

**Council of Ministers  
of  
the Republic of Bulgaria**



**PRIVATISATION STRATEGY OF THE  
ELECTRICITY DISTRIBUTION COMPANIES IN  
THE REPUBLIC OF BULGARIA**

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## **1. EXECUTIVE SUMMARY**

The Strategy for privatisation of the electricity distribution companies (the “EDCs”) in Bulgaria (the “Strategy”, the “Document”) is developed following the objectives, outlined by the Government of the Republic of Bulgaria (the “Government”), the existing legislation and the conclusions, made on the basis of the preliminary assessment of the Bulgarian and the world economies, the financial markets and the electricity sector.

This section represents a summary of the Strategy and interprets the following key points in the Document:

⇒ **PACKAGING** – Taking into account the objectives of the Government, the existing legislation and the conclusions, made after the preliminary market assessment, the electricity distribution companies (EDCs) will be grouped into three sale packages:

*Western Bulgaria* (EDC Stolichno, EDC Sofia Oblast and EDC Pleven)

*South-Eastern Bulgaria* (EDC Plovdiv and EDC Stara Zagora)

*North-Eastern Bulgaria* (BC Varna and EDC Gorna Oryahovitza).

⇒ **SEQUENCING** – The three packages will be offered for sale simultaneously in order to:

- increase the likelihood of privatising all the EDCs in the short term
- build demand momentum
- promote investor competition through multiple bids.

Three independent parallel tenders will be organised, one for each sale package. The three tenders will be synchronised, with simultaneous milestones, such as taking a decision on the sale method -- publicly-announced tender, submission of preliminary offers and submission of final offers.

⇒ **SHAREHOLDING OFFERED** - In order to secure critical interest from strategic investors, a shareholding of 67 % in each EDC will be offered.

⇒ **RESIDUAL EQUITY STAKES** - The actual (and envisaged) regulatory framework provide the Government with sufficient control and supervision prerogatives over the EDCs’ activities and ensure that the newly privatised entities will act in the “public interest”.

- Control through a “golden share” arrangement is not appropriate because it could be perceived as restrictive and dissuasive by strategic investors.
- The Government should retain maximum flexibility after the privatisation with respect to its ownership rights associated to its residual equity stakes, including the possibility to dispose shares at its own discretion.

⇒ **TARGET INVESTORS** - The bidding rules should target the optimum type of investors that can best meet the Government’s privatisation objectives.

⇒ **SALE METHOD** - The privatisation should be structured as a trade sale, through a public international tender process targeted at strategic investors.

⇒ **TENDER RULES** - Interested investors could participate in each tender, bidding for each of the three sale packages separately, but they will not be allowed to acquire more than one sale package nor to submit combined offers.

- ⇒ **INVESTORS' SELECTION** - The investors' selection should be based on a three-stage process, including (1) bidding eligibility, through the issuance of eligibility certificates; (2) pre-qualification, on the basis of preliminary offers; (3) qualification of preferred bidder(s), on the basis of the final offers.
- ⇒ **PARTICIPANTS IN THE PRIVATISATION** - To accomplish the objectives of the privatisation of the EDCs, strategic investors, consortia and special purpose vehicles (SPVs) will be allowed to participate in the tenders.
- ⇒ **STRATEGIC INVESTORS** - To be eligible to participate in the tenders, the strategic investors will be evaluated for compliance with the following eligibility criteria:
- 1) Volume of electricity sold (in GWh) based on 2002 operational data of the strategic investor, expressing interest in the tender. If the interested entity is a consolidated subsidiary (according to IAS 27), the compliance with the criterion would be defined at the consolidated level of the group as a whole.
  - 2) Shareholders' equity in euro (excluding minority interest and determined following the Framework for the Preparation and Presentation of Financial Statements under IAS) according to the balance sheet as of 31<sup>st</sup> December 2002 of the strategic investor, expressing interest in the tender. If the interested entity is a consolidated subsidiary (according to IAS 27), the compliance with the criterion would be defined at the consolidated level of the group as a whole.
  - 3) Credit rating of the strategic investor, expressing interest in the tender, as of the date of issuance of the eligibility certificate. Should a credit rating from an internationally recognised agency be unavailable, information, proving the creditworthiness of the participant will be required.
  - 4) Experience of the strategic investor, expressing interest in the tender, on a liberalised electricity market as of the date of issuance of the eligibility certificate. The compliance with this criterion would be defined for the interested entity or the entity, controlling (according to IAS 27) directly or indirectly the interested entity. The experience will be determined as a significant share (%) in a liberalised electricity market.

The specific minimum quantitative parameters under the above criteria, with which strategic investors have to comply, will be set in the decisions for sale method and the tender documentation.

- ⇒ **CONSORTIA AND SPECIAL PURPOSE VEHICLES (SPVs)** - In order to provide strategic investors with a larger degree of flexibility and, in particular, to encourage the participation of those candidates who would not (or prefer not to) bid on a stand-alone basis, offers submitted by consortia or special-purpose vehicles (SPVs) will be accepted. Consortia or SPVs could consist of:
- Strategic investors;
  - Strategic investor(s) and other non-strategic investors (such as private equity funds, international financial institutions, etc. ). The non-strategic investors should be allowed to participate in the tender process under certain conditions including the obligation for the strategic investor to assume the responsibility for the operational management of the EDCs should such a bidding consortium or SPV be qualified. For this purpose, the strategic investor alone or together with an international financial institution has to acquire at least 51 % of the share capital of the SPV or the consortium. If a consortium is established in the form of a civil company<sup>1</sup>, the strategic investor alone or together with an international financial institution should exercise control over the civil company.

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<sup>1</sup> i.e. no separate legal entity is established

1.1.

**Sale Structure Overview**

- ▶ **Packaging:** three sale packages

*Western Bulgaria* (EDC Stolichno + EDC Sofia Oblast + EDC Pleven)

*South-Eastern Bulgaria* (EDC Plovdiv + EDC Stara Zagora )

*North-Eastern Bulgaria* (EDC Varna + EDC Gorna Oryahovitza).



- ▶ **Payment:** cash

- ▶ **Target investors:** the bidding should be open to (i) strategic investors, or (ii) consortia and special-purpose vehicles (SPVs), complying with the conditions of this Strategy

- ▶ **Sequencing :** the three sale packages will be offered simultaneously

- ▶ **Bidding rules:** bidders should be allowed to submit individual offers for each of the three packages, but will not be permitted to acquire, either directly or indirectly, more than one package. Combined offers will be rejected.

- ▶ **Indicative timetable :** the three tender processes should be ideally launched in July 2003, with the target completion date by the end of 2003.

- ▶ **Shareholding offered :** 67% package offer of the EDCs

- ▶ **Sale Method:** publicly-announced tender

## **2. INTRODUCTION**

### **2.1. Important notice**

This Document has been prepared on the basis of the main principles, underlain in the “Energy Strategy” of the Republic of Bulgaria, adopted by the Council of Ministers (CoM) and approved by the 39 National Assembly of the Republic of Bulgaria. The information necessary for development of this Strategy has been communicated by the Ministry of Energy and Energy Resources (MoE), the Privatisation Agency (PA), the electricity distribution companies (the “EDCs”), potential investors and other public sources. The “Privatisation Strategy and Marketing Report for the Electricity Distribution Companies”, prepared by BNP PARIBAS, Paris, France, in association with its sub-contractors, and financed through funds from the European Commission PHARE Programme, mobilised and monitored by the European Bank for Reconstruction and Development (the “EBRD”). The members of the Steering Committee for the Project for privatisation of the electricity distribution companies, authorised by the Government through implementation of the Project to ensure achievement, to a maximum extent, of the Government’s objectives in the energy sector, participated actively in the preparation of the Document.

This Document, submitted in May 2003, is based on the actual situation: 1) of the world and Bulgarian economies, 2) on the financial markets, in general, and, 3) in the electricity sector, in particular.

### **2.2. Overview of the Strategy**

This Document presents a privatisation strategy, in which the sale method, the packaging and the sequencing applicable to the EDCs are defined. The Document comprises the following sections:

- ▶ **Section 3: Transaction background.** The starting point of the privatisation process are the objectives of the Government in privatising the EDCs. If the privatisation is to be successful, it must not only meet the objectives of the specific vendor – the Government, it must also balance the interests and concerns of potential investors. A number of issues which could undermine the prospects for success had been identified, as well as the outcomes of the preliminary market assessment have been taken into account.
- ▶ **Section 4: Packaging and sequencing.** The grouping into packages as well as the sequencing of the sales are aligned with the strategic objectives depending on Government’s priorities, regulatory and legal implications. The market demand and the goal to generate sufficient interest and competition among prospective bidders are taken into account in the elaboration of the packaging scheme and the sequencing of sales.
- ▶ **Section 5: Shareholding offered and remaining equity stake.** The Strategy defines the level of equity interest offered. Following a review of the main options, including the effect of the “golden share” provisions, the alternative scenario, which maximises the attractiveness of the privatisation offer is chosen.
- ▶ **Section 6: Target investors.** In this section The optimum type of investors that can best meet the Government’s privatisation objectives and will be allowed to participate in the privatisation process is determined in this section.
- ▶ **Section 7: Privatisation method and process .** Within the framework of the Bulgarian law, a privatisation method has been selected -- a publicly announced tender, which should result in the promotion of the candidacy of the most appropriate type of investors and fit with the very objectives of the sale. A particular attention is given to the selection process.

## **3. TRANSACTION BACKGROUND**

### **3.1. Government's objectives**

The objectives of the Government are to:

- (1) Improve the quality of service delivered to electricity consumers.** The privatisation is seen as an efficient way to achieve this goal.
- (2) Improve EDC's efficiency, competitiveness and viability.** The privatisation is expected to:
  - **Attract investment to modernise existing infrastructure.** The distribution sector requires substantial funding for rehabilitation, but as long as the EDCs remain state owned their ability to attract financing to support large investment requirements is limited.
  - **Encourage sound commercial practice** i. e. reorient EDCs' activity on a commercial basis and achieve greater operating efficiency by enhancing managerial, commercial, financial and administrative policies and discipline.
- (3) Promote sector liberalization and competition in compliance with EU requirements.** The reform objectives are in line with the principles set out in the EU Directive on the electricity sector liberalisation and include: competition, sector transparency, maximisation of efficiency, progressive introduction of end-user choice, foreign capital investment and know-how transfer. The privatisation of the EDCs is likely to make the sector liberalization process irreversible, with a clear time frame, and will support significantly reforms in Bulgaria, oriented towards EU convergence and accession.

Another strategic objective is to increase, through privatisation, the creditworthiness of the EDCs through privatisation, which is expected to be beneficial to upstream activities such as generation and transmission and lay the foundations for a successful future privatisation of power producers - an approach, stipulated in the "Energy Strategy" of the Republic of Bulgaria.

To meet the above objectives, it is essential that electricity sector liberalization:

- allow the privatised EDCs to choose suppliers of electricity;
  - allow the privatised EDCs to enforce disconnections (if necessary);
  - implement eligibility gradually so as to avoid the sudden migration of the largest customers to competitors.
- (4) Timing.** The Government is aiming at an efficient and prompt privatisation process. The urgency of reform, the need for upgrading the asset base and the political agenda are all motivating factors for the Government to undertake privatisation simultaneously with the introduction of the new regulatory framework. In view of this, the sale strategy is designed taking into consideration an accelerated privatisation process.
  - (5) Proceeds from sale.** The maximisation of the share sale price is one of the main objectives of the Government. It should be noted that companies, operating in a regulated market, the sale proceeds, as well as the commitments under the investment program, are directly related to the prices charged to end consumers. Therefore, the maximisation of the financial effects from the sale is interrelated with the future electricity price levels.

Along these lines, EDCs' finances at present are characterised by low profitability and limited ability to generate cash flows. In order to achieve a successful privatisation it is vital to send a clear positive signal to potential investors on the following elements:

- Re-balancing of electricity tariffs,

- Strengthening the independence of the SCER,
- Clear tariff-setting rules and implementation time-table.

(6) **Addressing environmental and energy efficiency issues.** One of the main objectives in the privatisation of EDCs concerns the environmental and energy efficiency issues. By encouraging transfer of new technologies and improving operations in accordance with national and EU environmental standards, the incoming investors will contribute to achieving this objective.

As far as the energy efficiency policy is concerned, it is expected that the privatisation of the EDCs and the on-going re-balancing of electricity tariffs will improve the energy efficiency across the electricity sector itself and stimulate the restructuring of energy-intensive activities which are currently relying on cheap electricity and/or act as bad payers. The effect could lead to an increasing demand side efficiency and contribute to a general improvement of Bulgaria's economic competitiveness.

(7) **Public and international image.** One of the Government's objectives is to run a privatisation process that is fair and transparent. Greater transparency could be achieved by abiding by clear and objective bidding rules during the tender process. Following the principles of objectivity and impartiality would ensure the strengthening of the international image and confidence in Bulgaria as a whole, and the privatisation process in particular.

### **3.2. Investors' rationale and concerns**

The main objective of the privatisation strategy is to attract strong and experienced strategic investors to invest and operate the EDCs over the long term. In order to attract such investors, the following key investors' concerns have been identified:

- ▶ **Control of management decisions.** Strategic investors wish to ensure that they would be able to control or largely influence the key management decisions. This means having a majority equity stake in the EDCs.
- ▶ **Return potential.** Prospective investors will analyse carefully the operations of the EDCs, their legal and regulatory framework as well as the economic conditions in order to assess: 1) the EDCs' profit generating potential; 2) the potential for cost savings (technical losses, improving collection rates, etc.); 3) the levels of capital expenditures required in future years.

In this respect, the achievement of an acceptable return depends on:

- **Adequate tariff level and tariff setting mechanism.** It is essential that clear and transparent tariff-setting rules as well as the implementation timetable are set and made public before the launch of the privatisation transaction (i.e. at the time of the marketing). The strategic investors will be interested to participate in the tenders only if the existing (and envisaged) tariff-setting framework allows to judge what future returns of their investment could be.
- **Legal and regulatory framework.** In addition to the type of tariff regulation, it is essential to complete and clarify the legal and the regulatory framework (especially the new Energy Law). The autonomy of the SCER should be ensured so that it has the capacity to enforce envisaged tariff re-balancing and relevant legislation, as well as adopt secondary legislation.
- ▶ **Ownership problems and legal aspects.** The existence of various legal problems can manifest itself through lower price prospective bidders would be willing to offer and /or investors' requests for warranties and indemnification from the vendor. In view of this, considerable efforts are put to increase and maintain potential investors' interest in the EDCs.
- **Competition from similar transactions.** International strategic investors will compare the investment opportunity in the EDCs, as well as the related conditions and incentives, with other privatisation or sale projects currently underway in the region. Competing or forthcoming

opportunities in Romania, Poland, Slovenia, Lithuania and Ukraine will be carefully analysed prior to launching tenders. In this respect, key drivers for attracting potential investors in the sale of the Bulgarian EDCs rely on: 1) careful timing; 2) preliminary market assessment; 3) active marketing of EDCs' strengths; 4) right-sizing of the sale packages and 5) an attractive and "uncertainty-proof" transaction.

- ▶ **Size.** International operators tend to give priority to large transactions. The decision to group the seven EDCs into a smaller number of sale packages has been clearly creative of value and will increase the international profile of the Bulgarian privatisation as compared to competing assets in the region.
- ▶ **Permit by the Competition Authority.** To avoid any doubts with regard to the issuance of a clearance by the Commission for Competition Protection (the "CCP") after a winning bidder has been selected, a preliminary view of the CCP on the concentration of businesses, which will be realised following the constitution of sale packages, will be requested.

### **3.3. Preliminary market assessment**

The pre-marketing with potential strategic and financial investors confirmed the shift in market conditions over the last twelve months. The main conclusion from the preliminary market assessment is that, as of today, strategic investors' demand for the Bulgarian electricity distribution companies has been diminished by the recent developments in the utilities market. However, Bulgarian EDCs still represent an attractive opportunity to potential quality investors. A number of European electricity operators, especially those that have been less active in the M&A market until now, continue to position Bulgaria on their radar screen.

## **4. PACKAGING & SEQUENCING**

### **4.1. Packaging**

#### **4.1.1. Packaging advantages**

The electricity distribution sector in Bulgaria is currently organised in seven regional distribution companies of relatively small size. Therefore, it is appropriate to offer packages of companies in order to maximise interest. The packaging of the EDCs will produce the following positive effects:

- ▶ **Promote investors' competition.** The constitution of packages would right-size the assets to be offered by rarefying the panel of investment opportunities, while still preserving the interest of prospective investors.
- ▶ **Assets' attractiveness.** Investors have a preference for larger entities because of the fixed nature of acquisition costs and the perception that smaller entities are more vulnerable in a deregulated environment. The mutualisation of the EDCs will mitigate the disadvantages of some smaller or less efficient companies, that could prove difficult to privatise on a stand-alone basis.
- ▶ **Achieve higher valuation.** The higher-than-average size of each package, resulting, among other things, in scale efficiency gains, implies a strategic premium for an immediate critical scale in the Bulgarian market.
- ▶ **Transparency.** The packaging builds on scale and visibility for the privatisation of the Bulgarian EDCs as compared to other competing assets in the region.

#### **4.1.2. Three-package scheme**

The following structures are determined based on the approach selected for packaging of EDCs:

Western Bulgaria (EDC Stolichno, EDC Sofia Oblast, EDC Pleven);

North-Eastern Bulgaria (EDC Gorna Oryhovitza, EDC Varna);

South-Eastern Bulgaria (EDC Plovdiv, EDC Stara Zagora).

##### **4.1.2.1. Advantages and potential risks of the three-package scheme**

Given the Government's priority to ensure an efficient sale process, the three-package scheme has the following advantages:

- ▶ Increased benchmarking and comparison for regulation purposes;
- ▶ Competition in supply business when the market is deregulated;
- ▶ Increased investors' competition, since the scale of the sale packages will allow medium-size players or larger investors with currently stretched balance sheets to participate in the tenders;
- ▶ Limited integration costs, implied by integration to parent investors' structure plus the grouping of several EDCs;
- ▶ Smoother concentration process from other stakeholders' viewpoint, including the insiders (management and employees).

The potential risks of the three-package scheme are as follows:

- ▶ Smaller packages when compared to some other investment opportunities in the region;
- ▶ Increased risk of an incomplete sale process in a bearish market.

#### **4.1.1.1. Approach in packaging the EDCs**

The selection of certain EDCs to be included in the respective packages aims at fulfilling the following objectives:

- ▶ Maximise the expected financial vitality of the packages, thereby creating businesses which are capable of securing financing and access to capital markets and of generating stable cash flows;
- ▶ Create homogeneous packages by balancing weaker companies with stronger companies, thereby ensuring that all the packages will be attractive;
- ▶ Achieve acceptable geographic organisation, thereby enhancing competition among investors.

The constitution of three sale packages through grouping of the EDCs is constrained by the following circumstances:

- ▶ EDC Stolichno and EDC Sofia Oblast cannot be offered separately for obvious geographical adjacency reasons;
- ▶ In order to constitute homogeneous , EDC Plovdiv and EDC Stolichno should not be part of the same package as these are the two biggest companies in the country.
- ▶ After EDC Sofia Oblast, EDC Stara Zagora is the company that offers the best geographical fit with EDC Plovdiv.

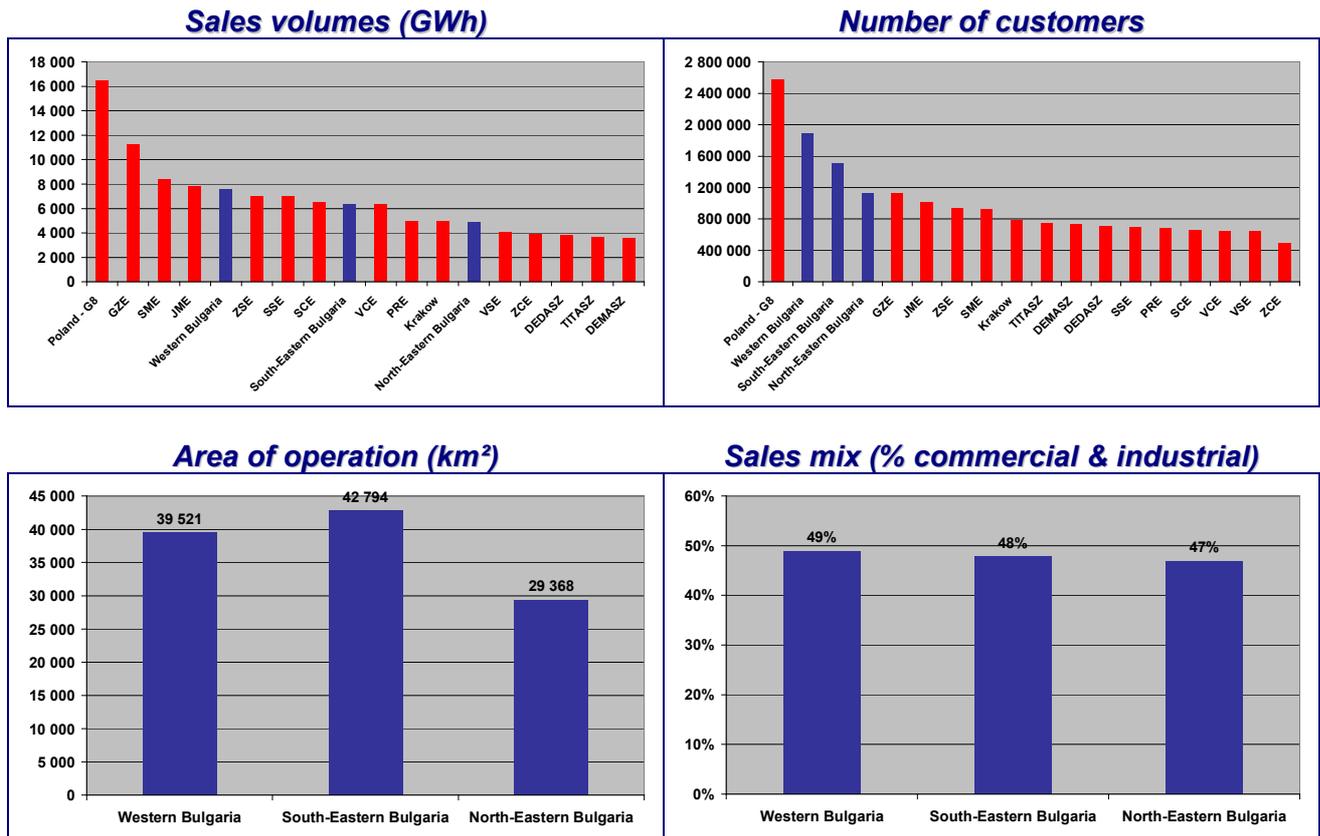
Assuming that, on the one hand, EDC Stolichno and EDC Sofia Oblast are part of a first package and that, on the other hand, EDC Plovdiv and EDC Stara Zagora are part of a second package, the third package should logically consist of EDC Varna and EDC Gorna Oryahovitza (for geographical adjacency reasons), leaving EDC Pleven as the sole company that can be incorporated in either of the three packages.

The strategic choice is to incorporate EDC Pleven in the package “Western Bulgaria” in order to make it more attractive for investors and to ensure the success of its sale:

- ▶ A package consisting of EDC Plovdiv, EDC Pleven and EDC Stara Zagora would create a “super package” (with 2.2 million customers compared to approximately 1.2 million in the two other), which is contrary to the principle of constituting homogeneous packages;
- ▶ A package consisting of EDC Varna, EDC Gorna Oryahovitza and EDC Pleven would make sense if the priority were to create interest for the less attractive north-eastern part of the country in a bullish market (i.e. a market situation where the interest in the package “Western Bulgaria” would be secured).

The following graphs illustrate the key characteristics of the proposed sale packages:

**A PRIVATISATION STRATEGY OF THE ELECTRICITY DISTRIBUTION COMPANIES  
IN THE REPUBLIC OF BULGARIA**



From the above graphs it is evident that the three packages rank among the biggest ones in terms of number of customers in Central & Eastern Europe, but are of average size in terms of sales volumes. In relative terms, the North-Eastern Bulgaria package is smaller than the two other proposed Bulgarian packages.

The review of the proposed grouping of the EDCs into three sale packages leads to conclude that:

- ▶ The three packages are of reasonable scale as compared to other investment opportunities in Central & Eastern Europe;
- ▶ The packages benefit from sufficient revenues to preserve the medium- to long-term competitiveness and viability in a liberalised regional market. The larger sales under a conservative capital structure create financially viable entities capable of meeting the challenges of a liberalised market.
- ▶ The proposed three-package scheme provides for a diversified benchmark for regulatory purposes and will enhance competition in supply, when the domestic market is liberalised.

## 4.2. Sequencing

**A PRIVATISATION STRATEGY OF THE ELECTRICITY DISTRIBUTION COMPANIES  
IN THE REPUBLIC OF BULGARIA**

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The choice of a simultaneous sale of all EDCs is prompted by the objectives of the Government to carry out an efficient sale process through building a demand momentum and promoting investor competition.

The main positive effects from a simultaneous sale of the EDCs can be summarised as follows:

- ▶ Minimising the risk of sub-optimum investor demand and competition. Thus, the depletion of competition for subsequent sales, which would be the case in a step-by-step approach, is avoided;
- ▶ The lack of future acquisition opportunities in the electricity distribution sector in Bulgaria will develop a sentiment of scarcity among investors, increasing the likelihood of multiple bids and reducing the risk that a package will remain unsold;
- ▶ The opportunity to schedule the tenders in a period that does not coincide with the critical stages in the current or forthcoming privatisations of electricity assets in the region is utilised;

Finally, the positive experience with simultaneous privatisations of electricity distribution companies in the CEE region should also be considered.

## **5. SHAREHOLDING TO BE OFFERED AND REMAINING STAKES**

### **5.1. Shareholding to be offered**

The strategic investors will target a level of management, operational and financial control which is offered by holding a shareholding of at least simple majority (50% + 1 share) and ideally a majority of two-thirds. As a rule, the minority shareholders are not given any blocking rights. Based on the legally established decision-making thresholds in Bulgaria, offering a 67% equity stake in each of the electricity distribution company will meet the requirements of strategic investors.

### **5.2. State involvement after the privatisation of the EDCs**

The Bulgarian legislation provides for the possibility of securing a “golden share” through the establishment of special majority for decision-making or issuance of preferred shares.

However, such “golden share” arrangements would be perceived as restrictive and dissuasive by the strategic investors, diminishing the overall attractiveness of the privatisation offer, but also the pricing of the control premium. Moreover, in some circumstances “golden shares” provision could contravene to the EU institutions’ approach.

In the case of EDCs, there is a wide range of areas where the Energy and Energy Efficiency Act, associated ordinances and the EDCs’ licenses foresee regulatory powers, exercised by the regulatory body in the energy sector, the SCER. The above described powers ensure the achievement of the strategic objectives for the sector related to security of supply, consumer protection, antitrust policy, etc.

Some of the more significant regulatory functions of the SCER worth noting are:

- ▶ Price control powers, which are set out in the existing Energy and Energy Efficiency Act and the Ordinance on formation and application of electricity prices and tariffs;
- ▶ Regulatory powers in respect of service standards, security of supply and development plans (in particular investment plans) through license articles.

### **5.3. Issues related to future disposals**

The main reasons, for the State, to hold the remaining shares over the medium-term are (1) to continue exercising a reasonable degree of protection of the State’s interests during the transition period of reforms in the electricity sector by participation in the management bodies of the EDCs and (2) to maintain the option for future profitable sales of its residual stake since the involvement of strategic investors is expected to increase the EDCs’ performance and value.

The Government will retain maximum flexibility with respect to its ownership rights after the privatisation, including the possibility to dispose shares within its shareholding at its own discretion.

## **6. TARGET INVESTORS**

### **6.1. Strategic investors**

For the purpose of this section, the concept of “strategic investor” refers to operators that are already active in the electricity distribution sector.

The motivation to target strategic investors is the following:

- ▶ Strategic investors are typically involved in the privatisation of electricity utilities around the world. Since they are from the same business as the target companies, strategic investors are hands-on, active managers, able to handle business and strategic issues with speed and efficiency.
- ▶ Compared to other type of investors, strategic investors have a longer term investment horizon and are ready to pay a higher price as well as to undertake to develop the electricity distribution companies provided that they are given the operational and management control.
- ▶ Strategic investors are less sensitive to market volatility or liquidity issues.
- ▶ To be eligible to participate in the tenders, the strategic investors will be evaluated for compliance with the following eligibility criteria:
  - 1) Volume of electricity sold (in GWh) based on 2002 operational data of the strategic investor, expressing interest in the tender. If the interested entity is a consolidated subsidiary (according to IAS 27), the compliance with the criterion would be defined at the consolidated level of the group as a whole.
  - 3) Shareholders' equity in euro (excluding minority interest and determined following the Framework for the Preparation and Presentation of Financial Statements under IAS) according to the balance sheet as of 31<sup>st</sup> December 2002 of the strategic investor, expressing interest in the tender. If the interested entity is a consolidated subsidiary (according to IAS 27), the compliance with the criterion would be defined at the consolidated level of the group as a whole.
  - 3) Credit rating (or information proving the creditworthiness of the participant) of the strategic investor, expressing interest in the tender, as of the date of issuance of the eligibility certificate.
  - 4) Experience and significant share of the strategic investor on a liberalised electricity market. The compliance with this criterion would be defined for the interested entity or the entity, controlling (according to IAS 27) directly or indirectly the interested entity.

The specific minimum quantitative parameters under the above criteria, with which strategic investors have to comply, will be announced in the decisions for sale method.

### **6.2. Bidders' consortia and special purpose vehicles (SPVs)**

In order to provide strategic investors with a larger degree of flexibility and, in particular, to encourage the participation of those candidates who would not (or prefer not to) bid on a stand-alone basis, offers submitted by consortia or special-purpose vehicles (SPVs) will be accepted. Consortia or SPVs could consist of:

- Strategic investors;
- Strategic investor(s) and other non-strategic investors (such as private equity funds, international financial institutions, etc. ). The non-strategic investors should be allowed to participate in the tender process under certain conditions including the obligation for the strategic investor to assume the responsibility for the operational management of the EDCs should such a bidding consortium or

SPV be qualified. For this purpose, the strategic investor alone or together with an international financial institution has to acquire at least 51 % of the share capital of the SPV or the consortium and exercise control over the consortium. If a consortium is established in the form of a civil company, the strategic investor alone or together with an international financial institution should exercise control over the civil company.

With regard to consortia, established in the form of a civil company, the strategic investor alone or with an international financial institution will be required to acquire at least 51% of the shareholding offered in each EDC.

### **6.2.1. Private equity investors**

Private equity investors (or venture capital investors) are a specific group of medium-term portfolio investors. The characteristic of private equity investors is that they are providing medium-term committed share capital to help unquoted companies grow and succeed.

The private equity investors' rationale is focusing on the following criteria:

- strong and entrepreneurial management with good track record;
- growth-oriented business plan;
- use of proceeds: expansion, product development, acquisitions, new market entry, etc.;
- expected IRR higher than that of strategic investors, strong financials with limited debt;

Attracting only private equity investors is not a suitable solution in the privatisation of the EDCs. While these investors are financially strong and experienced in investing in the electricity sector, they are not able to bring day-to-day management expertise, nor sufficient technical know-how.

Considering the above, private equity investors will be invited to participate in the privatisation process together with the strategic investors.

### **6.2.2. International financial institutions**

International financial institutions are organisations established and sponsored by governments for financing of international projects.

The involvement of an international financial institution in the privatisation of EDCs will be beneficial for both the Bulgarian authorities and potential strategic investors. The presence of an international financial institution will upgrade the status of the privatisation tender and increase the visibility of the transaction.

From the strategic investors' point of view, the participation of an international financial institution will be perceived as a protection against the risk of political interference. Such participation will result in an easier access to local and international debt financing.

Private equity investors and international financial institutions will be allowed to participate in the privatisation process through consortia or SPVs, that comply with the requirements of item 6.2 of this section.

## **7. PRIVATISATION METHOD AND PROCESS**

### **7.1. Privatisation method**

EDCs are included in Appendix №2 to Article 35a, para 1 of the Privatisation and Postprivatisation Control Act, comprising the commercial companies with over 50% State ownership and significance for the national security of the Republic of Bulgaria. Pursuant to the Amendments to the Privatisation and Postprivatisation Control Act, the privatisation of the EDCs is carried out through a publicly announced tender (Art.32(1), item 3 of the Privatisation and Postprivatisation Control Act). This privatisation method is not only legally established one but it is also an optimum privatisation option, which allows to reap the benefits associated to a sale targeting strategic investors.

### **7.2. Tender process overview**

Based on the tender regulation and chapter seven “a” of the Privatisation and Postprivatisation Control Act, a process in line with international practice and received by potential investors as transparent will be launched. It would include marketing and a two-stage selection process as described below:

- ▶ **Marketing:** in order to generate a maximum level of investors’ demand and identify with accuracy most interested parties, an intensive marketing campaign will be organised. Based on the outcome of this stage, the decision for the sale method of the EDCs will be taken and selection criteria will be set.
- ▶ **Preliminary stage:** interested parties who will pass eligibility criteria set in the decisions for sale method and in the Tender Rules (“Eligible Bidders”) will be eligible to purchase an information memorandum and submit preliminary non-binding offers (“Preliminary Offers”) for the shareholding in the EDCs.
- ▶ **Final stage:** following the selection of the bidders eligible to proceed to the final stage, the same will be allowed to submit final binding offers (“Final Offers”). On the basis of the Final Offers in compliance with the preliminary announced evaluation criteria, the Privatisation agency will submit a motivated proposal to the Council of Ministers ranking the offers submitted in the final stage. The Council of Ministers will decide on the selection of the preferred bidder.

#### **7.2.1. Marketing**

The purpose of the marketing stage is to attract strategic investors’ interest in the forthcoming privatisation and measure with accuracy the actual level of investors’ demand. The duration of this stage and the way to conduct the marketing campaign are to be defined by the Privatisation Agency.

##### **7.2.1.1. Call for Expressions of Interest**

Inviting potential investors to express interest in the Bulgarian EDCs is an efficient means to inform the investors community on the forthcoming privatisation and identify interested parties prior to deciding on launching a publicly announced tender.

The announcement will induce the interested parties to furnish a certain level of information:

- description of the candidate and its activities, including those in the electricity sector,
- reasons for interest in the EDCs,

- latest financial statements and operational highlights,
- any other relevant information.

The analysis of the Expressions of Interest is intended to measure the actual market demand and evaluate the individual profile of interested parties in order to (i) take or not the ultimate decision to privatise the Discos, (ii) set the eligibility criteria with which strategic investors have to comply, and (iii) initiate early-on in the process a meaningful dialogue with the interested parties.

#### **7.2.1.2. Decision to privatise through a publicly announced tender**

Based on the outcomes of the marketing stage, the PA is to adopt the decisions to privatise the EDCs through a publicly announced tender. Such decisions will be published in the State Gazette, as well as in at least two national daily newspapers and the international financial and specialised press.

### **7.2.2. Preliminary stage**

At this stage, potential investors which have purchased the tender documentation and comply with the eligibility criteria to obtain the information memorandum pursuant to Section 6.1. and the tender documentation, are issued certificates of eligibility to submit Preliminary Offers.

#### **7.2.2.1. Eligibility**

In order to obtain certificates of eligibility, potential investors should fulfil certain minimum criteria. If the information provided by the interested investor satisfies the eligibility criteria, the candidate is entitled to obtain the information memorandum (after reception of a signed copy of the Confidentiality Agreement) and submit a Preliminary Offer. There is no ranking in relation to the eligibility criteria.

Strategic investors, consortia and SPVs will be allowed to participate in the tender if considered eligible pursuant to the criteria defined in Section 6 of this Strategy..

#### **7.2.2.2. Preparation and content of Preliminary Offers**

The Eligible Bidders should submit their Preliminary Offers within a deadline and in accordance with requirements fixed in the tender documentation. In particular, the Eligible Bidders will be asked to submit Preliminary Offers containing the following information:

▶ **General information on the Eligible Bidder**

- the bidder's full name and registered address;
- the bidder's corporate and business profile;
- ownership structure or detailed information on the structure of the consortium;

▶ **Financial terms of the Preliminary Offer**

- a preliminary non-binding purchase price for the shareholding being offered in the EDCs;
- a description of the bidder's sources of funds for the acquisition.

▶ **Strategic and business aspects of the Preliminary Offer**

- a description of the bidder's strategy for the combined management of the EDCs within a package;

- a description of the proposed business development strategy for the EDCs;
- an indication of the information and documents that the bidder would reasonably expect to have access to as part of its due-diligence, should it be pre-qualified;
- a description of any necessary corporate, shareholder or regulatory approvals required to be obtained by the prospective investor prior to consummating the proposed transaction,
- any other factors and information which the bidder believes might be relevant to the Tender Commission in evaluating the bidders' level of interest.

In order to conduct a prompt and efficient tender process, the bidders should prepare the Preliminary Offers on the basis of information memorandum only, without access to the management and staff of the EDCs or to a data room. On the other hand, Eligible Bidders would be authorised to put questions to the Privatisation Agency. A list of such questions and requests together with answers/responses thereto will be disclosed to all participants entitled to submit a Preliminary Offer.

### **7.2.2.3. Opening and evaluation of Preliminary Offers**

The Preliminary Offers should be opened not later than the next business day after the deadline for their submission.

The Privatisation Agency could ask the bidders to remove irregularities, except in the cases when these irregularities lead to rejection of the offers without consideration, and/or provide clarifications on their Preliminary Offers.

The Tender Commission should prepare a motivated report to the Privatisation Agency on the candidates which the Tender Commission proposes to be allowed to submit Final Offers. Based on that report, the Privatisation Agency will determine those candidates.

## **7.2.3. Final stage**

### **7.2.3.1. Final stage rules**

Final stage rules will be communicated by the Privatisation Agency to all bidders who are entitled to submit Final Offers (the "Pre-qualified Bidders").

### **7.2.3.2. Investors' due diligence**

During the final stage, the Pre-qualified Bidders will be given the opportunity to conduct a detailed review of the EDCs. This will include controlled access to the EDCs' senior management, site visits and access to the data room containing financial, legal and technical information. The terms and conditions of access to the data room, site visits and management meetings will be communicated to Pre-qualified Bidders in due course.

### **7.2.3.3. Transaction Documents**

The Pre-qualified Bidders will be provided with drafts of the key Transaction Documents (Shares Sale and Purchase Agreement/Privatisation agreement, Shareholders' Agreement, Statutes of the EDCs, etc.). They will be invited to make comments and propose amendments to the draft Transaction Documents, highlighting separately all the changes that they consider as essential modifications. The Privatisation Agency will consider these comments and may hold meetings with Pre-qualified Bidders to discuss the amendments in advance of submission of Final Offers.

All investor queries and responses will be circulated, without identifying the investor asking the question, to all Pre-qualified Bidders simultaneously.

Before the deadline for submission of Final Offers, the Pre-qualified Bidders should receive the revised Transaction Documents, including any amendments the Privatisation Agency has agreed to introduce in the initial draft. The Privatisation Agency should retain complete discretion as to whether or not to include the proposed comments and/or amendments in the revised Transaction Documents.7.2.3.4.

#### **7.2.3.4. Preparation and content of the Final Offers**

After completing the detailed review of the EDCs and after having received the revised Transaction Documents, the Pre-qualified Bidders will be invited to make a final binding offer. The Final Offers will contain the following elements:

▶ **Updated information of the Pre-qualified Bidder**

- updated operational, ownership, legal and any other relevant documents and information as might be required by the Privatisation Agency.

▶ **Financial terms of the offer**

- the purchase price for the shareholding being offered in the EDCs together with the main operational, business, capital expenditure and financial assumptions on which the financial offer is based; the clarification of the assumptions in the Final Offer will not impact its evaluation. The only purpose to describe the main investor's assumptions is to receive an understanding of its business development forecasts.
- evidence of sufficient financial resources to fund the purchase price offered (own equity capital, local or international financing raised by the bidder, etc.).

▶ **Legal terms of the offer**

- approved Transaction Documents initialled by an authorised representative of the Pre-qualified Bidder including possible written comments.
- a description of any necessary corporate, shareholder or regulatory approvals required by the Preferred Bidder to consummate the transaction.

#### **7.2.3.5. Evaluation of Final Offers**

The Final Offers will be opened not later than the next business day after the deadline for their submission.

If necessary, the Tender Commission may suggest to the Privatisation Agency to request from some or all of the Pre-qualified Bidders clarifications on the Final Offers or removal of irregularities except for irregularities that lead to rejection of the Offers.

The Final Offer evaluation will be based on the offered purchase price. The amount of the offered investments and the employment levels to be maintained in the EDCs will not be applied as criteria for Final Offer evaluation due to the regulatory regime supervised by SERC which includes the following key regulatory functions:

- ▶ Price control and control of costs, including labour costs, as set out in the existing Energy and Energy Efficiency Act and the Ordinance on formation and application of electricity prices and tariffs;
- ▶ Control of service standards, security of supply and development plans (in particular investment

plans) through specific articles in EDCs' licenses.

#### **7.2.4. Execution of the privatisation agreement**

The draft privatisation agreement must be approved by the Supervisory Board of the Privatisation Agency and the Council of Ministers. The privatisation agreement has to be signed within the deadline determined in the decision on selecting the successful bidder.

### **7.3. Bidders' consortia and special-purpose vehicles**

While prospective strategic investors are expected to submit their Preliminary and Final Offers on a stand-alone basis, it is allowed to accept offers submitted by both consortia or special-purpose vehicles ("SPVs") as a means to provide strategic investors with a larger degree of flexibility and, in particular, to encourage the participation of those candidates who do not prefer to bid on a stand-alone basis. A precondition for offers submitted by consortia and/or SPVs will be that the strategic investors either alone or together with an international financial institution should own at least 51% of the shares purchased by the consortium or in the equity capital of the SPV. If the bidder is a consortium established in the form of a civil company, the strategic investor should exercise control alone or together with an international financial institution.

With regard to consortia, established in the form of a civil company, the strategic investor alone or with an international financial institution will be required to acquire at least 51% of the shareholding offered in each EDC.

Establishment of consortia or SPVs will be allowed already in the preliminary stage with certificates for participation in the final stage issued in their name after receiving the approval of the Privatisation Agency for the proposed form of participation.

The bids submitted by consortia or SPVs will be accepted subject to certain conditions to be specified in the Tender Documentation. Such conditions may include the following elements:

▶ **Disclosure**

- Relevant details of agreements among the consortium members or the SPV shareholders should be disclosed with respect to (i) the consortium structure or the SPV shareholding; (ii) role of each consortium member, indicating the consortium leader or the SPV lead partner; and, (iii) in the case of a consortium, allocation of shares to be acquired among all the consortium members.
- All consortium members or SPV shareholders should disclose their identity, relevant financial and corporate information, their ultimate shareholders (if applicable) and all other information that would be requested as part of the Preliminary and Final Offers.

▶ **Acceptance**

- The formation of a consortium or SPV as well as any material changes in the composition of such a consortium or SPV during the tender process should only be permitted with the prior agreement of the Tender Commission, provided that the resulting consortium or SPV meets the relevant criteria.

## **7.4. Co-ordination of tenders**

Three parallel tenders will be organised, one for each sale package. Interested eligible investors could participate in each tender, bidding for each of the sale packages separately, but they would not be allowed to acquire more than one nor submit combined offers (or conditional) for more than one package. The above restriction will stimulate competition after the privatisation of the EDCs, resulting in an improved efficiency in the sector. With regard to the privatisation process, the exclusion of combined and conditional offers will provide comparability of investors' offers and guarantee transparency of the process.

## **8. SOCIAL ASPECTS**

The existing and the now under preparation legislative frame renders the State enough authority to control and supervise the activities of the EDC through SERC and also it ensures that the privatized companies will conduct their activities in accordance with the public interests. Furthermore, the tender participants have to fulfill the additional requirements described below:

### **8.1. Requirements concerning preliminary offers**

In compliance with section 7.2.2.2, at the preliminary stage of the tender the admitted candidates will submit a general strategy for the development of EDC's activities. The general strategy will include also the candidate's views about:

- General labor conditions, including income
- Social partnership and collective labor agreement, including employment

### **8.2. Meetings with Nationally Represented Trade-Union Organizations**

The participants admitted to the final stage will be given an opportunity to perform a detailed analysis of EDC. For this purpose they will be given access to an information hall, which, beside technical, financial and legal information, will also contain comprehensive information about the existing labor legislation and collective labor contracts. Beside meetings with the management of the EDC, the analysis will include meetings with the Nationally Represented Trade-Union Organization in the respective EDC.

### **8.3. Requirements concerning final offers**

All candidates admitted to the final stage will be required to describe their basic assumptions, including the social ones, on which ground they have prepared their financial offer.

### **8.4. Guarantees concerning the proportion of the Wage Fund and social costs**

In the documentation to the deal, submitted to the participants in the final stage, clauses for social partnership will be included, as well as a requirement for the participants not to reduce labor costs (Wage Fund and social costs) below a certain level, in conformity with the regulations and the requirements of the activity's efficiency, determined by SERC, for a 2-year transitional period