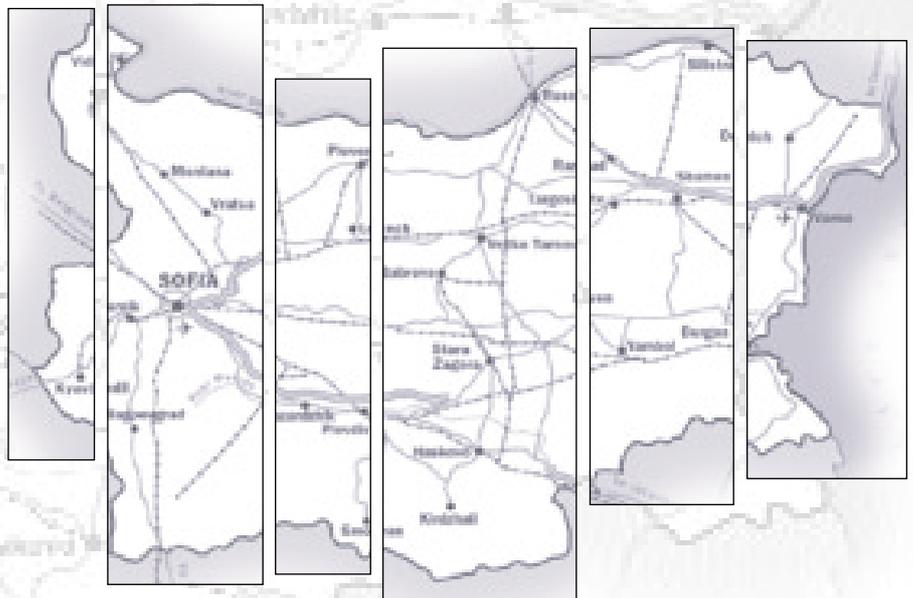


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Bulgarian law on concessions

- ¹ *Official Gazette*, Issue no. 56, 13 July 1991.
- ² Art. 18, Paragraph (5) of the Constitution.
- ³ *Official Gazette*, Issue no. 92, 17 October 1995.
- ⁴ *Official Gazette*, Issue no. 44, 21 May 1996.
- ⁵ Art. 2, Paragraph (1), Sub-paragraphs (1) and (2) of the Law on Concessions and Art. 67, Paragraph (1) of the Municipal Ownership Act.
- ⁶ Art. 2, Paragraph (1), Sub-paragraph (3) of the Law on Concessions and Art. 67, Paragraph (1) of the Municipal Ownership Act.

Bulgaria's law on concessions has provided a basic framework to facilitate the granting of concessions and the execution of concession agreements. The recent development of more detailed and specific legislation, in particular in areas such as telecommunications and energy, has meant that the significance of the law on concessions itself has diminished. This article explains the development of the law and examines its interaction with other relevant legislation. It also considers a number of obstacles presented to potential investors under the current regime.



The concept of a “concession” was first introduced in Bulgaria in the new Constitution of 1991.¹ The Constitution itself did little more than list the types of property and the activities in respect of which a concession could be granted, but it enabled Bulgaria’s National Assembly to enact legislation on the basis of which the state would grant concessions in respect of certain property and activities.² The first relevant legislation to appear included the Concession Law³ and the Municipal Ownership Act.⁴ As a result, the “concession” concept was developed on the basis that, although the state or individual municipalities, as public authorities, should continue to enjoy exclusive rights and powers in relation to certain property and activities, the private sector should not be excluded from investing in such property or

activities. The law therefore provided a framework whereby public control of public property and resources could be maintained while private participation could be encouraged. A “concession” is the constitutionally defined legal means whereby the state or municipality, while retaining its responsibility for the public interest, is able to grant rights to a private party to utilise such restricted resources and to engage in such restricted activities.

Concessions may be granted by both the state and individual municipalities in their capacity as public authorities, and different procedures are provided by the Law on Concessions and the Municipal Ownership Act, respectively, depending on the identity of the grantor. In addition, as indicated above, regardless of the

identity of the grantor, a concession has two aspects. The first is as a right to use public property⁵ or resources; the second is a permit for carrying out public services which are otherwise exclusively reserved for the state/municipalities.⁶

The situation has also become more complex because the Concession Law and the Municipal Ownership Act were enacted at a time when the Bulgarian legal system was underdeveloped, particularly in the areas of energy, telecommunications, water and natural resources. The recent enactment of legislation in these areas means that the importance of concessions under the Concession Law and the Municipal Ownership Act has gradually diminished. In relation to certain types of resource

(such as in the case of telecommunications and energy services) the original concession mechanism has been abolished and replaced by different procedures, including those for licences and other permits. In other areas, such as water and sewage services, the concession component in respect of certain resources has become relatively narrow, while licensing or other procedures have come to dominate the overall concession arrangement. Exploitation of public property or the provision of public services by the private sector is now governed not only by the Concession Law but by a combination of laws and regulations, the application of which is often not straightforward. Some aspects of the legislation are discussed below.

Scope of concessions

The scope of permissible concessions under Bulgarian law and the legal regime governing such concessions are largely determined by the nature of the state interest in the rights or assets which are to be the subject of a concession, and how such rights or assets fall within specific categories provided for in Bulgarian law, as more fully described below.

Character of state interest in concession assets

The interest of the state in assets which may be subject to a concession has four different possibilities under Bulgarian law.

Concessions for the use of publicly owned property and resources

The Constitution lists property and resources which may be owned only by the state and the utilisation of which by private entities may therefore be permitted only by way of concession. This property includes underground resources, beaches, national thoroughfares, waters, forests and parks of national importance, and natural and archaeological reserves. Such property is not limited to existing state-owned property; it also includes property which is developed at the concession holder's expense.⁷ This list is not exhaustive, as Article



17, Paragraphs (2) and (4) of the Constitution enables the National Assembly to enact legislation concerning the ownership rights of the state and municipalities. Accordingly, the National Assembly has the authority to declare additional properties as public property of the state or municipalities. Such property may not be transferred by its “public” owner to third parties, nor utilised in the way allowed for private assets. It may therefore be utilised by private entities only under a grant of concession.

As noted above, the legal regime applicable to concessions granted in respect of state or “public” property is defined both by the Concession Law and by sector-specific legislation (municipal concessions are discussed separately below). Sector-specific legislation includes the Law on Underground Resources⁸ and the Water Act.⁹ However, even within such specific legislation, the proposed nature of a concession right can have implications on whether the grant of a concession would be governed solely by sector-specific legislation or a combination of such legislation and the Concession Law. The Water Act, for example, distinguishes between the utilisation of water in the economic sense (for the purpose of generating profit) and the mere usage of the water, including as a means for the conduct of profit-generating activities.¹⁰

In addition, the Constitution and the Concession Law provide that, where the state exercises sovereign rights over certain prop-

erty the use of that property is also subject to the grant of concession by the state. Although this category of property is listed in both the Constitution and in the Concession Law, the Concession Law does not include those items which are covered by different legislation. For example, the utilisation of the radio-frequency spectrum is subject to the grant of a licence by the state under the Telecommunications Law¹¹ and not to a concession, and is therefore not specifically addressed in the Concession Law.

Concessions for the use of property and resources which may be state-owned or privatised

Another category of property specified under the Concession Law includes property which may be either public state-owned property or, alternatively, may be privatised and owned by private entities, including the state acting in a private capacity. This category includes:

- harbours and civilian airports for public use; the law expressly extends the possibility for grant of concession rights in respect both of existing facilities and facilities to be developed at the concession holder's expense;¹² and
- water-supply facilities and systems; as noted above; however, in the case of water, a concession right over water-supply facilities and systems may not be sufficient and a “water utilisation permit” under the Water Act may also be required in order to secure rights in respect of the supply of raw water.

Again, the character of state ownership of such assets can have implications in respect of the scope of concession rights which may be granted. Obviously, the ability of a concession holder to obtain private ownership of assets can have significant implications on his or her ability to control the development of a concession and obtain financing for it.

Concessions for the use of property and resources which may be owned by a municipal entity

If assets are owned by a municipal entity, the Municipal Ownership Act sets out the concession regime in respect of property owned

by municipalities. Again, this regime may have to be interpreted in conjunction with the procedure set out in other applicable legislation, such as the Water Act and the Law on Underground Resources.

Concessions for the use of property and resources which may be owned by 100 per cent state or municipal owned entities

The Concession Law and the Municipal Ownership Act were enacted at a time when a large proportion of state and municipally owned mining, water and energy industries had been restructured as commercial companies wholly owned by the state or by municipalities. It was not considered appropriate that such entities should be required to compete for concessions and for the right to carry on these industries. For this reason, an exception was created whereby 100 per cent state-owned commercial companies are authorised to utilise property and engage in activities for which a concession would otherwise be required under the Concession Law, without the need for a concession.¹³ A similar rule exists under the Municipal Ownership Act in respect of companies wholly owned by municipalities in respect of property and activities requiring a municipal concession.¹⁴ Until such time as these companies are privatised, no concession is therefore required by those industries.

Nature of activity in respect of a concession

Apart from the impact of the character of the state or a municipality's interest in a concession on the rights of a concession holder, the specific asset or activity with respect to which a concession is to be granted will largely determine the legislative regime applicable to such concession. As noted above, a number of such regimes exist in respect of water concessions, natural resource concessions, telecommunications concessions and other sectors. In addition, in respect of certain restricted activities, both the form in which such concessions are granted and the legal regime applicable thereto differ from those in other sectors.

Restricted activity concessions concern the grant of permission to carry out activities in respect of which the state has exclusive rights. A "permit" concession may be granted either together with or independently of a "utilisation" concession, depending on the nature of the grantor and the rights sought by the potential concession holder. For example, where a concession holder is granted a permit to provide water services on the basis of property which is not public property but is owned by the state or a municipality in its private capacity, a "utilisation" concession is not required. "Permit" and "utilisation" types of concession are also capable of being granted together, however, as would be the case if a concession were granted to utilise a publicly owned water and sewerage network together with a concession to provide water supply and sewerage services in respect of that network.

The state's exclusive rights in respect of certain activities arise from the concept of state monopoly. According to Article 18, Paragraph (4) of the Constitution, the National Assembly may establish a state monopoly over railway transport, national postal and telecommunications networks, nuclear energy, and manufacture of radioactive products, weapons, explosives and powerful toxic substances. Concessions may be granted by the state only in respect of those activities over which it has a monopoly. The Telecommunications Law has not established a state monopoly in respect of telecommunications networks (except in the case of certain fixed telephone services where the Bulgarian Telecommunications Company was granted an exclusive licence) and concessions therefore do not apply to telecommunications services. Similarly, the Law on Postal Services¹⁵ did not establish a state monopoly in respect of postal services. The Law on Railroad Transport¹⁶ also abolished the state monopoly over railroad services and opened the door for private undertakings to carry these out under a licence. The potential scope of concessions authorised by the Constitution has therefore not been realised and certain activities have been made subject to a licensing regime instead.

⁷ Art. 2, Paragraph (1), Sub-paragraphs (1) and (2) of the Law on Concessions and Art. 67, Paragraph (1) of the Municipal Ownership Act.

⁸ *Official Gazette*, Issue no. 23, 12 March 1999.

⁹ *Official Gazette*, Issue no. 67, 27 July 1999.

¹⁰ A concession would be required if a private company intends to provide water supply services to a city by way of utilising state-owned water, but the supply of raw water necessary for the provision of water services must be authorised by way of a water utilisation permit. This means that the Water Act is likely to dominate any structure where a concession is to be granted under the Concession Law.

¹¹ *Official Gazette*, Issue no. 93, 11 August 1998.

¹² Art. 4, Paragraph (1), Subparagraph (6) of the Concession Law.

¹³ Paragraph 3 of the Transitional and Concluding Provisions of the Concession Law.

¹⁴ Paragraph 9 of the Transitional and Concluding Provisions of the Municipal Ownership Act.

¹⁵ *Official Gazette*, Issue no. 64, 4 August 2000.

¹⁶ *Official Gazette*, Issue no. 97, 28 November 2000.

¹⁷ *Official Gazette*, Issue no. 133, 11 November 1998.

The Concession Law provides that a concession is required for the manufacture of weapons and explosives but the Law Concerning the Control over Explosives, Fire Arms and Ammunitions,¹⁷ on the other hand, provides that such activities are instead subject to a permit. The position of Bulgarian law as to the manufacturing of "powerful" toxic substances is also unclear. Various laws address and regulate manufacturing and other activities related to drugs and poisonous or other biologically active substances, but none of them clarifies whether the substances addressed by such laws fall within the constitutional category of "powerful toxic substances". None of these laws establishes a concession regime, but instead they set out permit or licensing requirements. Therefore, to the extent that the manufacturing of "powerful toxic substances" is addressed by specific laws, it is solely permits or licences which are required. Thus, the requirement of the Concession Law for the grant of a concession in respect of manufacturing of "powerful toxic substances" has not been translated into law and no state monopoly has been established for these activities. Until the legislation is clarified, the application of the Concession Law in respect of such activities remains unclear.

Procedures for granting concessions

The general rule: tender or auction

With limited exceptions, concessions are awarded by way of competitive tenders or auctions. When a concession is proposed the Council of Ministers is responsible for determining whether the concession should proceed and whether the concession should be awarded following a tender or an auction for the selection of the concession holder. However, where particular legislation allows a concession to be granted without a tender or auction (see below) the Council of Ministers itself will directly award the concession. The decision of the Council of Ministers is made only following consideration of a report on the legal, economic, financial, social and environmental implications of the tender. The decision of the Council of Ministers as to whether a proposed concession scheme will proceed is final and may not be the subject of appeal.

The Prime Minister is responsible for appointing the tender or auction commission, as the case may be, and determines which Minister shall be responsible for running the procedure. Applicants for admission to the procedure are required to submit comprehensive plans, on the basis of which they may be precluded from participating in the procedure. Following the tender or auction, this commission submits its report on the results to the Council of Ministers together with its recommendation for the award of the concession. The Council of Ministers then determines to whom the concession shall be granted and authorises the relevant Minister to execute a concession agreement with that person. Article 19 of the Concession Law provides that the concession agreement must be concluded within one month of the date of announcement of the successful bidder, a period which may be insufficient in many cases, particularly as, in practice, the successful applicant may need time to carry out further independent testing before being in a position to negotiate the terms of the agreement.



Concessions in respect of municipal property, as well as in respect of activities over which a municipality has exclusive rights, are granted by the relevant municipal council. In this case, the procedure is initiated by the mayor of that municipality and the municipal council determines whether the concession procedure proposed by the mayor should proceed. The municipal council determines whether the concession is to be awarded following a tender or auction procedure for selection of the concession holder. Following the completion of the tender or auction, the mayor executes the concession agreement with the concession holder. In practice, the subject of a concession may be owned by several neighbouring municipalities, requiring the proposed concession holder to enter into negotiations with each, thereby inevitably prolonging and complicating the procedure. This administrative difficulty has been addressed by the recently enacted Water Law in the case of water supply concessions. Concessions for water supply systems which are co-owned by several municipalities may now be awarded by the Council of Ministers, provided that the prior consent of the representatives of the individual municipalities is obtained.

A concession may be awarded for up to 35 years, although an extension of the term to a total maximum duration of 50 years is poss-

ible, if determined by the Council of Ministers or the Municipal Council, as the case may be. Upon the expiry of a concession, Article 3(3) of the Concession Law, unusually, appears to give priority to the incumbent concession holder for the grant of a new option. There would appear to be no reason to include such a right of priority in the law and, as no concession granted under the Concession Law has yet expired, the procedure has so far not been tested.

Direct award of a concession

Both the Concession Law and the Municipal Ownership Act authorise the grant of the concession without a tender or auction in particular cases provided for by law. In the absence of such authorisation, the concession may be granted only pursuant to a tender or auction.

An exception to the tender/auction requirement, common to both state and municipal concession, arises in the case of privatisation. As mentioned above, the law authorises companies wholly owned by the state or a municipality to utilise property and to carry out activities which would normally require a concession without the need for a concession. However, at such point as these companies are privatised, the privatised companies, whether privately owned in full or in part,

must be able to continue their normal operations. In these circumstances, the Privatisation Law authorises the Council of Ministers to award the required concession to the privatised company, without a tender or auction. The procedure requires the relevant concession agreement to be entered into before the privatisation agreement is signed. This procedure was utilised in the privatisation of the potash producing company Sodi Deyvna, which was sold in 1997 to Solvay S.A.. In this transaction the purchaser was able to acquire the company in a manner that ensured that the company had in place the necessary concession to carry on business under private ownership. The concession agreement is made conditional upon the transfer of ownership pursuant to the privatisation agreement. A similar rule exists under the Municipal Ownership Act, whereby the municipal council is authorised to award a concession to a municipally owned company in the process of privatisation without a tender or auction.

Another significant exception to the tender/auction rule is provided by the Concession Law in cases where a wholly state-owned company owns a significant shareholding in the potential concession holder. A concession may therefore be awarded without a tender or auction to a company in which (i) a state-owned company owns at least 25 per cent of the equity of such company and (ii) the value of such equity exceeds BGN 300,000.

Bulgarian law provides certain other circumstances in which a concession may be awarded without a tender or auction. Principally, the law specifically allows this in relation to privatisation procedures. The justification of this approach is twofold. First, the law seeks to exclude the potential for cases where a successful purchaser of a former state-owned company may end up not obtaining the concession required to enable the company to continue its activities. Second, the grant of a concession without a tender or auction in the course of privatisation is in any case preceded by the privatisation procedure itself. As this

is a competitive process the competitive component is considered to have been addressed already. The non-competitive award of a concession has not to date caused problems or invited allegations of abuse or corruption, although the overall privatisation process itself (with or without the grant of a concession) has provoked such allegations.

Transferability

A concession is non-transferable, unless transferability has been allowed by exceptional provision of a specific statute which applies to the particular concession. There exist two such cases. The first is the provision of Clause 2, Paragraph (3) of the Concession Law, which provides that “the rights and obligations of concession holders pursuant to contracts entered into during 1991 following an international auction, concerning exploration and extraction of oil and gas from the continental shelf of the Republic of Bulgaria, may be transferred only once to third parties which have a merchant capacity, following a permit by the Council of Ministers”. The second case is provided by Article 25, Paragraph (2) of the Law on Underground Resources, whereby the rights and obligations pursuant to an extraction concession may be transferred to certain qualifying third parties following a permit by the Council of Ministers. There is no apparent reason why this solution as provided in the Law on Underground Resources should not be developed to apply to all types of concession. This would, it is suggested, increase the commercial viability of concessions generally.

It is of principal importance to lenders that the concession holder has the ability to assign the concession rights and other related agreements to the lenders as security. At present, Bulgarian law prohibits assignment other than in the limited circumstances noted above. The assignment should also provide “step-in” rights for the lenders, enabling the lenders or a special purpose company controlled by them to be substituted as concession holder but, again, this is not permitted by Bulgarian law at present. This situation could be addressed if

¹⁸Clause 3, Paragraph (1) of the Law on International Commercial Arbitration, *Official Gazette*, Issue no. 60 of 5 August 1988.

¹⁹Article 9 of the Concession Law.

the non-transferability provisions of the Concession Law were made subordinate to any agreement of the Bulgarian government to permit assignments to lenders. In structuring security arrangements involving concessions lenders have therefore sought to secure not the concession itself but the shares of a special purpose company incorporated to hold the concession. Care has to be taken to ensure that the concession agreement does not include as a termination event the change of control of the concession holder. In addition to a pledge of the shares of the concession holder, lenders have also secured the right to vote the shares of the company following an event of default and to appoint a specialist management company to the board.

Dispute resolution

Of significant concern to international investors is the question of dispute resolution in relation to concession agreements. Although the state may freely agree to submit to arbitration, Bulgarian law prohibits the submission to domestic arbitration of any disputes to which the state is a party.¹⁸ Since this would be the case with all state-granted concessions, international arbitration is the obvious alternative to the domestic Bulgarian courts. This presents another major obstacle, however, as under the Concession Law a concession may be awarded only to an entity registered to do business in Bulgaria¹⁹ and Bulgarian law prohibits international arbitration where both parties to the dispute are Bulgarian entities. If the concession holder is a Bulgarian registered company, international arbitration involving the state would therefore be prohibited. It may, however, be possible for a foreign company to register a branch in Bulgaria and have the concession awarded to that branch. In this case the foreign nationality of the concession holder (a branch is not a separate legal entity under Bulgarian law) should mean that inter-

national arbitration is possible. There is growing support for these limitations on the availability of international arbitration to be lifted. Foreign private companies are uneasy that any disputes to which they are party in relation to a concession will by law be a matter only for the domestic courts, which may not always have the expertise to deal with the complexities of certain commercial disputes and may not be perceived to be entirely impartial.

Another issue of concern is the prohibition under Bulgarian law for disputes concerning rights *in rem* in real estate to be submitted to arbitration. While this concern should not be relevant to a concession which is solely for the carrying out of certain activities, any concession related to the utilisation of property classified as real estate is affected. Bulgarian law is not clear as to the precise nature of the “utilisation” concession right and the courts have not yet had an opportunity to take a position on this issue. Lawyers are divided as to what is the legal nature of a “utilisation” concession right. One view is that this is of a purely contractual nature and, therefore, should be treated as akin to a rental right. Disputes concerning such a right should therefore be capable of submission to arbitration. Another view, however, maintains that the “utilisation” concession right is a special kind of “usufruct”, i.e., a typical right *in rem*. In that case, the “utilisation” concession right being a right *in rem*, disputes related thereto would not be capable of being submitted to arbitration. Until Bulgarian law takes a clear position on this issue there will be some

uncertainty as to the validity of an arbitration clause concerning disputes over a “utilisation” concession right.

Finally, another issue should be addressed in the case of concessions granted by a municipality. Under Bulgarian law municipalities (unlike the state) are not prevented from becoming parties to domestic arbitration. If the concession holder is a Bulgarian-registered entity any arbitration involving the municipality would have to be domestic Bulgarian arbitration. Bulgarian arbitration law requires the arbitrators appointed to serve on the panel to be Bulgarian nationals and the language of the arbitration to be Bulgarian. Again, however, the technique of having the concession awarded to a Bulgarian branch of a foreign entity, thereby introducing a foreign party to the arbitration, would be equally valid in these circumstances to enable international arbitration to take place.

Conclusion

The Bulgarian concession law should be viewed as a statement of principle, rather than as an established and detailed system of rules and solutions. Each concession project is therefore capable of becoming a test case and may require creative solutions to unanticipated problems. Private sector investors who wish to utilise state resources or engage in the provision of public services must expect to comply not only with the Concession Law but with other laws and regulations. Coordinating the grant of the necessary concessions, permits

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and licences for the provision of public services represents a significant challenge to investors, both domestic and foreign.

On the other hand, the general spirit of Bulgarian law and the widely supported economic policy towards enabling, strengthening and broadening private initiative should not be ignored. Bulgaria has consistently ranked in the top quartile in the EBRD’s Legal Indicators survey of effectiveness and extensiveness of commercial laws. Such spirit and principles should ensure that Bulgarian authorities will act prudently, reasonably and diligently to solve the problems that will arise in the area of concessions. It can also be stated with confidence that with each project the legal framework for concessions and the implementation of concession legislation and other related legislation becomes more settled and accommodating in respect of future concessions. 