ANALYSIS OF THE BTC PRIVATIZATION PROCEEDINGS AND DRAFT CONTRACT: TRANSPARENCY AND LEGAL COMPLIANCE IN THE SALE OF BTC IN VIEW OF ITS SPECIAL IMPORTANCE, IMPLICATIONS AND IMPACT ON THE BULGARIAN PUBLIC

The Sale of BTC is the largest and most important privatisation deal in Bulgaria. Closing the sale definitely has significant implications for the Bulgarian economy. The completion of such a deal of this scale was indicative not only of the willingness of the Government to meet its commitments undertaken within the framework of negotiations with the WTO, but also of its policy toward meeting the criteria for EU accession. The BTC privatisation proceedings were part of the process of liberalisation of Bulgaria's telecommunications market. The legal regularity and openness of the deal was a guarantee for ownership of the democratic values adopted by Bulgarian society.

As a non-government organisation focused on monitoring for the existence of corrupt practices and the possibility for such practices to unfold in the Bulgarian society, *Transparency International - Bulgaria* (the Association) considered the privatisation of BTC as an event that would have material economic, strategic military and political significance for Bulgaria, and the proceedings involved in making the deal had to be sufficiently clear, open and in legal compliance.

WHY THE PRIVATIZATION OF BTC IS IMPORTANT FOR BULGARIA

The sale of BTC was the largest step made by the Government of Bulgaria toward pulling out government interference from the economy. **All EU aspiring countries, as well as all EU Member States (with the exception of Greece) have divested their state interest in their telecoms. As of 1 January 1998, with the exception of Greece and Portugal, all EU countries have fully liberalised telecommunications**, and this implies lower prices and better quality of telecommunication services. Full liberalisation of telecommunications in this country was scheduled to occur on 1 January 2003, and the liberalisation of the sector is a prerequisite for EU accession.

Despite the strategy of the Government of Bulgaria for a step-by-step liberalisation of BTC's rates schedule, to-date, the company continues to charge the highest rates on international calls in Europe, and the lowest on local calls. The unrealistically low charges on local calls are maintained through the so-called cross subsidisation of services. This means that the company sells its international calls at a much higher price in order to support its local traffic.

Another serious problem for BTC is service quality. The government is not in a position to provide all the financing necessary to rehabilitate the entire network alone, and given the current subscriber structure of BTC, such an investment would not make much sense. The company sells its services in a small market and at the same time it maintains a large network since it is burdened with a very large number of customers that generate very low revenue. By its policy of artificially low prices for the services in the highest demand (local calls), Bulgarian Governments have turned BTC into a "social company". Each increase in charge rates was made under a separate Government resolution, following a lengthy and cumbersome procedure. Corporate policy hinged on

purely political factors. Rate levels were determined not by market conditions or pursuant to agreements with creditors but by the timing of parliamentary or local elections.

Over the past two years, BTC has been in a process of financial stabilisation, yet without the partnership of any large telecom operator the government is not in a position to prepare the company for the environment of a full liberalisation scheduled for 2003. In the absence of *new investment in the network* that can change the quality of services offered, and without *a new subscriber structure*, **BTC will not be capable of facing the competition of large operators that will enter the Bulgarian market after its liberalisation**. Unless it is prepared for the conditions in a free market environment, the company is practically doomed to fail. In 2003, it will be possible for the same services to be offered by other telecom operators, yet at much better prices and quality. Their strategy will be focused on attracting the so-called business subscribers that account for more than 80% of the company's revenue.

Another argument in favour of the sale is the impact that the company will have on the national economy as a whole until the liberalisation of telecommunications in 2003. The inadequate quality of telecommunication services has a largely negative impact on the investment climate. Without good communications, our country cannot be a part of the Common market or implement its ambitious high tech policy. The status of the telecommunications sector is one of the reasons for foreign companies to prefer not to invest in Bulgaria or for the decisions of companies that have already invested in the country not to extend their operations, particularly where such operations are in direct dependence on the quality and price of telecommunication services.

BTC is the largest state-owned company to be put on sale since the onset of the privatisation process. Therefore, the very fact of government divestiture from BTC should have provided a clear sign of stabilisation in the investment climate and should have had a direct impact on determining country risk. On the other hand, however, *this factor should not be overestimated*, as its influence should be **estimated in this respect solely in the context of the implementation of the entire privatisation program and *the reduction of the level of corruption in public administration*.** The lack of transparency in the privatisation of large state-owned companies has a direct impact on the price of Bulgaria's foreign debt. An example of this was the refusal to announce publicly the price offered by the OTE / KPN consortium upon submission of their bid for 51% of the company's shares. Sparing this information on the part of the Government had an adverse effect on the price of Bulgarian Brady bonds and this drop was commensurate with the effect the Kosovo crisis had on the market value of our securities during the first week of the conflict.

Another direct effect from this deal is the liberalisation of the market of mobile telephony, since, as stated in the tender documents, the buyer of BTC was to receive also a license as the second GSM operator. A **process in which Bulgaria is lagging considerably behind the rest of the East European countries, where competition in that market became a fact several years earlier.** In this country, the second operator was expected to start up at the end of 2000; thus the transaction was expected to lead to a price decrease in mobile services.

Bulgaria was the last among East European countries to launch the sale of its telecom, although according to the time frames approved by the previous Governments, BTC was to have been privatised back in September 1997. In the final analysis, the divestiture from the Bulgarian Telecommunications Company had been prepared by three Bulgarian Governments: Videnov's, Sofianski's and that of Kostov. For the Cabinet of the Socialists, the primary reason for the sale of BTC was the revenue anticipated from the deal. The acute financial crisis that swept the country during that period and the anticipated crisis with respect to making the foreign debt payments was one reason why the Government of that time contemplated pledging a portion of the shares in the company in return for advance financing. A deal like this would provide fresh cash for the government as early as the end of 1996, yet at a stock price much below its market value. That was the reason why, despite the critical situation with the government budget, the Cabinet chose not to make such a deal. Moreover, **at that time the experts in the Socialist Government believed that it was possible to get the incredible amount of about one billion US dollars for 25% of the shares in BTC.** In mid 1996, from the parliamentary rostrum, Videnov even stated that he anticipated USD 1.2 billion from the sale of 25% of the company's stock. These clearly unrealistic high expectations ultimately saved the company from becoming collateral against a bridge loan. Despite hopes that the sale of BTC, albeit at a later point in time, would provide considerable revenue to the government budget, the Socialist Cabinet did not succeed to finalise the deal during its time in office.

The limited time and authority of the subsequent Government, **the caretaker Government of Sofianski**, prevented it from moving ahead with the proceedings significantly. ***Practically, however, it was then that the decision was made to sell 51% of the company stock.***

For Kostov's Government, the sale of BTC was important mainly as a strategic choice and a sign to potential investors as to the new climate in the country.

Following the crisis in Russia, the subsequent outcomes from the sale of Rosstelecom and the beginning of the Kosovo crisis, the Cabinet seemed to have a clear understanding of the possible proceeds from the privatisation of the national operator. *On the day of submitting the bids* for BTC, it turned out that there was **no interest in the deal.** *The only bid*, that of the Dutch KPN and OTE, the Greek state-owned operator, brought to a minimum the opportunity for the Government to make a good strategic choice and thus to attract foreign investor interest to Bulgaria in an effective way.

Understandably, against the backdrop of the Balkan crisis, this deal was defined by the Government as a success for Bulgaria. In the course of the negotiations, it was found that closing the deal in the format proposed by the Consortium would not bring any benefits to the Government; quite the opposite – it would be damaging to its public support ratings and to the economy as a whole.

The state-owned OTE is far from being among the best operators in Europe, but it was presumed that the partnership with KPN would offset some of the shortcomings of the Greek state-owned operator. The stress was placed on the investment that the Consortium intended to make in BTC and that this investment provided sound assurance

that the new owner would make an effort to prepare the company for the free European market of telecommunications.

HAVING CONSIDERED THE WEIGHT CARRIED BY ARGUMENTS MADE IN SUPPORT OF THE SIGNIFICANCE OF THE DEAL, the Association launched a monitoring project on the government divestiture from the Bulgarian Telecommunications Company.

In a letter Our Ref. No. 002 dated 29 January 1999 addressed to the Privatisation Agency, registered upon receipt under No. 48 00 219 of 29 January 1999, the Bulgarian Association *Transparency International - Bulgaria* stated its desire to participate as an independent and loyal observer in the privatisation proceedings for BTC.

Transparency International - Bulgaria provided the Privatisation Agency with the reasoning behind its wish to participate in the independent monitoring of the privatisation of the Bulgarian telecommunications Company stating that the above factors and circumstances indicate a need to involve an independent institution as an observer of the privatisation process that could commit itself to a detailed evaluation of the methods and procedures implemented. **The request for *Transparency International - Bulgaria, Bulgaria* to be given access to the BTC privatisation proceedings as an independent and loyal observer referred to the fact that *Transparency International - Bulgaria* is the Bulgarian National Chapter of the international organisation, *Transparency International,* which has earned a highly respected name in the processes of citizen scrutiny and corruption control.**

A number of national chapters of *Transparency International* have been involved, in the capacity of independent observers, in the processes of privatisation, procurement and legal regulation of access to public funds. *Transparency International - Bulgaria* avails of a vast collective experience in this regard. *Transparency International*'s National Chapter in Panama was directly involved as an independent observer in the privatisation of the country's Telecommunications Company and has an established methodology on observer participation in this type of proceedings. The Bulgarian Chapter of *Transparency International* has access to this methodology and considers it applicable to the BTC deal, after the proper adaptations are made. On the other hand, ***Transparency International - Bulgaria*** **pools the efforts of leading experts of national and international eminence in the areas of economics, finance, law and public administration, and has the capability to offer professional and highly responsible team of people who are in a position to evaluate the overall process of privatising BTC.**

It is particularly noteworthy that *Transparency International - Bulgaria* is a *civil, non-partisan association, the goals of which focus entirely on promoting the national interests of Bulgaria and its citizens.* According to its statutes, the Association does not take part in protecting or championing any private interest whatsoever.

In the course of negotiations for signing an agreement for monitoring the process of BTC's privatisation, **rules of monitoring** were established that have to do with **strictly defined restrictions and norms of behaviour** of the observation team, most importantly the following:

1. **Confidentiality clause: the team of observers shall not divulge any information regarding the privatisation proceedings, publicly or through private channels, until the final conclusion and practical execution of the deal.**
2. **The team shall observe and strictly abide by all restrictions relative to protecting the state secret and the commercial secrets of the parties to the deal. Observation does not imply any access to such highly confidential information. Should such information become known to the observers inadvertently, they must not disclose it even after the final completion of the process of privatisation.**
3. **The final due diligence report of the observation team shall provide an evaluation of the transparency and legal compliance of the privatisation procedure without divulging any details as to the proceedings of the deal itself. <u>What interests the Association is solely and entirely the procedure and its transparent coverage and not any details pertaining to the operational interests of the parties.</u>**
4. **The observation team and its individual members shall not to entitled to take any part whatsoever in the discussions between the Government of Bulgaria, potential buyers or their representatives. The team observes the deal but does not participate in it.**

After the Privatisation Agency took into consideration the appropriateness of involving a non-government organisation in the monitoring of privatisation proceedings for BTC, **an Agreement for the involvement of the Association as an independent and loyal observer in the process of privatising BTC was signed with the Agency on 16 February 1999.** Under this Agreement, representatives of the Association were granted access to certain documents on the privatisation of BTC. It is necessary to note that the Bulgarian NGO was offered access to the documentation following **the signing of the respective statement of confidentiality.** On its part, the Privatisation Agency strictly observed the provision of Article 3a **(envisaging restrictions on the provision of information relative to privatisation deals) of the Regulation on the Terms and Procedure for Providing Information on Sales under the Transformation and Privatisation of State-Owned and Municipal Enterprises Act** in terms of protecting the commercial secrets of potential buyers.

Because of the later date of involving *Transparency International - Bulgaria* as an independent observer of the deal, the Association's team faced the challenge of **evaluating the earlier part of the process by documentary evidence only.** Due to this, **access to documentation and information pertaining to the process was of material significance.**

The above circumstances made it necessary for the Privatisation Agency to undertake the following obligations vis-à-vis the Association as required for performing under the Agreement:

1. **To provide, upon the signing of confidentiality statements by the members of the observation team, the full volume of information on the privatisation process as necessary to make the evaluation;**

2. **To make it possible for the team members to sit in all meetings with the potential buyers and their representatives except for those of a strictly confidential nature;**
3. **To enable a briefing and a debriefing session for the team members and the potential buyers prior to and following the completion of the privatisation deal;**
4. **To make it possible for members of the team to attend the opening of bids and subsequent negotiations.**

Upon the project kick-off, the legal team of the Association performing the monitoring of the deal held a series of meetings with representatives of the Legal Department of the Privatisation Agency in order to finalise documentation and working meetings at which access was to be granted to the team. **Despite the numerous requests made by the monitoring team for access to documentation certifying the active legitimacy of potential buyers for the purposes of participating in the privatisation process for BTC (*whether the companies that have purchased the information memorandum meet the pre-selection criteria as published by the Privatisation Agency),* the Association was refused such access on grounds that the relevant documentation was kept with the intermediary, Deutsche Bank.**

The Privatisation Agency demonstrated bad faith in meeting its obligations under Item 2 of the Agreement on Monitoring of the Privatisation of the Bulgarian Telecommunications Company, which required the Privatisation Agency to enable the attendance of team members in all meetings with potential buyers and their representatives. Practically, the observation team was granted access to only two of the meetings of the Working Group on the Privatisation of the Bulgarian Telecommunications Company. Over the one-year duration of the Agreement, the Privatisation Agency did not make a single invitation, in meeting its contractual commitments, to the expert team of *Transparency International - Bulgaria* to attend meetings of the Working Group with the potential buyers.

It was entirely as a result of the efforts of Mrs. Assya Kavrakova, the Association's former Executive Director, and of Mr. Ian Logan, the Deutsche Bank representative, that a certain agreement was made with the Bank to co-operate in providing documents establishing the legal compliance and transparency of the privatisation proceedings for BTC. Following this agreement, **a fax was sent on 23 March 1999 on behalf of *Transparency International - Bulgaria* to Deutsche Bank, the intermediary, requesting that the relevant information be made available**. In case that proved unfeasible, the Association requested an official assurance by the intermediary of the facts contained in the fax message. **The above fax met with no reply**.

The Association also sent letters with surveys to be filled out by the rest of the potential buyers and participants in the privatisation proceedings for BTC: *Telephonica, Sakip Sabanchi Holding, OTE, KPN* and the World Bank, in order to establish their subjective opinion of the transparency of the process and the level playing field for all candidates. **The only reply came from a representative of KPN.**

In performance of the Agreement dated 16 February 1999, a representative of the British Chapter of *Transparency International* was allowed to attend the submittal of bids at the

Deutsche Bank – Grenfell central office in London on 18 March 1999. The report form *Transparency International - London* to *Transparency International - Bulgaria,* came in a special fax message that provided a detailed account of the attendance of the Organisation's representative at the submittal of the bid in London. The report stressed that the representative had been involved in the proceedings of submitting the bid for the acquisition of 51% of the equity of BTC, **but had not been allowed to attend the opening of the bid due to confidentiality considerations expressed by the intermediary in the deal, Deutsche Bank.**

On their part, representatives of the Bulgarian Chapter of *Transparency International* - its Executive Director Mrs Assya Kavrakova and the Association's legal expert Mr. Rossen Angelchev attended the sealing of the second copy of the submitted bid for the acquisition of 51% of the equity of BTC addressed to the Privatisation Agency. The said ***representatives of the Association did not attend the receipt of the bid at the Privatisation Agency but only its sealing on 18 March 1999 at 17:30; hence, they are not in a position to certify whether the bid was submitted to the Privatisation Agency in a timely manner.***

THE COURSE OF THE PRIVATIZATION DEAL

Pursuant to Article 3 paragraph 1 subparagraph 3, and Article 21 of the Transformation and Privatisation of State-Owned and Municipal Enterprises Act, and Decision No. 551 of June 1996 issued by the Council of Ministers, the Privatisation Agency, in its Decision No. 322 dated 14 June 1996 as published in the State Gazette No. 57 of 1996, opened proceedings to privatise up to 25% of the stock of the Bulgarian Telecommunications Company EAD (BTC EAD), Sofia. *Under the same Decision, it was prohibited to dispose with any long-term assets of BTC EAD, enter in any contracts for equity participation, joint ventures, securing claims or signing any loan agreements.*

Under Decision No. 532 dated 26 May 1997 as published in the State Gazette No. 47 of 1997, the Privatisation Agency removed the words "up to 25% of the stock" from the above Decision.

In its Decision No. 654-P dated 7 August 1998 as published in the State Gazette No. 95 of 1998, the Privatisation Agency announced the privatisation of an equity stake representing 51% of the capital of BTC EAD, Sofia, indicating also the method of privatisation: negotiations with potential buyers.

The Decision also indicates the pre-selection criteria (for the past financial year) to be met by potential buyers in order to make them eligible to participate in the negotiations, namely:

- ***To operate a telecommunications network connecting over 2 million subscribers;***
- ***To own companies with total revenue of over USD 300 per line.***

Participation was also open to international and foreign financial institutions, provided they have formed a consortium with a telecom operator meeting the above criteria as of

the date of submitting the bid. However, such financial institutions had to provide evidence that they manage capital of not less than USD 50 million.

Following the publication date of the Decision in the State Gazette, potential buyers had to send to Deutsche Bank, London, **a letter of interest indicating the names of authorised contact persons and documents evidencing that they meet the pre-selection criteria.**

Persons meeting the criteria could receive a copy of the information memorandum and negotiation documents after 15 September 1998 upon presenting a bank document certifying the payment of the document package price of USD 10,000.

Upon the purchase of documents, potential buyers were enabled to perform a due diligence analysis, and to this end they were provided access to a specially equipped Data Room on the premises of BTC until 13 November 1998.

An earnest money deposit for participation in the negotiations was set at USD 20,000.

It was indicated that:

- *The terms for participation in the negotiations were stated in the documentation package for negotiations with potential buyers, which was to be purchased;*
- *Bids could to be submitted between 16 and 30 November 1998, on any business day, from 9:00 till 17:30 in Room 209 at the privatisation Agency;*
- *Bids were to be opened on 30 November 1998 at 18:00 in the offices of the privatisation Agency, in the presence of representatives of the bidders;*
- *Contact persons were indicated.*

Under Decision No. 744-P dated 3 November 1998 published in the State Gazette No. 134 of 1998, the Privatisation Agency:

- *Extended the time for visiting the Data Room to 15 December 1998;*
- *Scheduled a new date for submitting the bids: 28 January 1999;*
- *Scheduled a new date for opening the bids: 28 January 1999.*

Because of the large volume of the privatisation deal and the specific nature of the company, a Working Group was set up, made up of representatives of the following: the Government of Bulgaria – Alexander Bozhkov, Deputy Prime Minister and Minister of Industry, experts from the Council of Ministers, representatives of the Committee for Posts and Telecommunications, representatives of Barents Group, representatives of Deutsche Bank, a representative of the legal firm which had prepared the due diligence report. *All meetings were to keep minutes, to be signed by the attendees.* ***The first meeting was held on 18 December 1998 under a business agenda announced in advance and determined by the consultant, Deutsche Bank,*** *namely:* a change in the

deadlines in the privatisation proceedings; comments on the minimum price payable for the stake of 20% of the stock earmarked for acquisition by employees under preferential terms; comments on GSM operator licenses to be granted; comments on expected investment; licensing fees; anticipated dividend on BTC stock for 1999. *As a result of the discussion, the following decisions were adopted: Deutsche Bank was to hold meetings with potential investors and hear their considerations with respect to changing the time schedule, with a decision to be made by 6 January 1999. New dates for providing the documents on the deal were adopted, which were not endorsed by the privatisation Agency, and for new comments by potential buyers on extending the time allotted for access to the information. Minimum share prices were determined, in accordance with the presentation made by Deutsche Bank, for 51% of the stock, and according to the appraisal made by Daneb Consult OOD, for the 20%.* ***An obligation for the potential buyers was envisaged to make investments through increasing the capital of BTC from own funds rather than through borrowing.*** *The policy of distributing dividends was to be determined upon consultations with the Ministry of Finance and pursuant to the effective regulations (meaning the State Budget Act and the effective currency board arrangement).*

On 15 January 1999, a second meeting of the designated Working Group was held. *The business agenda determined was as follows: changing the time schedule for the privatisation proceedings for BTC from the one announced in the Decision on the method and in the negotiation package; a policy of distributing dividends for 1999; the issue of a second GSM operator and the possible capability to have additional operators use the same frequency; service pricing. The following decisions were taken: The time schedule was modified as follows: receipt of comments from potential buyers – by 15 January 1999; issuance of draft licenses for BTC and for a second GSM operator – between 19 January and 26 January 1999. The State Committee for Telecommunications and Denter Hall were to file their drafts; final comments on the drafts by potential buyers –* ***by 2 February 1999; final version of the deal, upon consultations with the Council of Ministers –12 February 1999;*** *closing the Data Room – 12 February 1999; submission of proposals for ownership agreements – 19 February 1999; approval of proposed ownership agreements – 26 February 1999; submission of initialled documents on the deal and bank guarantees – 10 March 1999; submission of bids and opening the bids – 18 March 1999; signing the sale contract – 19 March 1999;* ***final closing of the deal – 5 April 1999****. Dividends on shares were to be distributed in accordance with the terms and procedure set in Decree No 35 of 1998 issued by the Council of Ministers on the Execution of the 1998 State Budget of the Republic of Bulgaria, and subsequent to the sale – according to the company's Articles of Incorporation. In negotiations to resolve the issue with RTC, Scenario No. 1 was to be followed:* ***(no data is available as to the contents of this scenario)****, and* ***Grozdan Karadjov was elected representative on behalf on BTC****.*

The above-cited decision was taken following discussions in the Working Group on 18 December 1998, upon the insistence of the intermediary, Deutsche Bank, with the argumentation that the former was necessitated by the late entry into the process of Telephonica, in order to enable the company to do the respective research and file a bid.

Under its Decision No. 849-P dated 15 January 1999 published in the State Gazette No. 6 of 1999, the Privatisation Agency:

- *Extended the time for visiting the Data Room until 12 February 1999;*
- *Changed the date for submitting and opening the bids to 18 March 1999;*

the decision to extend the time for submitting the bids was taken after holding discussions in the Working Group on 15 January 1999, upon the proposal of the consultant, Deutsche Bank. *The argument was that the structure of KPN and other participants in the process required the deal and the respective documentation to be approved by three bodies, which required process time.*

Under its Decision No. 910-P8 dated 26 February 1999, pursuant to Article 3 paragraph 1 subparagraph 2 and paragraph 3 of the Transformation and Privatisation of State-Owned and Municipal Enterprises Act, Decision No. 322 of 1996, published in the State Gazette No 57 of 1996, Decision No. 532 of 1998, published in the State Gazette No 47 of 1998, Decision No. 654-P dated 7 August 1998, published in the State Gazette No 95 of 1998, the Agency of Privatisation amended its Decision No. 654 dated 7 August 1998 and determined ***the amount of the earnest money deposit at USD 1,000,000.***

THE INVOLVEMENT OF AN INTERMEDIARY IN THE DEAL

For the purposes of providing technical assistance in the sale of 51% of the BTC stock, under a ***Contract for Consulting Services*** *between the Privatisation Agency and Deutsche Morgan Grenfell, London, dated 24 September 1997, the Agency hired* **Deutsche Morgan Grenfell, London, as an intermediary in the deal, subsequently renamed to Deutsche Bank,** *as evident from the additional agreement signed between the parties on 2 September 1998. Project financing for the involvement of an intermediary in this privatisation deal was obtained through a loan from the World Bank, Washington, which held a competition for the purpose, won by Deutsche Bank. It should be noted that the Bulgarian law on privatisation matters does not regulate the figure of the legal consultant (intermediary) and therefore its scope of authority was regulated by the parties in the Contract for Consulting Services cited above.*

Thus, for example, the Contract envisaged the following responsibility for the privatisation consultant:

- ***The consultant shall protect the legal interests of the Privatisation Agency in third-party relations;***
- ***The consultant undertakes to perform its obligations with the care of good husband;***
- ***The consultant must not receive any commissions, discounts or other benefits ensuing from its involvement in the contract executed between it and BTC;***
- ***It cannot participate in projects related to the scope of this Contract;***
- ***The consultant cannot engage in any activity that might lead to a conflict of interest between it and the Privatisation Agency; etc.***

The consultant's fee was agreed upon in an amount dependent on its success and was set as a percentage of the price agreed upon with the buyer.

In order to clarify all parameters of the deal, the privatisation Agency outsourced a due diligence analysis and a privatisation appraisal of BTC to Deneb Consult OOD, Sofia, reflecting the company's status and its value as of 31 June 1997. These analyses were updated as of 31 June 1998 and were presented to the Privatisation Agency, and the latter accepted them.

The consultant on the deal prepared the following reports and submitted them to the Privatisation Agency:

- ***Due Diligence Report;***
- ***Appraisal and Sales Strategy;***
- ***Documentation on the deal:*** *a contract for the privatisation sale, shareholders' agreement, management contract for services related to managing BTC, Articles of Incorporation for BTC;*
- ***Information Memorandum.***

RULES FOR PARTICIPATION IN THE PRIVATIZATION DEAL PREPARED BY DEUTSCHE BANK AND ENDORSED BY THE PRIVATIZATION AGENCY

PARTICIPANTS IN THE NEGOTIATIONS FOR THE PURCHASE OF 51% OF THE EQUITY OF BTC MUST FULFILL THE FOLLOWING:

1. The company submitting a bid

1.1. Bids must be submitted by the registered participant, but Assets may be held indirectly. registered participants may acquire the Assets:

(a) Directly;

(b) Through a company incorporated for that particular purpose, owned by the registered participant;

(c) Through a consortium set up in partnership with others.

If Assets are to be acquired through a consortium,

- *The consortium must be headed by a registered participant holding not less than 35% of its capital and having control;*
- *Where two registered participants decide to form a consortium, they must hold at least 50% interest in it and control;*
- *Manufacturers of equipment shall not be eligible to participate in consortia.*

1.2. By Friday, 5 March 1999, registered participants shall inform the Privatisation Agency which of the three options for acquiring the Assets is their choice:

(i) If the intention is to acquire the Assets directly, it shall not be required to submit any documents in addition to those already submitted in the course of the registration. Where a registered participant submits a bid directly, no guarantee agreement shall be required.

(ii) If the intention is to acquire the Assets through a company incorporated for that particular purpose and owned by a registered participant, a letter shall need to be submitted, listing potential shareholders and describing the equity structure.

(iii) If the intention is to acquire the Assets through a consortium, it shall be necessary to submit a letter, listing all potential shareholders and their proposed equity participation, and providing data from the agreement between shareholders so as to describe in a manner deemed satisfactory by the Privatisation Agency how the registered participant/s exercise(s) control in the consortium and what are the restrictions on the transfer of shares within it.

1.3. Proposed companies may also be set up and their capital be paid in as required in Item 1.2 above, after the date of submitting the bids but (for the winning bidder) prior to signing the Contract for the Sale of Shares.

1.4. The Privatisation Agency shall advise whether it accepts or rejects the proposed arrangement for the acquisition of the Assets by Tuesday, 9 March 1999.

1.5. No approval shall be required to make changes in the participation of individual shareholders in the company submitting the bid unless such changes affect the control of the company or the inclusion therein of new shareholders. For any other changes proposed, it shall be necessary to obtain the approval of the Privatisation Agency. The latter shall announce whether it accepts them within one business day.

2. Submitting the Bids and Initialled Documents on the Deal

2.1. Bids may be filed by registered participants whose proposals for the acquisition of the Assets have been received by the Privatisation Agency in writing.

2.2. To participate in the submission of bids, registered participants meeting the requirement as set under Item 2.1. need – by 12:00 on 18 March 1999 – to submit in person all documents listed under Items (a) through (d) below to representatives of participants, in Room 209, Privatisation Agency, 29, Aksakov St., Sofia 1000.

The documents are the following:

(a) ***Two identical copies of the bids****, in accordance with the rules set in Part 3 of the Rules, and in the format specified in Annex 4 to these Additional Rules, each copy sealed in a separate envelop inscribed "Privatisation of BTC";*

(b) ***Initialled copies of the Contract for the Sale of Shares, the Management Contract, the new Articles of Incorporation and the Guarantee Agreement*** *("Initialled documents") in a sealed envelop*

(i) in the final version in which they have been presented to investors on 21 February 1999 (since revisions may be made prior to 10 March 1999 through written communication with the Privatisation Agency, or by indicating on the documents themselves what changes they wish to make prior to signing the Contract for the Sale of Shares and the Guarantee Agreement;

(c) ***A bank guarantee*** *("the Guarantee") following the attached sample format as per Annex 2 to these Additional Rules, issued by a bank of a credit rating not lower than AA. The Guarantee must be valid for three months following the date of submitting the bids.*

(d) ***A cover letter*** *("the Letter") following the attached sample format as per Annex 3 to these Additional Rules,* ***in which the registered participant confirms its commitment to sign (within three months of the date of opening the bids) all initialled documents on the deal, should its, or that of the consortium it participates in, bid be selected, and its final proposed changes as approved by both parties.***

3. Rules for the Bids

3.1. The bid shall be made up of two components:

(a) ***An amount denominated in US dollars*** *("the Bidding Price")* ***representing the aggregate amount offered for the Assets****, which does not include the licensing fee due to the State Committee for Telecommunications for issuing the second GSM license, in compliance with the Telecommunications Act, since such licensing fee is payable separately and is not part of the bid; and*

(b) ***An amount denominated in US dollars,*** *which* ***the registered participant undertakes to invest in BTC*** *as provided in Clause 4.2 of the Contract for the Sale of Shares ("Investment Commitment").*

3.2. For each bid submitted by a registered participant, the Privatisation Agency shall:

(a) *Write down on the envelop* ***the date and time*** *the bid was submitted;*

(b) ***Sign off on each envelop*** *on the place it is sealed to mark its official receipt;*

(c) ***Ask the representative of the registered participant to also place their signature as an indication of agreement*** *as to the date and time of receipt as marked on the envelop;*

(d) *Place one of the envelops containing the bid in a new envelop to be sealed with wax and inscribed ("Copy of the Bid");*

(e) *Keep the other envelop to be reviewed by the Commission established by the Privatisation Agency especially for the purpose ("Original Bid").*

3.3. The Copy of the Bid of each registered participant shall be placed in safe custody in the safe of the Privatisation Agency. It shall be opened only in the event of a dispute between the bidder and the Privatisation Agency as to the contents of the Bid following the signing the Contract for the Sale of Shares. All other interested bidder shall be allowed to attend the opening on a Copy of a Bid.

3.4. Upon completion of the procedure described in Item 3.2 above, the Special Commission shall convene in camera to open each Original Bid and to proceed to review it in accordance with Part 4 of the Rules.

4. Ranking of Bids

4.1. Bids shall be reviewed by a Commission established by the Privatisation Agency especially for the purpose ("the Special Commission").

4.2. Bids shall be evaluated primarily on the amount of the Original Bid. To this end, the bidding price shall be multiplied by a weight factor of 100%, and proposed investments shall be multiplied by a weight factor of 33.33%.

4.3. In observance of the provision under Item 4.11, ***if the bid ranked as number one had been submitted by a registered participant, or by a company with its participation, with initialled documents without any proposed changes (as per 2.2 (b) (i) above) it shall be announced as the winning bid, and the respective registered participant, or company with its participation, shall be invited to sign the Contract for the Sale of Shares*** *and (unless otherwise required by these Rules) the Guarantee Agreement by 25 March 1999. Before the effective date of the Contract for the Sale of Shares, the winning bidder must file a Declaration under Clause 9 of the Transitional and Concluding Provisions of the Transformation and Privatisation of State-Owned and Municipal Enterprises Act (Annex 1).*

4.4. In all other cases, the Privatisation Agency shall evaluate bids by taking into consideration the following:

(a) The amount of the Bid;

and

(b) The effect that any changes proposed in the initialled documents may have on the government policy, the value of the bid, any

possible delay in the process, and any other factor the Privatisation Agency deems significant.

4.5. ***At its own discretion, the Privatisation Agency shall invite one or more investors to negotiate the documents in order to arrive at an agreement on any points of dispute*** *within 10 business days following the date of submitting of bids.* ***The Privatisation Agency may discontinue negotiations with any of the investors at any time.***

4.6. *Upon completion of negotiations,* ***the Privatisation Agency shall, at its discretion, select the bid, which it deems most beneficial for the Government of Bulgaria.*** *Within 2 days of the date on which it had been selected, the winning bidder shall have to re-initial the documents on the deal, including all bid details and the names of all parties, and submit then to the Special Commission at the Privatisation Agency, together with a declaration under Clause 9 of the Transitional and Concluding Provisions of the Transformation and Privatisation of State-Owned and Municipal Enterprises Act (Annex 1).*

4.7. ***Upon receipt of the documents, the Special Commission shall forward them to the Supervisory Board of the Privatisation Agency and to the Council of Ministers for their approval****, as required under Article 2 paragraph 3 of the Transformation and Privatisation of State-Owned and Municipal Enterprises Act, Bulgaria's Privatisation program for 1999, and Article 15 of the Administrative Rules of Operation of the Privatisation Agency.*

4.8. *Upon receiving the approval under Item 4.7, the Investor and the Privatisation Agency shall execute the Contract for the Sale of Shares and, if necessary, the registered participant (or its guarantor, if a third party) shall sign the Guarantee Agreement.* ***The Privatisation Agency may then publish the bid of the winner.***

4.9. *The realisation of the purchase/ sale shall be made in accordance with the Contract for the Sale of Shares.*

4.10. ***The Bank Guarantee*** *and the Cover Letter may,* ***upon the discretion of the Privatisation Agency,*** *be returned to registered participants either upon the signing of the Contract for the Sale of Shares and the Guarantee Agreement, or upon the realisation of the Contract for the Sale of Shares.*

4.11. ***Despite the above, the Privatisation Agency shall retain its right to reject any bid.***

5. ***Additional Terms***

5.1. ***The Privatisation Agency shall retain its right to add new terms, or amend the present terms, where so required for certain factors in the process.***

6. ***Time Schedule***

Submission to registered participants of the final package	*Sunday, 12 February*
Documents on the deal:	
Contract for the Sale of Shares, Guarantee Agreement, Shareholders' Agreement, Management Contract, BTC License and License for a second GSM operator	
Submission of a proposal for the form for acquiring the Assets	*Friday, 5 March*
Approval of the proposed form for acquiring the Assets	*Tuesday, 9 March*
Submission of Initialled Documents on the deal. Submission of the Cover Letter	

The Contract for the sale of 51% of the equity stock of BTC AD shall become effective as of the date it is signed by the parties. A prerequisite for the closing of the deal shall also be the granting of a license as a second GSM operator. The date of closing the deal shall be the date of the transfer of 51% of the equity shares in BTC and the payment of the transaction price. In the case of a failure to grant a license as a second GSM operator, the Contract shall be terminated. Under Article 43, paragraph 1 subparagraph 2 of the Telecommunications Act, the granting of a license for the development of telecommunication networks is to be done on the basis of a tender, competitive bidding, or without any tender or competitive process, if so provided by the law. Under Clause 5 (e) of the Transitional and Concluding Provisions of the Transformation and Privatisation of State-Owned and Municipal Enterprises Act, there is a provision allowing the granting of a license or concession without any tender or competitive process to the buyer and to the privatised company, where such an arrangement is part of the privatisation contract.

The Shareholders' Agreement regulates relations between future shareholders in BTC and establishes the method and terms for making the investments, the procedure for transferring the shares, and post-privatisation proceedings.

The Contract for providing services related to management regulates the required qualification, number of members, method for determining their remuneration and the manner of its disbursal.

In conclusion, having examined the procedure involved in the deal, *Transparency International - Bulgaria* has to make the following summary:

Despite the fact that the legal framework dealing with the matter of negotiations with potential buyers is quite comprehensive and allows for the establishment of own rules (both by the Privatisation Agency and by Deutsche Bank), even those rules were constantly and inconsistently changed in the course of the proceedings.

After the fact of the deposition of a single bid – that of the Consortium, it was arrived at a legal absurdity to have the rules of negotiations with potential buyers be adapted to the requirements of the bidder. The new modifications render meaningless the original terms (such as the idea to have the deal scrutinised by the National Assembly) and make the Bulgarian party look ridiculous in the eyes of its international partners.

INVOLVEMENT AND MONITORING ON THE PRIVATIZATION DEAL FOR BTC BY TRANSPARENCY INTERNATIONAL - BULGARIA

Despite the existence of an Agreement dated 16 February 1999 for monitoring the legal compliance and transparency of the privatisation proceedings for BTC, as of the end of February 2000, *Transparency International - Bulgaria* **was not provided with any information** as to the criteria for the selection of a consultant on the deal, the method of the subsequent formation of a consortium between KPN and OTE, or documents evidencing the legal regularity of opening and conducting the negotiation procedure with the potential buyers, KPN/OTE.

In a letter Our Ref. No. 087 dated 10 February 2000, *Transparency International - Bulgaria* made an official query addressed to Mr. Zakhari Zheliazkov, Executive Director of the Privatisation Agency, copied to Mrs. Galina Gergova, Head of Legal Department, Privatisation Agency. The above letter, registered upon receipt under Their Ref. No. 50 – 00 – 17 on 18 February 2000, the Association referred to the Agreement signed on 16 February 1999 with the Privatisation Agency, and demanded that the following documentation be made available, since it was necessary for the purposes of performing under the Agreement for monitoring the BTC deal:

- **Pre-selection criteria for potential buyers (authored by Deutsche Bank);**
- **Letters of Interest submitted by potential buyers;**
- **Documents proving that the potential buyers meet the pre-selection criteria as required for the purposes of obtaining the information memorandum and the negotiation package;**
- **The final comments of the State Committee for telecommunications and Denton hall on proposals made by potential buyers;**
- **A legal services consulting contract with Deutsche Morgan Grenfell, London dated 24 September 1997 and an Agreement with Deutsche Bank dated 2 September 1998;**
- **Documents evidencing the procedure for participation and registration of participants in the deal;**
- **An approval by the privatisation Agency regarding the acceptance of the proposed arrangement for the acquisition of assets within the Consortium, dated 9 March 1999;**
- **Correspondence between the Privatisation Agency and the Consortium till early 2000.**

On the part of the Association, it was pointed out that the provision of the said information was important in view of evaluating:

- **The legal compliance of accepting KPN and OTE as potential buyers;**
- **The legal regularity of holding the privatisation proceedings;**
- **The legal and timely decision-making by Deutsche Bank as the legal adviser on the deal;**
- **The legal compliance of the Privatisation Agency's actions as a body in the meaning of Article 3 of the Transformation and Privatisation of State-Owned and Municipal Enterprises Act on which the process of managing and administering negotiations for the sale of BTC depends, and whether we have cases of infringement into jurisdictions by various government institutions.**

The requested documentation was to clarify the issue of the legal regularity of OTE's participation in the privatisation deal. The agreement to set up a consortium signed between KPN and OTE as part of the privatisation proceedings proposed by the Privatisation Agency would have provided clarification as to the equity participation of the two corporations in the consortium. In case that more than 50% of the interest was held by OTE, as is implied from the statement made by Deutsche Bank in commenting on the KPN/OTE's reply dated 1 February 2000 (Item 23 explicitly states that "the Consortium cannot change the ratio between GSM2 and BTC, since the agreement between the consortium members is based on a 2:1 ratio, as indicated in the Original Bid of February", **negotiations with the Consortium** had to be declared in **legal non-compliance**, and from the very start so. No reply to the requests made was received from the Privatisation Agency. The Privatisation Agency did not make the requested information available to *Transparency International - Bulgaria*, and no explanatory letter followed. This behaviour of the Privatisation Agency could not be interpreted but as a tacit rejection to provide information.

As a result of the performed monitoring on the proceedings held to privatise BTC, as of 24 March 2000, the following irregularities have been established:

1. Irregularities in Procedure

- Under Article 1 paragraph 3 of the Transformation and Privatisation of State-Owned and Municipal Enterprises Act, **"Privatisation is the transfer to natural or legal persons with less than 50% state and/or municipal participation of:**

  1. Stakes and shares owned by the State or the municipalities, in commercial entities;

  2. The ownership of entire enterprises, autonomous parts thereof, or unfinished construction projects (…)".

  From the text of the law, it follows that **enterprises with a predominant state-owned equity** should **not be allowed** to participate in privatisation proceedings. It

is common knowledge that OTE is state-owned and its admission as one of the candidates for buyers of BTC is **evidently in legal non-compliance.** The Transformation and Privatisation of State-Owned and Municipal Enterprises Act does not distinguish between Bulgarian and foreign legal persons; rather, it looks at the size of state participation in its equity. Such participation should not exceed 50%.

The documents on the deal clearly show that as of 18 December 1998, **OTE was admitted as an individual candidate buyer**, as seen from the record of proceedings from the meeting of the Working Group established under Decision of the Council of Ministers, under Record of Proceedings No. 66 of the meeting of the Council of Ministers dated 18 August 1997. **According to the provisions of the law, such an admission is entirely irregular.**

The Transformation and Privatisation of State-Owned and Municipal Enterprises Act provides a legal definition of the term "privatisation"; it establishes the status of participants in the privatisation, the bodies competent to effect the transfer of ownership from the state or municipalities to private persons ("**natural or legal persons with less than 50% state or municipal participation", according to the text of Article 1 paragraph 3**), entities subject to privatisation, and the methods for effecting their privatisation.

- Article 3 of the Act lists the bodies that are competent to make a privatisation decision. In a blanket form, subparagraph 1 authorises the Council of Ministers to determine the state body competent to open privatisation proceedings for a state-owned enterprise whose balance sheet value of long-term assets does not exceed BGL 350,000,000 as of 31 December 1997 (after the deflation, BGL 350,000). In one of its Decrees, the Council of Ministers constitutes as such a body the respective minister, in accordance with specific sector scopes of competence. In all other cases of privatisation of state-owned enterprises, the competent body **is the Privatisation Agency, which takes its decisions independently, or upon the approval of the Council of Ministers, where the enterprise falls among the entities listed in the annual privatisation program set by the Council of Ministers**. With respect to municipal privatisation, the only competent body is the Municipal Council. The procedure envisaged precludes the possibility for overtaking competence falling within the jurisdiction of another government body, which is a trend observed toward the end of negotiations. With its actions, the Council of Ministers definitely takes over the scope of authority delegated to the Privatisation Agency by the law to carry out negotiations with potential buyers. Such an unauthorised intervention by the Council of Ministers is a violation of the procedure envisaged by the law for privatising state-owned enterprises planned for divestment in the annual privatisation program. The legal scope of authority of the Council of Ministers is limited solely to approving the actions of the bodies of the Privatisation Agency (an Executive Director or a person authorised by him/her, and the Supervisory Board of the privatisation Agency). The opposite is a material violation of the procedure for privatising state-owned and municipal enterprises as regulated in the

Transformation and Privatisation of State-Owned and Municipal Enterprises Act and can lead to invalidation of agreements reached on the deal.

The Involvement of the Council of Ministers or its members in the negotiations on the deal constituted a classic example of conflict of interest where **the Government parted with yet another independent (not burdened with negotiations) control body** envisaged by the law. The division of functions among the various government bodies envisaged in the law aims at strengthened control for legal compliance and appropriateness in the conclusion of deal of material significance for the economy of the Republic of Bulgaria. The violation of the legal provision is not to be recommended, not only from a legal viewpoint, but also from the viewpoint of governance.

- In performance of the contract for monitoring the BTC privatisation process, the Association expressed the opinion that, with the expiration of the required earnest money deposit, **continuing the negotiations** with the consortium was a **legal irregularity** because such negotiations are in contravention with the pre-selection criteria for entry into the tender and for purchasing tender documents. The earnest money deposit required for participation in negotiations with potential buyers in a privatisation deal is intended to serve as a **guarantee** for the *bona fide* participation in negotiations of the potential investor, and to **secure** the performance under the obligation to close the deal. In its last bid, the Consortium stated that it would make the earnest money deposit **upon reaching agreement** on all disputable issues, which Deutsche Bank deemed to be a reasonable proposal. However, under the hypothesis of not reaching the necessary agreement and the consortium pulling out due to terms it finds unacceptable, the **Bulgarian party would not have been secured** for benefits lost due to the Consortium's withdrawal. The opinion of Deutsche Bank was dictated by the belief that the Consortium would close the deal by all means, but such an opinion **did not take into account the interests of the Government of Bulgaria** because the difference in the positions assumed by each of the parties on certain issues was significant. It should be noted that **the earnest money deposit is a prerequisite for participating in the negotiations**, and it is not something recommendable or desirable. The failure to fulfil this prerequisite **is a material violation of the procedure for carrying out negotiations with potential buyers**. The deal has to be terminated until such time as the required earnest money deposit is set up, within a time period specified by the Working Group. **Any failure to make the deposit or making it after the prescribed deadline constitutes sufficient grounds for terminating negotiations with a defaulting investor.**

2. Findings of Legal Non-Compliance and Lack of Transparency in the Deal

Findings of legal non-compliance and lack of transparency in the deal are based on draft documents reflecting the intentions of the parties as of a certain point in time in the course of negotiations.

- From the very start of the privatisation proceedings for BTC, KPN/OTE **tied up the success of negotiations with a future, comprehensive acceptance of changes to the law as proposed by them.** In the last bids submitted on 30 January 2000, and on 28 March 2000, the Consortium continued to insist on substantial amendments to the Bulgarian law. The desire to adapt the law of the Republic of Bulgaria to limited private interests was obvious. The Consortium would gain considerable commercial priority in case it achieved an exception from the outsourcing procedure provided under the Public Procurement Act, an introduction of a monopoly on voice services, including international voice services (Item 8), the introduction of changes aimed at placing all services rendered by BTC to the authorities of the Ministry of the Interior, the Ministry of Defence, the national security services and the National Investigating Service on a commercial footing (Item 9). **Without any comment on the appropriateness of the said proposed changes, *Transparency International - Bulgaria* is obliged to point out that the process of making and updating the law is not subject to negotiation between the legislative branch of the Government of the Republic of Bulgaria and a third, private, party.** The adoption of the contrary position would have meant a breach of the principles underlying the Constitution of the Republic of Bulgaria of 1991, which proclaim the independence of the legislature, guarantees by the state for a competitive business environment (Article 19 paragraph 2 of the Constitution of the Republic of Bulgaria), and a prohibition on the creation and existence of privileges in the Republic of Bulgaria. Through the contractual documentation, the Consortium was practically being delegated legislative initiative, a right which, by Constitution, is held only by the Council of Ministers and members of Parliament.

- KPM/OTE exhibited a desire to achieve **the introduction of a monopoly** on international connectivity and the restriction related to its existence, and long periods (till the end of 2004) during which to provide **international connectivity – the connection from Bulgaria to any other point of the world.** In this regard, the Association has the following opinion, as expressly stated:

  The provision in Article 18 paragraph 4 of the Constitution of the Republic of Bulgaria reads, "Through a law, a state monopoly may be established on railway transportation, national and telecommunication networks, the use of nuclear energy, the manufacturing of radioactive products, weapons, explosives and substances having a strong biological effect". The property rights of the state listed in Article 18 paragraph 4 of the Constitution of the Republic of Bulgaria are not its pre-eminent domain and that is why the Constitution provides for a possibility to set a state monopoly in these exhaustively listed areas solely by means of a law. The Constitutional text explicitly emphasises that a monopoly thus created must be only a state monopoly. The creation of a private monopoly is precluded in spheres of such paramount national importance. Allowing such a violation would be anti-constitutional and

would always result in a significant potential possibility to cancel any deal (contract) which contradicts the Constitutional provisions. **Consent to grant monopoly rights to a private person is an absolutely unacceptable and unlawful act. The monopoly in favour of KPN/OTE envisaged in the draft contract cannot be sustained in the law and therefore this clause must be eliminated from the contract. The Constitutions provides for the possibility to set up a state monopoly on the telecommunications sector by way of an exception, and the law-maker's intention has been to achieve an improved centralised management of the telecommunications sector. The Constitution does not provide for a possibility to grant a private person any type of monopoly. On the contrary, Article 19 paragraph 2 of the Constitution states, "The law creates and guarantees to all citizens and legal persons equal legal conditions for business activity by precluding any abuse of monopoly position and unfair competition, and by protecting the consumer".**

The Constitutional provisions have a direct effect and, therefore, any introduction or granting of a state monopoly to a private person is null and void.

- **The statement of opinion issued by the Commission for Protection of Competition** dated 29 December 1999 on the Draft Act Amending the Telecommunications Act, and the opinion of the European Commission on Monopolies (an opinion by Mr. Robert Veru on Article 45 and Article 46 of the Europe Association Agreement between the European Communities and their Member-States, on the one side, and the Republic of Bulgaria, on the other, ratified by a law on 15 April 1993, effective as of 1 February 1995), **disagree with the extension of the monopoly and the introduction of a monopoly on international connectivity.** ***Transparency International - Bulgaria*** **took the position that the Commission and the Constitutional Court should be requested to rule not only on the acceptability of extending the monopoly to telecommunications but also on whether it is at all possible to grant a monopoly in that area to a private person, since such an act evidently contravenes Constitutional texts, despite the existence of a scanty regulatory treatment on natural monopolies in the Competition Act.** ***Transparency International - Bulgaria*** **upholds that the provision in the Competition Act itself is in contradiction to the Constitution.**

- The Consortium supported the idea of introducing a monopoly on two-way telecommunications through cable networks designed for radio and television signals, i.e. the introduction of a monopoly on Internet services provision through cable networks. The statement of opinion issued by the Commission for Protection of Competition dated 29 December 1999 and preliminary inquiries with members of the European Commission strongly opposed the introduction of such a monopoly, which would be "**a particularly severe violation of the rules of free competition"**. In the Commission's opinion,

"**this would provide a monopoly not only on the transmission of voice messages between the country and other countries, but also on any other type of data (…). This circumstance is in drastic contrast with the policy of liberalisation and the provisions and regulations in this field adopted by the European Commission. The absence of competitive pressure on BTC in the area of transborder data transmission would result, on the one hand, in increased prices for these services of vital importance for the economy and, hence, to maintaining high prices in all areas related to information technologies."**

- **According to EC Directive 96/19 making amendments to Directive 90/388, a monopoly may exist in an extremely limited range of cases, mainly limited to the ordinary voice telephony service. All other services, including mobile and personal telecommunications, must be open to free competition.**
- **The *Statute on Voice Telecommunications,* which is harmonised with the requirements of the acquis communautaire (the EC law), emphasises that owing to the development of the software market, it is now possible to encrypt, compress and send voice information on the Internet to various network subscribers, and to standard telephone sets using the Internet. This newly designed service is different from the ordinary telephone service and from the broadcasting of voice information using radio broadcasting, a method used in providing the GSM service. The *Statute on Voice Telecommunications* provides an exhaustive list of cases where a voice service carried by the Internet can be treated as an ordinary telephone service. In all other cases, it is a separate service and putting it together with the ordinary voice service and the GSM service into a joint service, "fixed voice service", or the provision of a monopoly on this service of the Consortium definitely leads to extending the monopoly on the telecommunications sector in Bulgaria.**
- **On the other hand, the GSM service and the Internet service are licensed as separate types of commercial services provided on the market.**

  The licensing theory considers a license in two aspects:

  (a) A license provides protection to the inventor for having created something new and useful for the public;

  (b) The license stimulates the economy and social development since it encourages others to seek for ways to attain similar, or better, results (relative to the result achieved by means of the licensed technology) by creating a new type of technology.

From this vantage point, the blending of several different technologies into one joint service (fixed voice service) and the provision of the right to use it to a single person does not enhance the development of society and the economy; on the contrary, the lack of competition, or scarce competition, slows down the development of any society.

- On its part, **Bulgaria has also undertaken commitments to the WTO** (the World Trade Organisation), and the Agreement signed with the WTO on 1 February 1997 specifies explicitly the areas of telecommunications in which it is allowable to establish a STATE monopoly. It has been agreed that the **establishment** and existence of a STATE **monopoly position** shall be allowed **only in ordinary telecommunication services**.

- Contrary to the established rules of international commercial law whereby **anybody is held liable for any damages caused by non-performance**, the Consortium aimed to avoid any possibility to pay damages in cases of non-performance under its obligations under the Contract for the purchase of 51% of BTC.

  On the other hand, in the entire documentation coming from the Consortium, the authorised representatives of the Consortium insisted on **exorbitantly high guarantees** and the payment of significant damages by the Government of Bulgaria in the event that the Government of Bulgaria should fail to perform under any of the terms proposed by the Consortium and subsequently agreed upon.

- **As regards the damage liability to be assumed by the Republic of Bulgaria relative to the deal and the publicised idea of the Government for the National Assembly to ratify the INDEMNIFICATION AGREEMENT constituting an integral part of the deal as an International Treaty on Financial Liabilities of the State (Article 85 paragraph 1 subparagraph 4 of the Constitution of the Republic of Bulgaria), the Association firmly supported the following position:**

  Under Article 85 paragraph 3 of the Constitution, the signing international treaties requiring amendments to the Constitution must be preceded by the adoption of such amendments. Therefore, should the Indemnification Agreement be treated as an international treaty and should any of its clauses contradict the Constitution, then in order to sign the Agreement in this version, there ought to be a preceding amendment to the respective Constitutional provisions. Embracing the opposite position implies that there will be a non-compliance with the Bulgarian Constitution in carrying out the deal.

  In the opinion of the Association, in case the Indemnification Agreement be treated as an international treaty and be tabled in the National Assembly for ratification, then prior to effecting this procedure, the Constitutional Court must exercise its authority granted pursuant to Article 149 subparagraph 4 of the Constitution of the Republic of Bulgaria, i.e., "to rule on the constitutionality of international treaties entered into by the Republic of Bulgaria prior to their ratification, and on the consistency of laws with the generally accepted norms of international law and with international treaties to which the Republic of Bulgaria is party". The wording used in Article 149 subparagraph 4 is "rule", as different from the wording in Article 149 subparagraph 2 of the

Constitution of the Republic of Bulgaria, "rules upon a request for or by".

The logical conclusion is that the Constitutional Court can rule both upon a request by the bodies authorised to approach it under the Constitution, and upon its own initiative, by self-seizure, in cases it deems it necessary to do so. On the other hand, the wording "rule" suggests that the Constitutional Court must necessarily perform an *ex ante* judicial review in ratification and an *ex ante* and *ex post* review in verifying the consistency of laws with the generally accepted norms of international law. The conclusion is that under the examined hypothesis, Bulgaria cannot avoid the payment of damages under the Indemnification Agreement accompanying the signing of the deal.

- The idea **to reduce the price of the deal by an amount placed in an escrow account in advance**, to be used in cases of possible changes to the law in the event of a **successful attack** on texts from the Act Amending the Telecommunications Act **before the Constitutional Court** was unacceptable. In its bid submitted to the Privatisation Agency on 31 February 2000, the Consortium apparently gave up the escrow account it had demanded, but under the condition that:

  1. Changes to laws and secondary legislation requested by the Consortium "be adopted and become effective within 40 days of signing the Contract for the Sale of Shares";

  2. Should, at the time of, or prior to the final closing, legal changes be attacked in a court of law by any person other than the Consortium, and should there be sufficient grounds to believe that such an attack would be successful, the Consortium shall have the discretionary right (…) to demand that a certain amount be deposited with a fiduciary until the receipt of the final ruling on the attack".

In the last bid of 28 March 2000, the demand to keep a certain amount as an indemnification payment under the contract in the case of a failure to effect the requested amendments or their attack in a court of law or the Constitutional Court of the Republic of Bulgaria was renewed and even increased.

- **In Bulgarian law**, there is neither practice, nor the legal framework regulating the deposition, in an escrow account, of **an amount to be used as indemnity in case a certain law is not passed or if it is pronounced legally irregular by the Constitutional Court**. The conclusion of contracts of a private legal nature between civil legal corporations (such as the state, in its capacity of shareholder in BTC EAD, and the Consortium) must **take place in observance of the legal framework, and not in contradiction to it**. It is unallowable to aim, as a consequence of such a contract, to effect a change in the legal framework so that it matches the contractual clauses or licensing terms. **Contracts have the force of law between the parties signatory to it but cannot be binding on third parties, the state or the legislature**. A

contract is signed in execution of the provisions of the law, and not vice versa. **All clauses of a private legal nature that contradict the imperative norms of the law are null and void and are automatically replaced by the respective legal norms regulating the matter at hand**. In case the outcome desired by the parties does not occur, the contract is terminated by mutual agreement or in court. If the contract has been signed conditionally (which is what the requirement of KPN/OTE is for making changes in the legal framework within a 40 day period following the signing of the contract, for the deal to be concluded) and the fulfilment of this condition is impossible, it does not render the entire contract invalid but only the relevant part thereof. **If the parties consider the condition to be of paramount material significance**, i.e., one without which the contract would not have been concluded, the law (the Contracts and Obligations Act) envisages two ways to proceed:

1. ***The contract can be terminated by mutual agreement;***
2. ***In the absence of agreement by one of the parties, the contract is terminated through court proceedings.***

Nowhere in EU law is it allowable for a contract to lead to a change in the legislation of the respective EU member country, nor can the country be obligated to adopt the respective changes in its legal framework within a set period of time. A contract is not a source of law, unlike the law. **Contracts that contravene the law or good manners are null and void** and their invalidity cannot be reversed even upon the will of the parties. Anyone can refer to their nullity.

On the other hand, provided the National Assembly does not adopt the requested amendments to the Telecommunications Act and the deal does not close, the Republic of Bulgaria would have been forced, under the jeopardy of having to pay indemnity, to provide, in contravention to Article 18 paragraph 4 of the Constitution (according to which a state monopoly can only be executed under a law), PRACTICAL MONOPOLY on international connectivity.

- From the very beginning of negotiations, the Consortium maintained the position that **its investment commitments (which stood at the basis of the decision to open privatisation proceedings for BTC) ought to be extinguished, should an indemnity claim be filed** under the Indemnification and Guarantees Agreement, i.e., the investment commitments of KPN/OTE were tied up with the emergence and filing a claim for damages. In its last bid submission of 31 February 2000, **as a result of the new policy of the Government, the Consortium forewent this demand**.

  What did stay, however, in Clause 5.3.3 of the Draft Contract, was the caveat that for a period of 10 years following the date of signing, the GSM operator cannot be required to spend more tan USD 1.25 million on the purchase of special equipment to support the control or tracking activities of the national security services. In view of the brisk development of telecommunications and the continuous discoveries and

introduction of new, expensive technologies, this caveat restricts the right of the Republic of Bulgaria to avail of and operate that technology. If the GSM operator has spent those funds over the first several years, it cannot be compelled to provide up-to-date competitive equipment until 2010.

THIS HAMPERS THE ABILITY TO MAINTAIN THE NATIONAL SECURITY POLICY OF THE REPUBLIC OF BULGARIA.

- The obligatory condition for investments posed by the Government of the Republic of Bulgaria as a primary prerequisite among the preliminary requirements for participation in the privatisation deal for BTC was transformed by the Dutch – Greek Consortium into a possibility to invest an amount borrowed from international institutions, and not from own funds of the future owners of BTC. This requirement is contained also in the Memorandum signed on 9 June 1999 by the initial negotiating team headed by the former Deputy Prime Ministers Evgeniy Bakardjiev and Alexander Bozhkov. In the negotiations renewed in December, 1999, the Consortium continued to maintain the position achieved in June, now before the new Working Group. The extremely negative opinion of the new negotiators forced the Consortium to propose a revision in which only half of the envisaged investment come from borrowing, insisting, however, that that amount, too, be written down in the main capital. Such a transformation of the investment strategy for BTC did not correspond to the main philosophy in privatising the company, which was to privatise it in order to find a strategic investor for BTC that would prepare the company for a smooth transition to the next step in the liberalisation of telecommunications in the Republic of Bulgaria after the end of 2002. **Increasing the capital through the so-called investment amount of USD 150 million lead to a hypothesis under which the consortium practically acquired more than 51% of the shares** in BTC, given the announced tender for 51% of the equity of BTC EAD. In its statement of opinion addressed to the Privatisation Agency, the Association pointed out that this was a decision of material legal irregularity and that, on that account alone, the deal could be cancelled as legally non-compliant.

  The regulatory framework on increasing registered commercial capital as provided in Article 192 of the Commercial Act requires a decision to increase capital to be taken by the General Meeting of Shareholders of the commercial entity, and not by tying up its decisions with conditions set in privatisation documents. This approach, as described above and as pursued by the Consortium, is **an infringement on the right of the remaining shareholders and bondholders to have their voices heard on two issues of material significance in the management of the company**: should there be new issues of shares or bonds, and should the company's capital be increased, to what size and in what manner.

  Capital increases can be carried out under certain conditions as indicated in Article 192 of the Commercial Act and regulated in detail in the Draft Contract for the future AD (joint-stock company). In view of this regulation, a decision to increase capital needs to be made by the General Meeting of

Shareholders of the joint-stock company with **a majority of two-thirds** of the votes of shares represented at the meeting. In its last sentence, Article 192 of the Commercial Act provides that "**through the Articles of Incorporation, it is possible to envisage a larger majority requirement, and additional conditions to be met**". This provision is **dispositionary** in its nature; however, this is a dispositionary norm with a set minimum on the basis of which the parties may negotiate **only on a majority larger than the one set by the law**. In registering a joint-stock company, **the court makes sure *ex officio* that the imperatives of the Law are observed, in this case – those of the Commercial Act**.

Increasing the capital of a joint-stock company **does not automatically result in increasing the interest of shareholders.** Such a possibility is allowed only in cases of increasing capital by the company's own funds. **In the Commercial Act, the term "own funds" is taken to mean funds generated as a result of profit** – c.f. Article 197 of the Commercial Act. Consequently, **in any other cases, shareholders receive only the right to acquire a portion of the new shares proportionate to their stake prior to the increase of capital**. In order to exercise that right, they need to purchase the shares. Their only privilege is that this may be done at the nominal value of the shares. However, it is possible for the purchase price to be set at **the value at issuance (i.e., the stock exchange price), which will raise their price additionally** and shareholders will have to pay a considerable amount in order to retain their position as a percentage of all stock. Bearing in mind the majority state interest in BTC EAD, the single-member joint-stock company, and the process for purchasing newly issued shares should be sufficiently transparent and legally compliant. The right to purchase shares expires after a period of time determined by the General Meeting of Shareholders, but not sooner than one month following the date of publication of the decision to increase the capital in the *State Gazette* (Article 194 paragraph 1 of the Commercial Act). **The take-over of this authority by the Board of Directors is a legal violation and renders the legality of the deal questionable**.

Following the advice of their Bulgarian legal counsel, the firm Djingov, Goginski, Kyuchoukov and Velichkov, (a statement of opinion issued by the law firm and dated 8 February 2000, addressed to the Privatisation Agency), in their last bid made to the Working Group, KPN/OTE made a proposal to convene an extraordinary General Meeting of BTC, which should "**empower the future Board of Directors to increase the capital and issue new shares under specific circumstances in the presence of which the Republic of Bulgaria shall not have veto rights**". According to the representatives of KPN/OTE, unless such a General Meeting is held, the Consortium will not conclude the deal. A proposal of this kind **clearly indicates that KPN/OTE is aiming at a legal way around the Bulgarian law.**

Had the proposal been accepted by the Working Group, the Board of Directors would have held a major part of the management power in the

Company and this would have enabled it to dictate the major policy of the company through its decision, thus ignoring the General Meeting of Shareholders and, therefore, the state interests of the Republic of Bulgaria. Bearing in mind the material economic, strategic military and political significance of BTC for Bulgaria and the development of the Bulgarian economy, the Association believes that decisions regarding corporate governance should be subject to more serious supervision and a larger degree of transparency should be guaranteed for the management of the company, at least for the period for which it holds monopoly rights on Bulgarian telecommunications.

- In contradiction to established commercial practices and the provisions of the Bulgarian Commercial Act, through the Contract for the privatisation of 51% of BTC, KPN/OTE aimed at taking over other prerogatives of the General Meeting of Shareholders of the future company as well. This conclusion follows unequivocally from the fact that the Consortium insisted on determining in advance the fixed pay of the four future managers of BTC. This condition was an integral part of the above-cited Memorandum dated 9 June 1999. **The right to determine who the managers of BTC will be, the size and method of their remuneration, however, resides solely with the General Meeting of the Shareholders**. According to the Draft Articles of Incorporation of the future joint-stock company, such a decision can be taken with a qualified majority of two-thirds of the votes of all existing shares. The underlying principle in the Articles of Incorporation is for decisions of material importance for the management of the company to be made collectively and not single-handedly.

- Another unallowable condition was the requirement by the Consortium to be given the right to sell a substantial part of the shares acquired as a result of the privatisation immediately after closing the deal, without requiring the consent (written approval) of the Bulgarian partner. Such a possibility (for the Consortium to remain as the holder of a negligible percentage of the shares) runs entirely against the limitations set in the preliminary conditions for participation in the deal.

- **The contract for the purchase of BTC restricted the possibilities of the Republic of Bulgaria to hold negotiations, undertake and meet commitments to the WTO, EU and NATO**. Appearing to agree that any commitments undertaken to the World Trade Organisation, the European Union and NATO are within the exclusive jurisdiction of Bulgaria, in its bid submitted on 31 January 2000, in Item 14 and in subsequent proposals, the Consortium posed the condition:

  - The Republic of Bulgaria should "**co-ordinate**" with the Investor and the Consortium all aspects of the negotiations **prior to undertaking any commitments** to the World Trade Organisation, the European Union and NATO that might engender indemnity rights under the Indemnification Agreement, or could affect the licensing rights and obligations of BTC or the GSM 2 operator."

- **It is unallowable for the Republic of Bulgaria to be held liable for non-performance of obligations under the Indemnification Contract that ensue from commitments undertaken to the World Trade Organisation, the European Union and NATO. A private person cannot determine or approve the national priorities and commitments of a sovereign country.** Any legal person **doing business** in Bulgaria ought to run it **in compliance and in observation of the effective domestic and international regulations to which Bulgaria is signatory or that have been ratified by it.** The opposite hypothesis leads to illegal actions by the legal person and no guarantees can be sought to justify or prevent them by restricting the sovereign right of self-governance of a country.

- It is unacceptable for the Republic of Bulgaria **to include, in the definition of "force majeur" (i.e., events or phenomena that cannot be overcome through the application of normal human effort, natural disasters),** under the Indemnification Agreement, **acts of the court**. Rendering this proposal binding would grant an illegal privilege to the Consortium vis-à-vis the remaining commercial entities on the Bulgarian market and was completely contradictory to the existing regulatory framework relative to force majeur circumstances, in which there is a non-guilty failure to perform. **The purpose of judicial review is precisely in achieving that goal**. Therefore, it is **impossible** to accept the Consortium's proposal not to be held liable for its own unlawful acts. **There is a precept in law, that nobody can draw rights from their own unlawful behaviour.**

  The court has the authority to review the behaviour and actions of all natural and legal persons and thus guarantee a legal and competitive business environment. In view of the above, it was absolutely illegal to include actions of the court of law in the definition for "force majeur". The opposite would mean that for KPN/OTE there would be no authority to review the legal compliance of its behaviour on the Bulgarian market and to ensure that it meets its obligations undertaken to other Bulgarian and foreign contractors. In cases where the court would have fulfilled its duty for an accurate application of the effective law, the consortium would not have been liable for damages and would have been entitled not to meet an obligation its had assumed, or to meet it, but solely at its discretion, when and as it deems appropriate. By accepting this proposal, a possibility would have been created for the Consortium to be beyond any control and immune to any punishment. Therefore, the Contract for the Sale of BTC was attackable as legally non-compliant before the competent Bulgarian courts.

  Attacking and cancelling certain parts of the Contract or the entire Contact by the court would have created problems not only for BTC but for the Bulgarian State since it opens the possibility for international arbitration where the Consortium has high chances of successfully suing the Bulgarian Government to pay substantial damages.

3. Recommendations

- The proposal of the Consortium dated 31 January 2000 to increase the company's capital with the amount intended for investments was unacceptable. Had the position of KPN/OTE been accepted, this would render questionable not only the equity participation of the Bulgarian government in the future company, in case it failed to purchase newly issued shares, but also the equity participation of the Consortium, should it refrain from the possibility to purchase new shares. We would have been faced with the possibility to have a new shareholder/s in the company. The amount with which it was envisaged to increase the capital of BTC was substantial and could lead to a change in the shareholder ratio in the future company. This proposal, again, was aimed to restrict and generally derogate the scope of authority of the General Meeting of Shareholders in the future joint-stock company that are exercisable through a qualified majority. In its essence, the proposal was not an investment that would allow BTC to develop new technologies and to offer better and more competitive services. On the contrary, this would have created a myriad of legal complications. Increasing the capital of BTC **would have reduced the ability to pay out dividends** to future shareholders, **including to the Bulgarian government**, in case annual profits did not exceed to size of registered capital This possibility was completely feasible, considering that the best financial results of BTC for the past 1999 did not exceed DM 100 million. This would also have created a legal possibility to circumvent the ban originally imposed by the Republic of Bulgaria for participants in the competition for the acquisition of 51% of the ownership of BTC not to sell the shares acquired through privatisation over a period of 3 to 5 years.
- The Consortium should undertake an obligation to maintain a certain level of sales and profit achieved by BTC in the financial year 1999. In this connection, the Republic of Bulgaria required indemnity for damages incurred due to reduced sales and profit levels below those in 1999, for the exclusivity period for rights on telecommunications granted to the Consortium. In the bid submitted to the Working Group dated 31 February 2000, **the Consortium expressly refused payment of damages for reduced sales and deteriorated quality of service** but made a request to the Government of Bulgaria to introduce changes to the rates schedule for telephone services according to which KPN/OTE would be able to determine alone the method of determining the charges.
- The company set up by the consortium, bearing the provisional name of Bulco, as the holder of the Consortium's stake in BTC was incorporated in Cyprus as an offshore company. The same was true of the Operator providing management services. The Association warned the Republic of Bulgaria that it should not be allowed to have the company owning BTC and the Operator providing management services be incorporated as offshore companies outside the European Union. Adopting the contrary would be conducive not to increasing investment in Bulgaria but, rather, to exporting capital.
- It was unacceptable to agree to the proposal of the Consortium to entitle it (grant it the privilege) to assign a management contract without any tender or competitive bidding, to a company related to it. Throughout our law, there is the permeating idea of intolerance to contracts between related parties. They provide for a worrisome possibility for a **lack of transparency** in the actions of such related parties,

significantly infringe upon the abilities to engage in normal commercial activity and create the prerequisites for unfair competition and unlawful gains for **related parties** at the expense of **lost revenues for the state treasury**.

- **The sale of BTC would have created a concentration of capital on the Bulgarian market. The result would have been occurred due to the fact of acquisition of the ownership of BulFon, Mobika and BTC pay phones by one and the same company. Had the deal taken place in this form, the Commission for Protection of Competition would have been in its full legal right to rule against the establishment of such a monopoly position that would promote unfair competition and not protect consumer interests. A decision to that effect would have incurred damages to the Republic of Bulgaria under the Indemnification Agreement, which constitutes and integral part of the deal.**

The findings of legal non-compliance and lack of transparency in the deal are based on non-confidential information, which the Association is entitled to disclose, under the Monitoring Agreement for the privatisation of BTC.

The Association is fully aware that a large portion of the terms that are legally irregular and unfavourable for Bulgaria have been agreed upon and confirmed by the previous Working Group headed by former Deputy Prime Ministers Evgeniy Bakarjiev and Alexander Bozhkov. All problems described herein of legal and organisational nature and discussed in the final report of *Transparency International - Bulgaria* ensue from the Memorandum signed on 9 June 1999.

The report takes into consideration the fact that the new Working Group set up in December 1999 has achieved considerable progress in the negotiations with the Consortium to minimise and eliminate legal irregularities and the requirements of the buyers that are unfavourable for the Republic of Bulgaria.

Despite those efforts, however, the deal as a whole is legally non-compliant and does not correspond to the interests of Bulgaria, which are focused on EU accession and joining NATO.

The Association recommends to the Government of the Republic of Bulgaria to terminate negotiations with the current buyer, the KPN/OTE Consortium, to separate the sale of a second GSM operator from the sale of BTC and schedule new tenders for BTC and the GSM operator not later than in the end of 2000, after developing a new, long-term strategy for the development of the Bulgarian market of telecommunications.

TRANSPARENCY INTERNATIONAL – BULGARIA