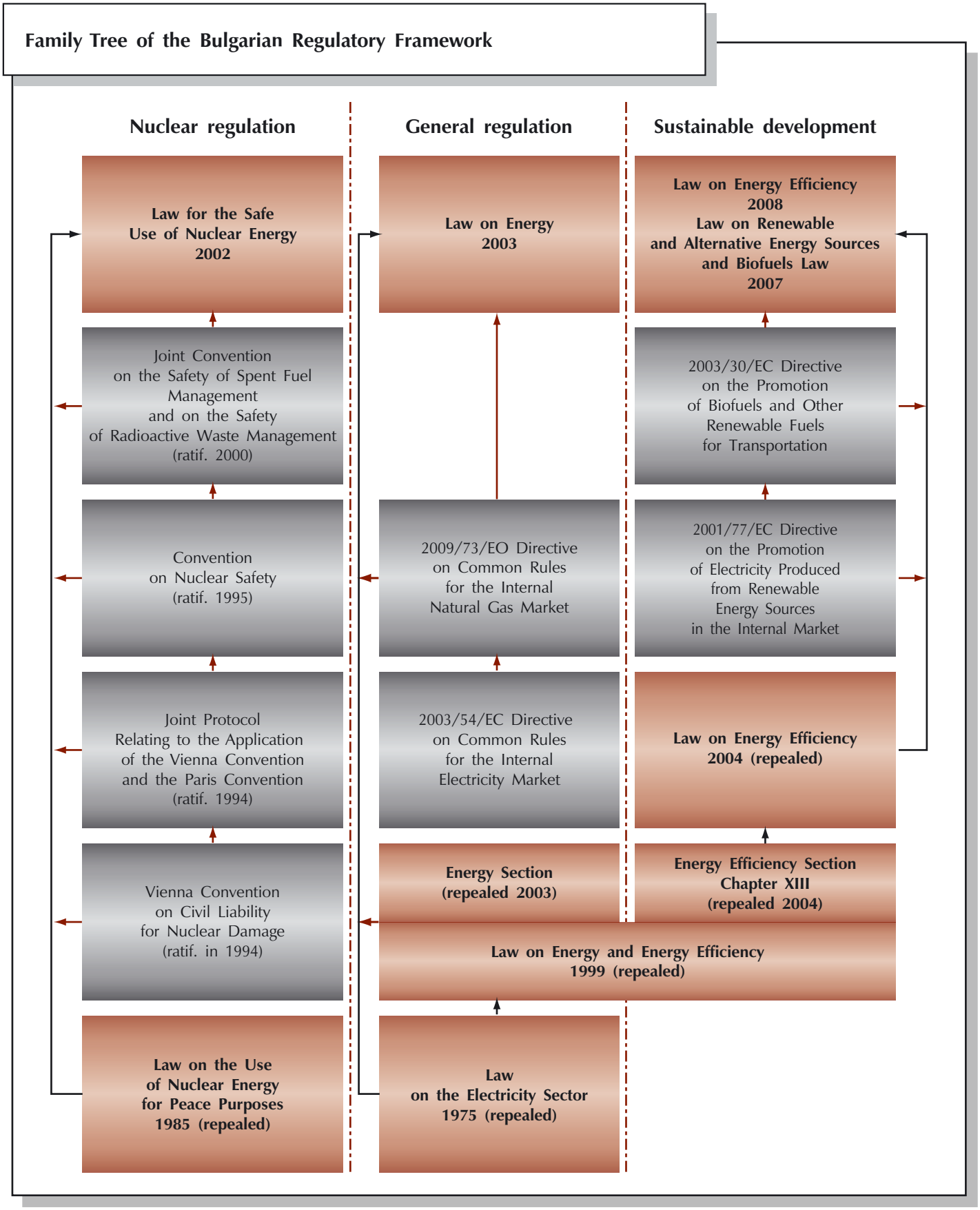
- **Employing leading experts** and consulting services, if necessary from abroad, for critically important analyses;

- Achieving **resolve and efficiency** in implementing timely measures to save taxpayers' money;

- **Ensuring governance transparency** without compromising the ultimate goals of energy policies;

- Striving towards **full awareness of the environmental and social consequences** of strategic actions.

ANNEX 1. FAMILY TREE OF THE BULGARIAN REGULATORY FRAMEWORK



ANNEX 2. THRESHOLDS FOR PUBLIC PROCUREMENT FOR SECTOR CONTRACTORS

Thresholds for Public Procurement for Sector Contractors

CONSTRUCTION		
	From	To
Public Procurement Law (thresholds)	2,150,000	unlimited
Ordinance on the Award of Special-purpose Public Procurements (thresholds)	200,000	2,150,000
Three-offer thresholds	45,000	200,000
No procedure (with invoice)	0	45,000
DELIVERY		
	From	To
Public Procurement Law (thresholds)	180,000	unlimited
Ordinance on the Award of Special-purpose Public Procurements (thresholds)	50,000	180,000
Three-offer thresholds	15 000	50,000
No procedure (with invoice)	0	15,000
SERVICES		
	From	To
Public Procurement Law (thresholds)	110,000	unlimited
Ordinance on the Award of Special-purpose Public Procurements (thresholds)	50,000	110,000
Three-offer thresholds	15,000	50,000
No procedure (with invoice)	0	15,000
CALL FOR PROJECTS		
	From	To
Public Procurement Law (thresholds)	110,000	unlimited
Ordinance on the Award of Special-purpose Public Procurements (thresholds)	30,000	110,000
Three-offer thresholds	0	30,000
No procedure (with invoice)	0	30,000

Note: The amounts are in leva (BGN) excl. VAT as of 1.1.2009 and the projects are implemented in the country.

ANNEX 3. PUBLIC PROCUREMENT CONTRACTS IN THE ENERGY SECTOR IN 2008 – 2009

Public Procurement Contracts in the Energy Sector in 2008 – 2009

No.	Energy Sector	Name of Contractor	2008					2009				
			Contractor account	Public Procurement Contracts (count)	Number of signed contracts	Total value of the signed contracts		Contractor account	Public Procurement Contracts (count)	Number of signed contracts	Total value of the signed contracts	
						currency	value				currency	value
	Elelectricity											
1		Kozloduy Nuclear Power Plant	353	244	222	BGN	85,798,723	353	144	157	BGN	106,877,313
					26	EUR	77,430,507			20	EUR	24,604,484
					-	USD	-			-	USD	-
2		Brikel EAD, Galabovo	758	3	2	BGN	1,904,772	758	5	3	BGN	64,500
					1	EUR	518,402			-	EUR	
3		Kozloduy Nuclear Power Plant	1,281	6	3	BGN	261,583	1,281	2	1	BGN	6,595,000
					-	EUR	-			1	EUR	98,000
4		EVN Bulgaria EP (EVN Bulgaria Elektrorazpredelenie AD)	143	59	123	BGN	2,937,259	143	66	166	BGN	72,068,374
					1	EUR	0			-	EUR	-
5		EVN Bulgaria Toplofikatsia Plovdiv EAD	129	2	1	BGN	0	129	-	-	BGN	-
6		Electricity System Operator EAD	1,379	121	140	BGN	57,459,136	1,379	102	108	BGN	29,854,974
					5	EUR	1,902,167			4	EUR	1,901,265
7		Electricity Distribution Pleven AD	924	-	-	BGN	-	924	-	-	BGN	-
8		Electricity Distribution Sofia Oblast AD	155	-	7	BGN	739,342	155	-	-	BGN	-
9		Electricity Distribution Stolichno AD, Electricity Distribution Sofia Oblast AD, Electricity Distribution Pleven AD	695	-	27	BGN	0	695	-	16	BGN	0
10		Electricity Distribution Stolichno AD	542	-	4	BGN	1,512,411	542	-	-	BGN	-
11		Enel Maritsa Iztok 3 AD	15	137	104	BGN	31,983,190	15	56	73	BGN	20,708,532
					45	EUR	15,591,343			45	EUR	11,210,371
					-	GBP	-			-	GBP	-
					1	USD	2,050,000			1	USD	1,797,000
12		Energo – Pro Bulgaria EAD	992	1	-	BGN	-	992	-	-	BGN	-
13		E.ON Bulgaria Grid AD	609	42	83	BGN	33,129,760	609	16	23	BGN	9,279,496
14		E.ON Bulgaria Sales AD	225	-	60	BGN	2,971,559	225	-	41	BGN	12,734,542
15		ESO EAD, Network Operational Region – Ruse	1,379	1	1	BGN	202,985	1,379	-	-	BGN	-
16		National Electric Company EAD	26	110	86	BGN	84,266,195	26	52	47	BGN	46,278,755
					14	EUR	13,958,632			9	EUR	19,530,505
					-	USD	-			-	USD	-
17		National Electric Company EAD – Belene NPP	26	-	-	BGN	-	26	-	-	BGN	-
18		National Electric Company EAD – Rila Hydro Power Group, Sofia	26	5	6	BGN	523,778	26	1	3	BGN	211,263
19		National Electric Company EAD – High Voltage Networks Enterprise	26	-	-	BGN	-	26	-	-	BGN	-
20		National Electric Company EAD – Trafoelectroinvest, Sofia	26	-	10	BGN	2,296,034	26	-	6	BGN	1,225,963
21		National Electric Company EAD – Dams and Cascades, Sofia	26	3	2	BGN	113,158	26	2	3	BGN	165,709

Public Procurement Contracts in the Energy Sector in 2008 – 2009 (continued)

No.	Energy Sector	Name of Contractor	2008					2009				
			Contractor account	Public Procurement Contracts (count)	Number of signed contracts	Total value of the signed contracts		Contractor account	Public Procurement Contracts (count)	Number of signed contracts	Total value of the signed contracts	
						currency	value				currency	value
22	Elelectricity	Bobov Dol TPP	217	38	36 -	BGN EUR	11,531,901 -	217	12	25 1	BGN EUR	7,536,093 58,000
23		Varna TPP EAD, Ezerovo	123	62	55	BGN	8,492,512	123	30	49	BGN	8,552,717
24		Maritsa Iztok 3 TPP, Dimitrovgrad	460	1	1	BGN	0	460	2	2	BGN	147,200
25		Maritsa Iztok 2 TPP EAD	246	234	306 -	BGN EUR	204,375,748 -	246	133	225 1	BGN EUR	80,513,323 6,419,200
26		Toplofikacia Varna EAD	421	-	-	BGN	-	421	-	-	BGN	-
27		Toplofikacia Pleven EAD	305	15	11	BGN	1,540,086	305	6	9	BGN	1,046,131
28		Toplofikacia Rousse EAD	678	30	22 -	BGN EUR	2,461,579 -	678	22	18 -	BGN EUR	2,417,738 -
29		Toplofikacia Sliven EAD	198	7	6	BGN	2,744,389	198	3	3	BGN	1,724,729
30		Toplofikacia Sofia EAD	277	75	93 2	BGN EUR	14,521,159 664,197	277	56	84 2	BGN EUR	6,610,199 1,093,752
31		CEZ Distrubution Bulgaria AD	1,467	41	93	BGN	12,080,439	1,467	45	76	BGN	15,182,454
32	Production, transmission and distribution of natural gas and heating	Balkangaz 2000 AD, Botevgrad	967	2	1	BGN	41,040	967	-	-	BGN	-
33		Brikel EAD, Galabovo	758	-	-	BGN	-	758	-	-	BGN	-
34		Bulgargaz EAD	428	-	- -	BGN EUR	- -	428	-	- -	BGN EUR	- -
35		Bulgargaz EAD	1,352	1	1	BGN	213,000	1,352	1	-	BGN	-
36		Bulgartransgaz EAD	1,351	99	69 6 1	BGN EUR USD	10,974,843 1,739,474 1,612,000	1,351	43	43 2 -	BGN EUR USD	9,684,433 2,402,600 -
37		EVN Bulgaria Toplofikatsia EAD	129	4	5 -	BGN EUR	1,675,880 -	129	14	15 1	BGN EUR	5,319,288 1,699,000
38		E.ON Bulgaria Grid AD	609	-	-	BGN	-	609	-	-	BGN	-
39		Kavarna Gas, LLC	1,567	1	-	BGN	-	1,567	-	-		-
40		Nevrokop Gas AD	1,955	-	-	BGN	-	1,955	2	2	BGN	4,314,046
41		National Electric Company EAD – High Voltage Networks Enterprise	26	-	-	BGN	-	26	1	-	BGN	-
42		Svilengrad Gas AD	1,951	-	-	BGN	-	1,951	2	2	BGN	2,945,538
43		Electricity Distribution Stolichno AD	542	-	-	BGN	-	542	-	-	BGN	-
44		Sigas, Silistra	1,576	1	1	BGN	42,790	1,576	-	-	BGN	-
45		Maritsa Iztok 2 Thermal Power Plant EAD	246	-	-	BGN	-	246	-	-	BGN	-
46		Toplofikacia Varna EAD	421	-	-	BGN	-	421	-	-	BGN	-
47		Toplofikacia Pernik EAD	305	15	11	BGN	1,540,086	305	6	9	BGN	1,046,131
48		Toplofikacia Rousse EAD	678	30	22 -	BGN EUR	2,461,579 -	678	22	18 -	BGN EUR	2,417,738 -
49		Toplofikacia Sliven EAD	198	7	6	BGN	2,744,389	198	3	3	BGN	1,724,729
50		Toplofikacia Sofia EAD	277	75	93 2	BGN EUR	14,521,159 664,197	277	55	84 2	BGN EUR	6,610,199 1,093,752
51		Toplofikacia Shumen EAD	1,184	-	-	BGN	-	1,184	-	-	BGN	-

Public Procurement Contracts in the Energy Sector in 2008 – 2009 (continued)

No.	Energy Sector	Name of Contractor	2008					2009				
			Contractor account	Public Procurement Contracts (count)	Number of signed contracts	Total value of the signed contracts		Contractor account	Public Procurement Contracts (count)	Number of signed contracts	Total value of the signed contracts	
						currency	value				currency	value
52	Exploration and extraction of coal and other solid fuels	Causto-Gold AD, Kyustendil	552	4	3	BGN	2,480,259	552	-	-	BGN	-
53		Zdravetz Mine EAD (being currently liquidated)	592	3	2	BGN	259,620	592	2	2	BGN	261,200
54		Pirin EAD Mine, Simitli	323	-	-	BGN	-	323	-	-	BGN	-
55		Mini Maritsa Iztok EAD, Radnevo	265	182	198 5	BGN EUR	197,326,213 620,731	265	85	132 2	BGN EUR	65,511,032 27,688,016
56	Exploration or extraction of natural gas or oil	Mini Maritsa Iztok EAD, Radnevo	265	1	9	BGN	3,161,871	265		1	BGN	500,000
57		Oil and Gas Exploration and Production AD, Sofia	1,123	1	- -	BGN EUR		1,123	2	- 1	BGN EUR	- 200,000
58		Rusgeokom BG AD	1,754	1	1	EUR	915,000	1,754	2	1	EUR	18,590

Notes:

1. The figures for "Number of signed contracts" and "Total value of signed contracts" include calls for projects.
2. The information is based on the data available at PPA as of 11.01.2010.
3. Some contractors appear in different energy sectors because in the document (notice or information on the contract) the contractor has indicated more than one core business.
4. The column for "Public procurement contracts (count)" includes public procurement contarcts opened in the current year.
5. The columns for "Public procurement contracts (count)" and "Total value of contracts" include the contarcts signed during the respective year.

Source: Public Procurement Agency, 2010.

ANNEX 4. EXTRACTIVE INDUSTRY TRANSPARENCY INITIATIVE

The Extractive Industry Transparency Initiative (EITI) is a relatively new initiative, announced for the first time at the World Summit on Sustainable Development in Johannesburg, South Africa in September 2002. Its principles for increasing transparency over financial transactions between extractive companies and governments in resource rich countries were agreed in 2003. Some new possibilities of expanding the initiative from extractive industries to transport and transit of fossil fuels are presently under discussion in the EITI framework. Ukraine and Bulgaria, as two major transit countries, are expected to pioneer in this endeavor. By publicly endorsing the initiative in 2003, the World Bank has now been assigned a specific role, as a leading international institution, to openly advocate for structuring the transparency of revenues.

In order to fulfill the EITI's global standard minimum and accede to the initiative, candidate countries should meet a set of criteria and indicators applied by EITI. Basic indicators in the preparation process and the EITI implementation phase are:

- Official public declaration stating the will of the government to participate in the initiative;
- Eagerness of the government to cooperate with the companies and civil society organizations on matters related to EITI;
- Active participation of all stakeholders in the process;
- Formation of a multi-stakeholder group – government, businesses, and civil society organizations;
- Development and publication of an Action Plan for candidacy and implementation of EITI (including budget, risk management strategy, etc.);
- Preparation of methodology for monitoring and reporting on the extractive/transit industry revenues;
- Consensus over the selection of a reconciler in the EITI implementation process;
- Government-guaranteed transparency over the activities of all relevant extractive industry companies;
- Provision of accurate data of companies, verified by independent external audit of these companies

- Guaranteed access for the reconciler to the data on all participating extractive industry companies in the country and to the account books of state revenues in the sector;

- Proven match between data on payments and revenues submitted by both companies and state agencies;

- Broad publicity of the payment and revenues verification by the independent reconciling organization.

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