

### 3. ENERGY POLICY INSTRUMENTS: PUBLIC PROCUREMENT

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

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

- **Insufficiently detailed legal regulation** regarding the status and functions of the specialised anti-corruption unit at the Ministry of Economy, Energy and Tourism (MEET);
- **Considerable economic interests at stake and substantial financial resources involved** in the energy sector;
- **Privatisation** of electric distribution companies;

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

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

<sup>70</sup> Data of the Public Procurement Agency as of the end of November 2010.

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

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

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

### 3.1. LEGAL REGULATION AND GENERAL PRINCIPLES OF PUBLIC PROCUREMENT

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

<sup>72</sup> Law Amending and Supplementing the Law on Public Procurement (promulgated in State Gazette issue 37 of 5 May 2006).

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

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

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

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

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

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

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

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

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

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

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

<sup>79</sup> See Article 118b of the Law on Public Procurement.

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

<sup>81</sup> The activities referred to in Articles 7a to 7e.

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

<sup>83</sup> See Annex 2: Procurement thresholds for sectoral contracting authorities.

### 3.2. PUBLIC PROCUREMENT DYNAMICS IN THE ENERGY SECTOR

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

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

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

Source: Public Procurement Agency, 2010.

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

<sup>84</sup> See Annex 3 Public Procurement in the Energy Sector for 2008 – 2009.

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

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

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

**Table 5. Number of Contracts Awarded by the Biggest Contracting Authorities in the Energy Sector<sup>86</sup>**

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

Source: Public Procurement Agency, 2010.

<sup>86</sup> The table illustrates the position that energy enterprises hold in the ranking of the 30 top contracting authorities in terms of number of awarded contracts.

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

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

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

Source: Public Procurement Agency, 2010.

### 3.3. MAJOR PROBLEMS IN PUBLIC PROCUREMENT IN THE ENERGY SECTOR

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

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

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

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

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

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

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

## Avoiding Supply Competition

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

- **Highly competitive procedures** where all interested parties may submit a tender. Open procedures under the LPP, open contests under the RSSPP, commodity exchange transactions and to some extent design contests fall under this category;
- **Partly competitive procedures** where a limited number of interested parties may submit a tender, i.e. only those explicitly invited by the contracting authorities (the restricted procedure under the LPP);
- **Non-competitive procedures** where a limited number of interested parties may submit a tender and thereafter negotiations are conducted. This category includes the negotiated procedure with and without publication of a contract notice under the LPP, the competitive dialogue, and the negotiated procedure following an invitation, as well as the selection among three submitted tenders, both under the RSSPP fall under this category.

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

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

<sup>88</sup> Reports of the Public Financial Inspection Agency for the period 2006 – 2009 obtained pursuant to the *Law on Access to Public Information*.

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



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

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

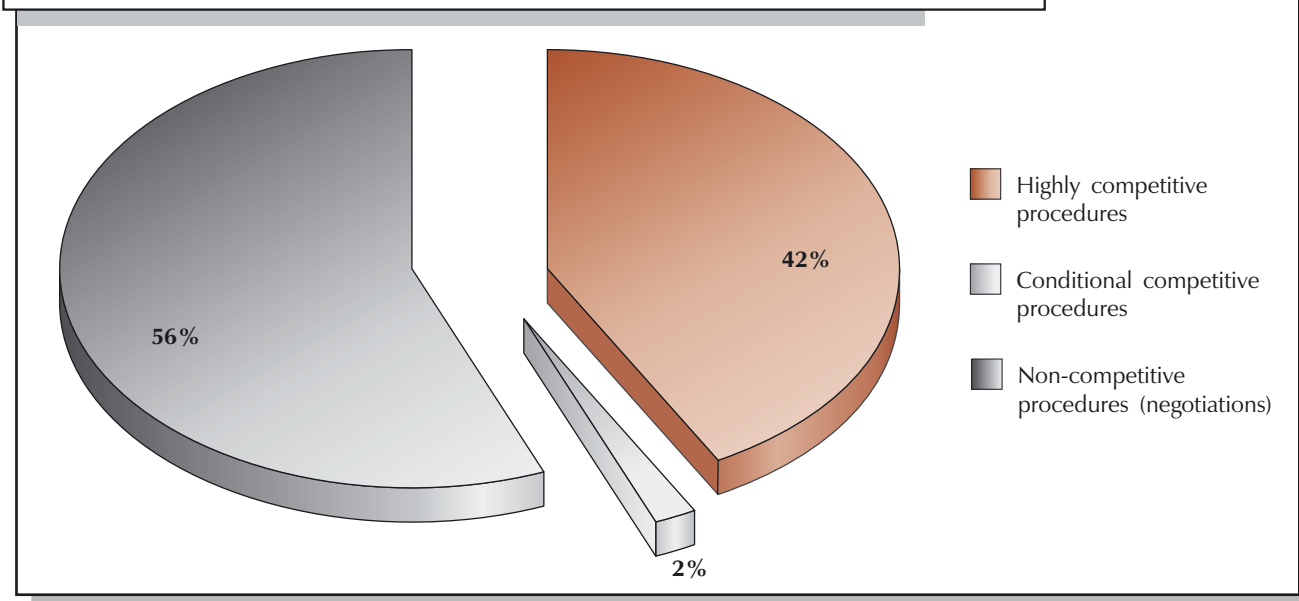
**Table 7. Types of Procedures Followed in the Energy Sector**

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

Source: Public Procurement Agency, 2010.

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

Figure 18. Favoured Public Procurement Procedures in the Energy Sector



Source: Public Procurement Agency, 2010.

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

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

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

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

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

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

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

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

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

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

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

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

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

## Transparency of Public Procurement Contracts

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

- Where it allows the tenderer to designate at the time of submitting the tender which part of said tender is of a confidential nature.<sup>93</sup> In such cases the contracting authority may not disclose any information designated as confidential or constituting technical or trade secrets, with the exception of registration of data regarding concluded contracts;
- Where it prescribes obligations for the contracting authorities to preserve the integrity and confidentiality of tender applications and bids;<sup>94</sup>
- Where it allows the contracting authority to refuse candidates or bidders access to data contained in the memorandum where the disclosure of said data conflicts with a statutory instrument or prevents, restricts or distorts competition;<sup>95</sup>
- Where it allows sectoral contracting authorities not to indicate the object of or quantities related to awarded research and development activities, should the disclosure of such data violate a trade secret. In those cases the contracting authorities however are under the obligation to provide data concerning all aspects of the publication.<sup>96</sup>

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

<sup>93</sup> Article 33, paras 4 and 5 of the LPP.

<sup>94</sup> Article 58a, para 3 of the LPP.

<sup>95</sup> Article 73, para 4 of the LPP.

<sup>96</sup> Article 118a, para 1 of the LPP.

<sup>97</sup> Argument by Article 33, paras 3 and 4 and Article 73, para 4 of the LPP.

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

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

## Special Public Procurements

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

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

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

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

**Limited or no access to official data however renders any measures against such violations impossible.<sup>99</sup>**

#### **Box 6. National Security and Maritsa Iztok 2 TPP EAD**

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

- (1) that with a decision of the government from 2004 the enterprise had been designated a 'strategic object of national importance', and
- (2) that the procurement involved classified information and special security measures.

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

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

### **3.4. JUSTIFYING PUBLIC BENEFIT**

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

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

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

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

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

### Box 7. Public Procurement in the Nuclear Sector

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

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

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

### Box 8. Planning of Public Procurement in the Energy Sector

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

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

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

### 3.5. CONTROL EFFICIENCY

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

#### Box 9. Kozloduy NPP

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

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

<sup>102</sup> PFIA Report No. ФИ1Вр-0006 of April 14, 2009, obtained pursuant to the *Law on the Access to Public Information*.



**Box 9. Kozloduy NPP (continued)**

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

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

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

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

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

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

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

### 3.6. CONTROVERSIAL FINANCIAL SERVICES

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

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

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

<sup>104</sup> See for example contracts nos. 00246-2008-19 and 00246-2008-20 under the Public Procurement Agency Register.

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

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

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

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

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<sup>105</sup> Article 4, para 3 of the LPP.

<sup>106</sup> Item 6 of Annex 2 to Article 5, para 1, item 1 of the LPP.

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

<sup>108</sup> Article 15, para 2, item 6 of the LPP.

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

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

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

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

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

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

<sup>110</sup> No. 01351-2008-0090 in the Public Procurement Agency Register.

<sup>111</sup> No. 00428-2006-0033 in the Public Procurement Agency Register.

<sup>112</sup> Nos. 0026-2008-0040 and 0026-2009-0054. The procurement on Consultancy services regarding financial, economic and legal aspects of the NPP Belene is under No. 0026-2008-0101.

<sup>113</sup> Nos. 00246-2008-0235 and № 00246-2010-0010 in the Public Procurement Agency Register – both contracts were awarded through open procedures.

<sup>114</sup> Nos. 00246-2006-0074 and № 0075 in the Public Procurement Agency Register, awarded through negotiation following invitation on the basis of the pre-selection system.

<sup>115</sup> Nos. 00246-2007-0015 and 0016 in the Public Procurement Agency Register, awarded through negotiated procedure with a publication of a contract notice.

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

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

### 3.7. INDICATORS OF HEIGHTENED RISK IN PUBLIC PROCUREMENT

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

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

- **unwarranted increases in company costs** of energy producers and energy distribution companies over a certain period of time. Additional indicators for nuclear energy enterprises could be the higher exploitation costs compared to rates in similar NPPs operating in countries with open energy markets;
- **unwarranted decreases in company profits** accompanied by increased profitability of outsourcing or partners who have contractual relationships with these companies;
- **changes in management teams** following parliamentary elections without publicly stated and clearly defined arguments;
- **repetitive launching of public procurement procedures** for the award of identical services/supplies/construction works;

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