

## PROJECT FINANCE

# Bulgaria

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### SECTION 1: Market overview

#### 1.1 Please provide an overview of the project finance market in your jurisdiction.

The market is currently dominated by a trend of restructuring and refinancing of existing projects. Lenders, sponsors and in some cases responsible government bodies are seeking to develop or restructure existing projects that have refinancing needs. Local commercial real estate, energy and renewable energy projects have been subject to restructuring and in some cases the consolidation of lenders' syndicates. There have been no greenfield renewables projects due to local requirements that restrict power generation. Notable refinanced projects include a natural gas project and several real estate projects (shopping centres). The State is mainly involved in developing large road and railroad infrastructure projects and improving water treatment facilities, financed through the State budget and the European Structural and Investment Funds.

The local lending market has been in a standstill during 2016 and beginning 2017, as the results of a recent country-specific asset quality review and banking system stress test have had a dampening effect over lending. Some of the local subsidiaries of Greek lenders, which are generally highly active in the country, have also been holding their liquidity potential because of pending consolidations and acquisitions initiated by their parent banks. These factors contribute to a slow local project finance sector.

The nonrecourse finance as a typical form of project finance (PF) is not generally available in the Bulgarian market. PF transactions usually range from limited recourse to full recourse for the project sponsors.

There has been one significant bond issue, subscribed by some institutional investors, as well as by a regional development bank, for the purposes of modernising the electrical grid in northeast Bulgaria. There have been some small-scale bond issues in the agriculture and real estate sectors and one for the modernisation of a power plant.

#### 1.2 What is the composition of the market in terms of the types of active lending institutions and has this been evolving?

Typical PF structures in the country involve small syndicates and club deals. In terms of lending institutions, the market is composed mainly of

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Reneta Petkova leads the Deloitte Legal practice in Bulgaria. She has over 26 years' professional experience and is recognised by the eminent legal directories as a leading lawyer in Bulgaria. Her main area of expertise includes: project finance, asset finance, acquisition finance, structured finance, corporate lending and restructuring, capital markets, banking regulations and compliance, M&A, privatisation and foreign investments.

Prior to joining Deloitte, Petkova acted as managing partner and senior partner at CMS Cameron McKenna, Bulgaria; senior associate with Hayhurst Robinson Law Firm; head of legal department for United Bulgarian Bank; chief legal adviser for Bank Consolidation Company; and legal adviser to the management board of the Bulgarian National Bank.

Petkova graduated with an LLM from Sofia University Faculty of Law. She is member of the Sofia Bar Association and International Bar Association and a registered mediator. Her specialisations include: Georgetown University Law Center, Washington DC, LLM-Visiting Researcher, 2001-2002 – Banking and Securities Regulation; International Banking Institute, Sofia and Chartered Institute of Bankers, London, 2000, Banking and Finance Programme; and International Financial Law, 2009, Cambridge University, UK.

commercial banks (usually local subsidiaries of European banks), international financial institutions and export agencies, as well as, to some extent, venture capital funds and other forms of collective investment, including private equity funds.

### **1.3 Please describe any major current projects or initiatives that are influencing activity.**

Significant recent projects include an equity finance of a precious metals mining undertaking, an equity participation in a major bio foods factory, a debt facility to a major municipality for integrated infrastructure investments and an electrical grid renovation project, among others. New projects have been financed mainly by international development banks and funds.



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Yoana Zhechkova has over 10 years of professional experience and is a dual (Bulgarian and English) qualified lawyer under the Qualified Lawyers Transfer Scheme. Her main areas of expertise include banking and finance, M&A and real estate. Prior to joining Deloitte, Zhechkova was a senior associate in the international banking and finance department at CMS Cameron McKenna (Sofia), a secondee in the CEE loan syndication team at UniCredit (London), a legal counsel with the Bulgarian Telecommunications Company and an associate in Hayhurst Robinson Law Firm.

## **SECTION 2: Transaction structures**

### **2.1 Please review some recent notable transactions involving your market and outline any interesting aspects in their structures.**

The equity PF for the purposes of precious metal ore concession development in Bulgaria (see above) was provided to a dedicated vehicle in the country of origin of the concession holder, which in turn provided the funds to a dedicated subsidiary (mining company), while selling a derivative financial instrument on future ore. The transaction is notable in terms of materiality for the local market, as well as in terms of publicity.

The refinancing of an existing natural gas water transportation project is a notable deal. As is a syndicated loan consolidation from a syndicate to a single lender, involving a refinancing of part of the exposure towards a large shopping mall in Sofia. Both these deals being typical examples for the refinancing and restructuring activity that has become the local trend.

### **2.2 What might the projects above mean for the market and have you noted other noteworthy developments in the way project finance transactions are being structured for a) energy projects and b) infrastructure development?**

Private energy projects are financed by local and international banks. Large state developed energy and infrastructural projects need significant EU funding support to start and complete development.

## SECTION 3: Legislation and policy

### 3.1 Describe the key legislation and regulatory bodies that govern project financing in your jurisdiction.

There are no Bulgarian laws that are specifically intended to regulate PF. Nevertheless, a number of legislative acts hold general relevance to PF:

- The Credit Institutions Act governs the authorisation, licensing, activity, supervision and winding up of credit institutions.
- The Obligations and Contracts Act governs contractual relationship, the establishment of regular security, including mortgages and pledges.
- The Special Pledges Act – the establishment of registered pledges.
- The Spatial Development Act governs spatial development, construction and restrictions on ownership for development purposes.
- The Currency Act governs cross-border transfers and payments.
- The Financial Collateral Arrangements Act defines the perfection, contents and effect of financial collateral arrangements.
- The Concession Act regulates the grant of concessions for use of public property, as well as public private partnerships (PPPs) to the extent that they relate to concessions for construction or provision of services.

Depending on the type of PF transaction, the parties may also have to comply with sector-specific legislation, such as the Energy Act, the Subsurface Resources Act, the Public Offering of Securities Act, the Competition Protection Act, etc.

Due to the lack of dedicated legislation or any approval/registration regimes for PF, there is no dedicated government authority designated to govern transactions of this kind. Nevertheless, there is a multitude of authorities involved in different stages of PF. The Public Procurement Agency governs the procurement relationship of the parties, where the relevant PF transaction involves public funds. Secured debt financing may require perfection of the established securities by way of registration with the Central Registry of Special Pledges (CRSP), the Commercial Register, the Property Register or the Bulgarian Patent Office. Equity financing would typically require notification to the Competition Protection Commission and/or the Financial Supervision Commission, if a prospectus is necessary.

### 3.2 Have there been any recent changes to regulations or regulators that may impact the finance structuring in terms of guarantee and security regimes, local currency rules and foreign investment restrictions?

The Special Pledges Act recently went through a comprehensive overhaul, which sought to modernise the CRSP, improving accessibility for creditors and third parties.

Effective July 1 2017, the Commercial Act was amended to include a procedure for the stabilisation of over-indebted companies. The procedure aims to prevent insolvency by reaching agreement between the company and creditors regarding performance of the obligations, so as to enable continued commercial activity.

No foreign investment restrictions apply, that differ from such existing restrictions in the EU.

### 3.3 Please describe the regime governing renewable energy investment.

Development of renewable energy sources (RES) projects is regulated by



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the special Renewable Energy Sources Act. Since 2012, new power generation capacities from RES that intend to benefit from a FIT (see below in 3.4) are subject to an annual quota principle. Bulgaria has reached its EU targets for RES. Therefore, new generation may be developed if the power is offered on the free market or for own consumption. Since 2018, the major share of the power generated from RES that is not subject to FIT must be offered on the free market only through the National Energy Exchange.

### 3.4 Does your jurisdiction have incentive schemes in place for various types of energy or infrastructure project development?

Bulgaria initially adopted a feed-in tariff (FIT) and guaranteed purchase of the power generated from RES. This incentive scheme was subsequently restricted by the quota principle. The major conventional power generation installations benefit from long-term power purchase agreements (PPA). Large infrastructure projects are designated as projects of common interest and generally enjoy good political support. New incentives for electric vehicles are currently being developed.

### 3.5 Are there any rules, legislation or policy frameworks under discussion that may impact project finance in your jurisdiction?

No relevant concrete local discussions are publicly available. However, banking-specific regulatory requirements are increasing following the implementation of various EU regulations. As a consequence, banks are being required to reserve more capital on their balance sheets and ensure they have sufficient liquidity buffers, which undoubtedly influences long-term financing.

## SECTION 4: Market idiosyncrasies

### 4.1 Please describe any common mistakes or misconceptions that exist about the project finance market in your jurisdiction.

A common misconception can be seen in PF products that conventional commercial banks offer and advertise in the country. They are not necessarily classic PF structures. As mentioned above, non-recourse or even limited recourse finance is difficult to accomplish in our market and usually requires considerable research, assessment and risk mitigation. In some cases, lenders seek state guarantees to cover risks. However, due to state budget constraints and state aid rules, government guarantees are not usually available. Lenders are forced to provide a hybrid form of project-based finance that combines PF and corporate finance techniques. Ultimately, the sponsors are required to undertake some form of recourse obligations where the extent of the recourse depends on the project risks.

### 4.2 What measures should be taken to best prepare for your market idiosyncrasies?

Project management, quality and coordination of the consulting teams is pivotal for avoiding operational difficulties and risks. From a lenders' and borrowers' perspective, it is important to have trusted advisors in each jurisdiction with market-specific knowledge. Knowledge sharing and education of international teams about the local specifics is also a key prerequisite for a successful transaction.

## SECTION 5: Practical considerations

### 5.1 How established is the legislative framework and authorities that govern PPPs and where have PPP structures most successfully been applied?

The Public-Private Partnership Act was repealed as of January 1 2018, because of its alleged functional ineffectiveness. There is currently no indication that the legislator intends to draft a new framework to regulate PPPs. However, Bulgarian law has not left PPPs unregulated. The newly adopted Concessions Act targets PPPs and allows an economic operator to carry out construction or other services, commissioned by a public entity by way of concession for the construction or concession for services.

Bulgaria has traditionally used public procurement and concessions to establish PPPs. There is already significant experience in such structures. From 2018, major PPP projects will be legally developed through concession agreements. Governing authorities are the Council of Ministers and competent ministers, for state concessions, and municipal councils and the mayors for local PPPs. Recently, through the establishment of the Fund of Funds, the state has created some potential for PPP structures. Most notably, the Fund of Funds operates the Fund for Urban Development, which focuses on projects for improvement of urban infrastructure and energy efficiency.

### 5.2 What are the key considerations relating to foreign investment into projects as regards insurance and tax structures?

The project company secures insurance at their expense, typically. Both

construction and operation insurers provide insurance for core risks, including loss or damage to assets, construction-all-risk insurance and third-party liability insurance.

The key tax consideration when structuring a project finance deal is usually with regards to possible withholding tax on the interest payments made in Bulgaria by the project vehicles. Bulgaria is very well positioned with multinational and bilateral tax treaties. Most notably, common tax structures involve the use of favourable tax treaties that Bulgaria has in place with the Netherlands, the UK, Malta and Luxembourg.

### 5.3 Are there any specific issues creditors should be mindful of regarding a bankruptcy and restructuring scenario?

The general drawback of Bulgarian insolvency proceedings is the slow rate of advancement, with creditors often having to wait years to recover receivables. The timeframe may be extended even further by the introduction of recovery plans, which the court is under statutory obligation to review.

The short term afforded to creditors to submit a claim to their receivables in the relevant court is another issue. The total term is three months and starts at the date of registration of the proceedings with the Commercial Register. The brevity of the term is made even more inconvenient by the fact that Bulgarian law imposes no obligation on any actor in the insolvency procedure to inform creditors that the term has started to run. It is important to note that the insolvency procedure, once initiated, is the single, universal creditor enforcement method, meaning that generally no other enforcement procedure is available once a company is declared insolvent by virtue of a court decision.

Restructuring, remains largely unregulated, including in terms of tax legislation, transfer and/or forgiveness of debt. Lack of clear restructuring and taxation rules, as well as authority oversight and case practice, create legal uncertainty. It is thus necessary to keep away from untested scenarios and remain conservative in developing structures. While a common trend in Bulgaria, the restructuring of existing projects has certain local particularities, including unsophisticated participants and a general lack of trust between the different players.

## SECTION 6: Outlook

### 6.1 What are your predictions for the next 12 months in the project development and financing sector and how do you expect legal practice to respond?

While we look forward to the next 12 months in hopes that the market will support some new projects, we predict that significant infrastructure will continue to be procured and financed by the State and EU structural funds, while new power generation capacity will be held back by their specific requirements and restrictions, which might result in no greenfield projects. On the other hand, these factors can potentially lead to M&A activity, which would require refinancing of existing projects or their restructuring.

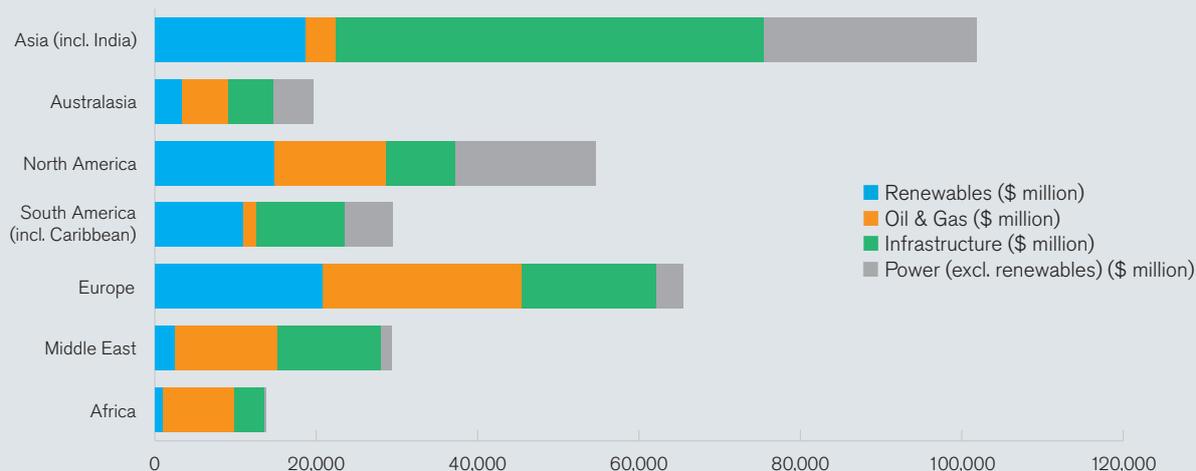
New energy infrastructure might be an area to look forward to, as certain cross-border projects could be initiated in the area. Refinancing and restructuring could further develop as a trend during the coming year, including in the real estate and energy sectors.

# Year in numbers

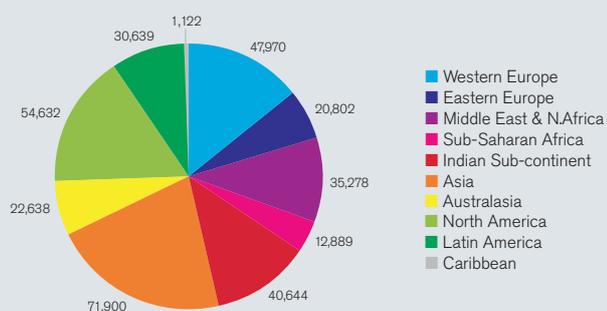
Some key statistics on project financing during 2017

Source: Dealogic. Data period: Jan 1-Dec 31. Value: \$ million.

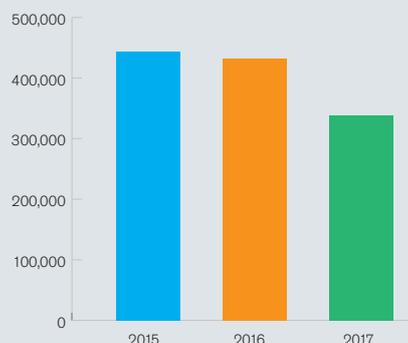
## Biggest four sectors by region 2017



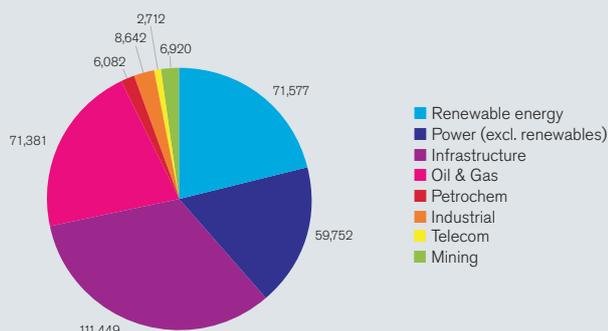
## By region in 2017



## Totals 2015-2017



## By sector in 2017



## Top 10 countries for project finance 2017

Country	\$ million	No. of deals
US	43 871	128
India	38 264	279
China	33 585	24
Australia	22 472	52
Indonesia	17 922	19
Russia	16 611	3
UK	13 640	46
Brazil	13 330	149
Canada	10 761	28
Mozambique	10 393	3