



Directorate C: National and European Accounts

Luxembourg, 24 SEP. 2007
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Subject: Methodological treatment of transactions related to the concession for building a tolled motorway from Kalotina to Bourgas (Trakia motorway)

Ref.: Your letter dated 18 February 2005
Our letter ESTAT/C-3/EB/LP/gr D(2005) 30069 dated 29 March 2005
Your letter received on 29 December 2005
Our letter ESTAT/C-5/JV/EBC/np D(2006) 50019 dated 7 April 2006
Your letter dated 3 July 2007

Dear Mr Todorov,

Following your letter of 3 July 2007, I am in a position to reply to the question you asked on the appropriate statistical classification for the case you have presented.

The accounting issue for which a clarification is requested

The issue for which an opinion is being sought is a determination of the correct treatment in national accounts of transactions related to the concession of a tolled motorway from Kalotina to Bourgas (Trakia motorway).

Documentation provided

Together with the above-mentioned letter, the Bulgarian statistical authorities provided Eurostat with a document (hereinafter referred to as "Addendum") containing changes introduced to the original concession agreement.¹ It is recalled that the original concession agreement had also been subject of a request by the Bulgarian authorities (dated 18 February 2005) for an ex-ante advice by Eurostat (provided on 29 March 2005).

Description of the case

It is understood that the concession contract involves tolls payable to the concessionaire by users of the motorway, but with the specificity that government will pay "deficiency payments" in a manner to guarantee some minimum target revenue to the concessionaire.

¹ "First addendum to the agreement on awarding a concession in respect of the national road "Kalotina – Sofia Ring Road (North Arch) – Orizovo – Stara Zagora – Nova Zagora – Yambol – Karnobat – Bourgas", Exclusive State property, dated 29th of March 2005".

To recall from the Eurostat letter of 7 April 2006, the main features of the contract are the following:

- A private company ("Trakia Motorway AD" - 49% owned by two 100%-State-owned companies, 51% by a Portuguese consortium) has signed a concession with the Bulgarian State to build a new motorway stretch and to refurbish existing roads.
- The "concession contract" will run for 35 years. Trakia will have the sole right to levy tolls on the motorway, but the Bulgarian State will retain legal ownership.
- On expiry of the concession the motorway will be transferred to the Bulgarian State with no payment to Trakia.
- Furthermore, the Bulgarian State will pay to Trakia amounts relating to the passage of trucks over 12 tons, whilst the existing vignette system operates.
- If the concession is terminated early by the Bulgarian State for certain reasons, the State will make a termination payment to Trakia equivalent to all outstanding debt for the project (interest and principle) plus fees/costs/expenses.
- No concession fee is mentioned specifically in the documents provided, though we understand from press reports that there will be a concession fee payable by Trakia.

In the original contract, the deficiency payments were designed to ensure a minimum total return on the project, which caused Eurostat to indicate that the motorway assets were on the government balance sheet. This design is abandoned under the amended contract.

Compared to the original concession agreement, the main changes are the following:

- The concessionaire will be responsible for the provision of the motorway according to the specification set out by the Bulgarian government and by the agreed deadline. Not meeting this deadline will result in fines to be paid by the concessionaire to the Bulgarian government (amendments to the art. 48 of the original contract).
- In case parts of the highway are closed for the traffic, the concessionaire will be financially liable for such closures (newly introduced art. 58a).
- The calculation of deficiency payments paid by the Bulgarian government to the concessionaire will be based on a difference between the negotiable fixed target revenue amount and the cash revenue actually collected by the concessionaire (amendments to the art. 40).
- All revenues, including amounts of deficiency payments, should be used in first place for the purpose of repayment of the amounts due under the loan agreement which is coordinated by the Bulgarian government (amendments to the art. 40).
- The concessionaire's right to deficiency payments is limited to until full repayment of the loan agreement (amendments to the art. 40).

It is assumed that the loan, referred to in the amended art. 40, is only coordinated and not granted by the Bulgarian government.

Methodological analysis and clarification by Eurostat

After an examination of the provided documentation, Eurostat has reached the following provisional views.

Applicable accounting rules

The operation has a nature of a concession, structured with certain government guarantees, in such a manner that the main resources of the operator might originate from government payments (notably through the deficiency payments mechanism). To that extent, the relevant Eurostat ESA95 Manual on government deficit and debt (MGDD) chapter is the one on "Long term

contracts between government units and nongovernment partners (Public-private partnerships)". Therefore, the classification in national accounts would need to be undertaken on the basis of distribution of risks.

Availability of national accounting analysis

The Bulgarian statistical authorities in their letter of 3 July 2007 consider that the changes introduced by the Addendum reduce the risk exposure of the Bulgarian government in the project and that the construction and the availability risks are borne by the private partner of the concessionaire company. No conclusion is submitted with respect to the demand risks distribution.

Analysis

Deficiency payment and nature of the contract

Eurostat takes note that some aspects of the deficiency payments of the initial agreement, which had *de facto* the nature of government guarantees, were changed by the Addendum. The concessionaire has not any longer a right to a deficiency payment until the end of the concession, but only until the redemption of the loan under a specific loan agreement. Besides, under the Amendment, the deficiency payments are now capped to (negotiated) fixed target revenue and will not be function of the costs incurred by the concessionaire.

However, it is not known to Eurostat how and according to which criteria the amounts of target revenues for the purpose of the deficiency payment calculation will be fixed, and on which level².

Separately, it is also worth noting that the concessionaire will be receiving another payment from the Bulgarian government: substitution payment for the passage of the trucks over 12 tonnes.

In this context, it would seem that if the amounts of target revenue are set on the high level, the amount of deficiency payments and of substitution payments could exceed 50% of the revenue of the concessionaire. This would then indicate that the concession contract has in fact a typical PPP character, and a full analysis of the transfer of risks (construction, availability, demand) would then be necessary.

Analysis of PPP risks

Eurostat considers that the construction risk under the amended concession agreement seems indeed borne by the concessionaire, in particular with the amendments to article 48 and article 94 of the original agreement. The obligations of the concessionaire refer to building or renovating a motorway according to the specifications, assuring required quality and bearing full responsibility for the organisation and safe performance of the works.

In addition, the amendment to article 40 provides that the deficiency payment obligation starts upon the date of entry into service of the toll system (motorway), and the amendments to the article 94 of the agreement foresee financial penalties to be paid by the concessionaire if the construction of the motorway was not completed by the agreed deadlines due to reasons attributable to the concessionaire (or when the toll collection system has not been implemented).

Furthermore, it is understood by Eurostat that the loan agreement, while coordinated by the Bulgarian government, is not granted by government but by financial institutions.

² The Addendum does not describe the way the target revenue will be fixed, but refers only to an Appendix 40 of the agreement, which was not made available to Eurostat.

Concerning the availability risk, Eurostat observes that the new article 58a introduces also fines, to be paid by the concessionaire, in case parts of the motorway are closed for the traffic. However, the limits of acceptable closures of highway stretches, stated in article 58a(1) and 58a(3) seem at a high level. In practice, such a high limit would mean that the concessionaire would *de facto* hardly be liable for the payment of fines on closure. In addition, exposure of one party or the other to the availability risk will also depend on the level of the fixed target revenue and deficiency payments.

Finally, it is also not clear, from the provided documentation, if the concessionaire will be receiving deficiency payments in case of closure of the highway or parts thereof (e.g. lanes). Thus, Eurostat considers that it is questionable if the availability risk has been transferred to the contractor, rather than remaining on the side of the Bulgarian government.

Concerning the demand risk, the changes to the agreement seem to move some of it to the side of the contractor. In both draft agreements, the concessionaire can reap the benefit of a high traffic. However, after the Amendment, the concessionaire is less protected to lower traffic, because deficiency payments: (1) expire at redemption of the loan agreement; (2) are now capped to the (negotiated) fixed target revenue.

However, it is not known how and according to which criteria the amounts of target revenues for the purpose of the deficiency payment calculation will be fixed, and on which level. In this context, it would seem that if the amounts of target revenue are set on the high level, the amount of deficiency payment could become large (exceed 50% of the concessionaire revenue) which would indicate that the demand risk has not been sufficiently transferred.

Finally, it should be noted that termination payments in case of termination attributable to the concessionaire can have the feature of a guarantee, with the effect of modifying the assessment of risks transfer. These should be carefully assessed. In this context, it would seem important to know what does the term "all investment costs", used in the newly introduced art. 105 under 2.1.a) and 2.2.a) of the Addendum, exactly mean, i.e. cost of investment agreed between parties and capped under the investment programme, or actual total outlays incurred with no limit set beforehand by the parties.

Conclusion

On the basis of the above considerations, Eurostat considers that the motorway assets could be recorded in the national accounts outside the general government sector (as a conventional concession), if the mechanism of deficiency payments is designed to merely provide some supporting guarantees and is not expected to constitute a major part of the concessionaire revenue.

In case of expectation of noticeable deficiency payments, the contract should be considered instead as being of a PPP nature, with insufficient risk transfer to the contractor, with the consequence that the motorway assets would be recorded on general government balance sheet in national accounts.

In the case the Bulgarian statistical authorities elect to classify those assets outside the general government sector, Eurostat advises them to closely monitor the financial flows between the Bulgarian government and the concessionaire, in order to calculate the share of the deficiency payments in the concessionaire revenues.

Procedure

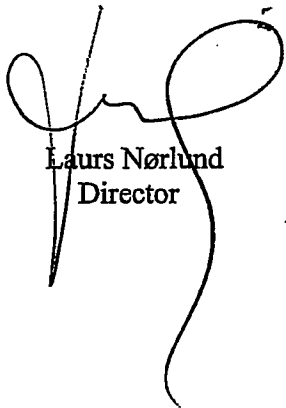
There is no explicit Community legislation which governs a procedure by which Eurostat gives its views on operations which have not yet been enforced. Nevertheless, Eurostat is prepared to give a preliminary view on the statistical classification of such operations provided that it is in

possession of all of the necessary background information. The preliminary view is given in accordance with the guidelines for ex-ante advice published on the Eurostat web-site.

This preliminary view of Eurostat is based on the information provided by the country authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view. To this end Eurostat would request to be informed of the final details of the operation (contract and accompanying papers where relevant) when they are available, or (should this be the case) information that the planned operation has been abandoned.

In this context, we would like to remind you that Eurostat is committed to adopting a fully transparent framework for its decisions on debt and deficit matters in line with the amended Council Regulation 3605/93 and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC. Eurostat, therefore, publishes all official methodological advices (ex-ante and ex-post) given to Member States, on the Eurostat web site. In case you have objections concerning this specific case, we would appreciate if you let us know. In any case (regardless of whether you have objections or not) we would like to receive an answer from you on the issue no later than 21 September 2007.

Yours sincerely,



Læurs Nørhund
Director