

NATIONAL REPORT

Bulgaria



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State Owned Enterprises: Preventing Corruption and State Capture The case of Bulgaria

Sofia, November 2017

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1. GENERAL NATIONAL OVERVIEW ON SOE

This report is based on an analysis of legal documents regulating the activity of state-owned enterprises in Bulgaria, on 21 structured interviews with experts regarding the activity of state enterprises in various industries¹, five in-depth interviews², data from the Commercial Register, websites of the 11 enterprises included in the comparative study, media publications concerning the enterprises included in the study, official reports concerning the management of state-owned enterprises, statements from a round-table discussion of the expert group on the topic³, held on July 4, 2017.

1.1. LEGISLATIVE OVERVIEW

1.1.1. Analysis of the legal framework

The current legal regime of state-owned enterprises in Bulgaria is a hybrid one, insofar as this matter is regulated by both commercial law and public law.

There are two types of state-owned enterprises:

The first type is established under the Commerce Law and has the legal form of incorporation of any other company: state-owned enterprises can be either a single-owner limited liability company – *EOOD*, or a single-owner joint stock company – *EAD*⁴.

The second type is incorporated and regulated by a special law, and it is not formally considered a company⁵. This type of company cannot declare bankruptcy⁶. An example of such an entity is *Holding BDZ EAD* (the Bulgarian Railway Company).

State-owned enterprises with company status must comply both with common commercial regulations and with a special code – *Code of procedure for the exercise of government rights in companies with state participation*⁷, i.e. the basic principles regulating this type of state enterprise – with company status – are governed by secondary legislation.

Regardless of the type of enterprise, however, the state must observe EU state aid rules, in order to prevent SOEs from enjoying undue benefits in comparison to private competitors and to affect competition.

1. The interviews now total 26, but the data analysis was already completed when the remaining 5 were submitted. They will be taken into account in the final text of the report.

2. The interviewees were: member of two Bulgarian Parliaments – former Deputy Prime Minister and Minister of Economy and Minister of Foreign Trade; former Minister of Economy in a caretaker government; two independent experts, from Industry Watch and CSD; former member of Parliament and Chair of a leading NGO in the field of economics, currently a scientist in academia

3. Round table held on July 4 2017, Hotel Sense, Sofia.

4. Commerce Law, Art. 61 and 62.

5. CL, art. 62 (3): State-owned enterprises which are not companies may be formed with a law.

6. CL, art. 612 (1): No bankruptcy proceedings shall be instituted for public enterprise merchants exercising a state monopoly or established by a special law.

7. <http://www.lex.bg/laws/ldoc/2135467843>

Provisions in the *Rules of organization and procedures for the exercise of government rights in companies with State participation*⁸ preventing the abuse of public authority

There are propitiatory clauses restricting participation in the management bodies of state-owned enterprises indicated in Section VI; however, conflicts of interests are not discussed.

It is specified that the term of appointment for the management is of up to 3 years, while management positions are occupied through open calls for applicants (according to current regulations). Candidates are required to submit business plans for the entire management cycle and for each year of operation (Art. 28.)

There is a requirement for regular submission of written reports, Art. 23, "concerning the results of the implementation of the company's business plan, the financial and economic state of the company, problems and measures taken to solve them."

There are wage caps for members of the management bodies, calculated in relation to the average wage, i.e. there are caps on the salaries paid to managers, management bodies and comptrollers.

What aspects of the Rules are problematic and what remains covered therein?

The most important issue is that there is regulation which allows overriding in case there are other types of provisions stipulated other laws.

The *Rules* provides too much power to the sole owner – the State. The principal decides on the strategic development of the company, the appointment of management bodies, and the distribution of profit, therefore there are significant legal prerequisites for the managers as well as for the board of directors to act as a proxy for the sole owner.

There are no clear procedures for exercising public scrutiny and for applying the principle of transparency to the management of public enterprises. There is no indication or written provision of compliance with international standards for good corporate governance (e.g. the Organization for Economic Cooperation and Development - OECD, the GRI). There are no explicit guidelines for the standardization of financial reports and precise requirements for annual reports; for example, the enterprise's aims and policy for financial risk management are not mentioned in the *Rules*.

It should be noted, however, that recent requirements standardize the basic financial indicators to be reported to the Ministry of Finance. The Law amending and supplementing the Law on Public Offering of Securities⁹ introduces a requirement that the stipulations under chapter 6 'A' related to disclosure of Information are also applicable to: persons whose activities are regulated under the Energy Act and the Act on the Regulation of Water Supply and Sewerage Services by the Energy and Water Regulatory Commission, state-owned enterprises under Art.

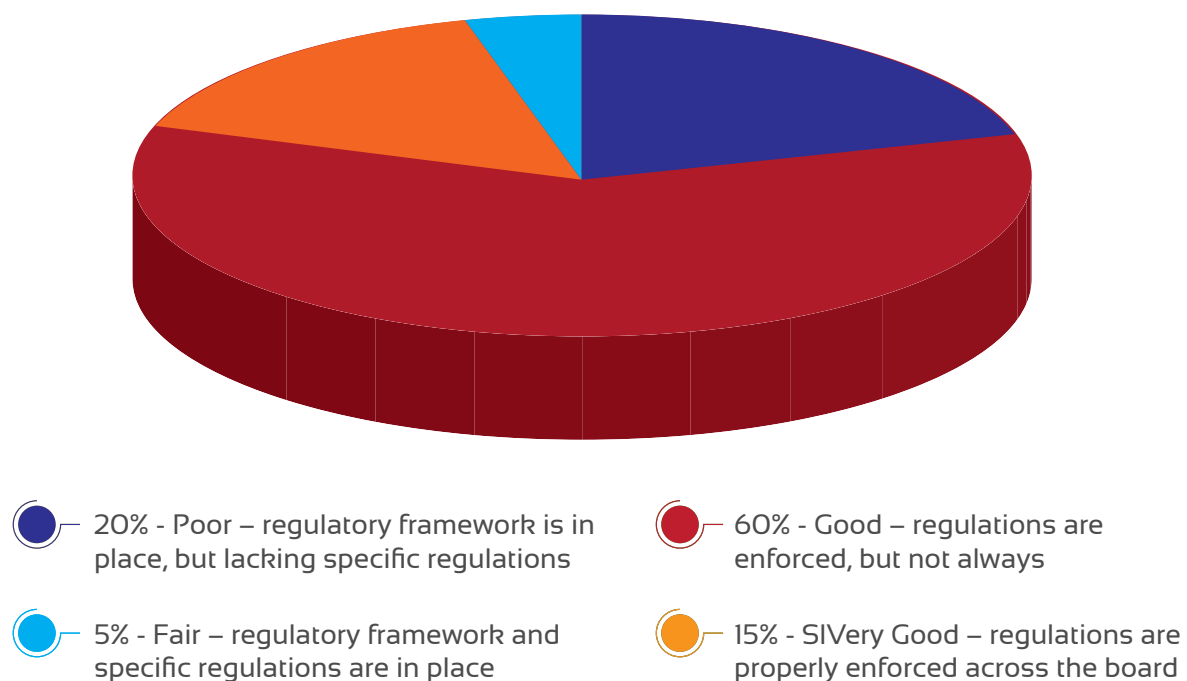
8. Adopted with Communication of the Council of Ministers No. 112 on 03.06.2003 and revised multiple times. Hereafter referred as Rules.

9. § 1d, subparagraph 1 of additional provisions of LPOS, promulgated State Gazette issue 42 on 03.06.2016

62, paragraph 3 of the Commerce Law and companies where the state or municipal authorities hold more than 50% of the shares. A specialized financial media portal, Infostock AD, was contracted to publish the required information as stipulated in the legal provisions. However, only the reports of Toplofikacia Sofia EAD are available on the website of Infostock.

1.1.2. Evaluation of the quality of the legal framework regarding the state-owned enterprises in the study

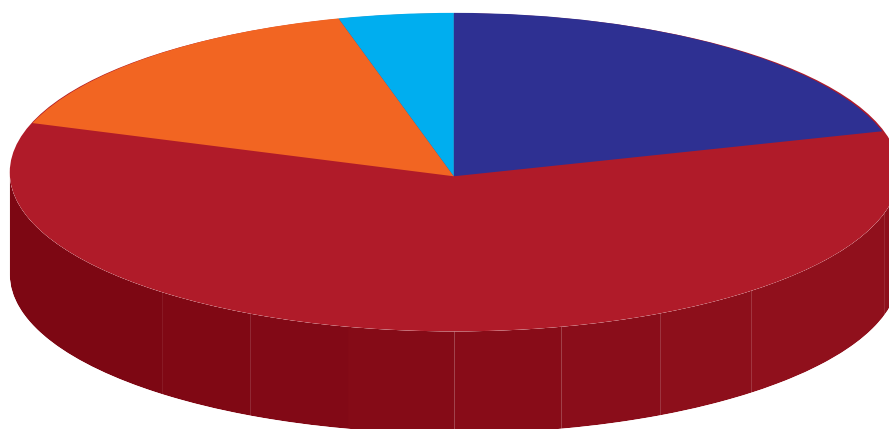
Quality of the legal framework at national level



While no respondent indicated that a legislative framework is lacking altogether, only one person stated that the legal framework is both good and properly enforced. The main problem according to the respondents is the **lack of compliance with the existing legislation**.

This problem stems from a lack of effective supervisory mechanisms – these mechanisms exist *de jure*, but not *de facto*, as reflected in the responses to the following question:

Evaluation of the quality of the supervision mechanisms concerning state-owned enterprises



● 15% - Poor – no mechanism in place

● 70% - Fair – mechanism is in place, but not functioning

● 5% - Very Good – mechanism is functioning well

● 10% - Good – mechanism is in place, but applied to only some SOEs

The question *“Are there any cases of sanctions applied to the Ministry for mismanagement?”* got to following answers: 62% – No; 24% – Yes. 14% – No answer.

Once it is established that the regulation has no requirement for transparency, it comes as no surprise what responded replied to the question: *“Are international standards for good corporate governance applied – those of the OECD and the GRI?”*

None	67 %
Example provided	19 %
No answer	14 %

In fact, 81 per cent of the responses were negative. There were 4 responses indicating examples concerning businesses certified by ISO, FSC, and other standards. There were reports on the implementation of business plans, and one concrete example – the Bulgarian Posts.

To **summarize the following issues were identified in the legislative framework** on the basis of the analysis of the documents and interviews:

- Lack of synchronization of the various laws and regulations, contradictions within the regulations.
- Governance through secondary legislation – legal rules and procedures,

ordinances, letters, administrative orders. Management through administrative orders given over the telephone were often mentioned.

- Lack of regulation for the application of international standards for good corporate governance (OECD and the GRI).
- Ineffective mechanism for appointing and control of the management bodies.
- Lack of effective supervision and control mechanisms.
- Issues when convicting personnel in senior management positions for misconduct in office due to the principle of collective responsibility.
- Very vague regulations applicable to municipal enterprises.

1.2. MAIN CHALLENGES

The survey identified the following challenges:

		Responses	Percent of Cases
§q3all(a)	Political challenges	15	71,4%
	Financial challenges	11	52,4%
	Management challenges	14	66,7%
	Non-existent legal regulation	4	19,0%
	Other	3	14,3%

The analysis highlighted the following:

There are intricate and multi-layered challenges for state-owned enterprises in Bulgaria and commercial joint ventures where the state holds shares. They start with the state's involvement in the business, namely the absence of any framework analysing the state's role in a business. Bulgaria currently lacks procedures to help decision makers identify whether state participation is required in a specific business or in a particular industry. There is no serious public debate on this issue, while any voices raising it are rejected *a priori* as purely ideological. An inevitable consequence of the absence of well-founded reasons for state's involvement in a sector through a business entity is also the absence of well-founded criteria to determine the success of such involvement – including from a financial, economic, or social perspective.

Stemming from these problems, there is a second layer of challenges related to the framework of governance of state participation in economic activities. There is no clear and objectively identifiable regulation of how state-owned enterprises should be managed. There are no clear principles for determining the form of incorporation of the enterprise - such as whether it should be a private limited company or a public limited company - or, in the latter case, how the size of the state's share ownership should be determined. There are also no established criteria and procedures for appointing the management, as open competitions are optional and almost never occur in practice. As a consequence, the responsibilities for business operation become blurred, and, in

many cases, ownership is shifted repeatedly between multiple government authorities, which, of course, puts stress on their management and results. In some cases, this shift is due to the unwillingness of any public authority to undertake responsibility for the results of the enterprise or company. In other cases, it is due to competition between the public authorities on who is going to take the lead.

The third layer of problems relates to accountability. Financial accountability exists for all state-owned enterprises, as it is formally required by law and they cannot conduct their operations in a manner different from other, non-state enterprises in the country. Financial reporting is mandatory by law with respect to tax collection and is subject to control by several state institutions. The level of detail and public availability of financial statements varies widely between state-owned enterprises. This is not the case, however, for economic accountability, where both their activity and the effectiveness of their reporting are of concern. The scarcity of this type of reporting significantly hinders any assessment of their social and economic performance, particularly in terms of the achievement of the objectives set for them by their owner.

The combination of these three layers of challenges leads to a fourth layer of problems, which regards the ability of both the State and its citizens to evaluate the effectiveness of the activity. Typically, direct involvement of the state in certain industries is justified as fulfilment of a social function or national interest (including national security), but there is no set of indicators to measure these functions. Most often, when the state has shares in a business in a certain industry, it does it as monopoly, making comparative analyses of its effectiveness difficult. Neither the legislation nor judicial practice indicate any understanding that because of their public ownership, state-owned enterprises are subject to different standards of transparency and confidentiality than other private companies.

1.3. PERSPECTIVES/ GOOD PRACTICES

Overall, there was only one example of good governance provided during the expert and in-depth interviews, mentioned by two respondents: Metropolitan EAD Sofia. The seven-factor evaluation of the analysed SOEs indeed qualifies Metropolitan EAD-Sofia as a 'good performer' with a total average rating of 3.63 out of 5. It was rated well for control – 4.13 – the highest score in the study, as well as for transparency of management and for access to data.

To address this need, this section will present views on the possible prospects for improving the management of state-owned enterprises. There is consensus concerning the following further steps:

1) 1. Assessment of the need for SOEs

An **overall assessment, after public debate, of the need for and relevance of state-owned enterprises by sector.** It should be determined which SOEs are required to remain and which are not. But the question is who should be making this assessment and whether there's need for a new, expert, independent authority with a voice in solving key issues regarding state-owned enterprises. Again, there is consensus

concerning the need to **establish a public body – a Council of management of state-owned enterprises**, comprised of representatives of NGOs with experience in relevant industries and sectors, independent experts, and academics. This Council would receive the annual reports of state-owned enterprises and would intervene in case of critical situations in the sectors and industries where there are SOEs.

2) **Formulation of well-designed strategies for economic development of industries, with clear priorities**

Opinions are divergent on this topic.

3) **Transition to a market strategy – through a radical or moderate alternative. The radical alternative**, described in two of the in-depth interviews, **requires privatization of all state-owned enterprises based on the assumption that competition is the only stabilizing strategy.**

The moderate version requires issue of shares at the stock exchange (public offers) – at least 20% to 50%.

4) **Adoption of the Act on Public Enterprises (a draft of the Act was developed in 2014 and presented for discussion, but was not submitted to the National Assembly¹⁰).**

The objectives of the Act are as follows:

Art. 2.1. Creating proper conditions for the achievement of state policy for sustainable development of public enterprises in the course of their commercial activity and in the execution of tasks assigned to them for the provision of services of public interest, including in social, healthcare and environmental protection matters; 2. A clear distinction between the commercial activity and the social functions and roles of public enterprises. 3. Striking a balance between the autonomy of SOEs and their control mechanisms in order to enhance the efficiency of their management. 4. The establishment of clear rules, criteria and procedures for the appointment of candidates for the management and control bodies of public enterprises; 5. Public control through the implementation of the principle of transparency in the management of public enterprises.

The discussions and the interviews indicated support for the following:

Art. 2, para. 3: A share of the profit which remains to be determined shall remain at the disposal of the management of the enterprise, in order to ensure an invested interest in its development and the utility of business plans

Art. 2, para. 4: Establishing the principle of open competitions [in employing personnel]; making business plans compulsory; issuing an annual public report on the overall development of the enterprise and the implementation

10. The bill is available at:
<http://www.strategy.bg/PublicConsultations/View.aspx?lang=bg-BG&Id=1335>

of the business plan; more detailed regulations of conflicts of interest.

Art. 2, para. 5. Standardisation of indicators for reports, to include not only economic indicators, but also transparency and good corporate governance indicators, including those of OECD and GRI; regulation and control aimed at maximum public disclosure of these data and reports – on the websites of the business, on particular media outlets; transition to e-services, maximizing the number of administrative e-services.

5) Utilization of the capacity of the Audit Office to evaluate economic performance

To a significant degree, deficiencies in economic accountability of SOEs in Bulgaria can be addressed by utilization of the existing capacity of the Audit Office to evaluate the finances of the enterprises from a formal and legal point of view, but also to make informed assessments of their economic effectiveness and, whenever required, social efficiency. There are internationally accepted methodologies for such assessments and their implementation can be a useful first step towards economic streamlining and disciplining SOEs.

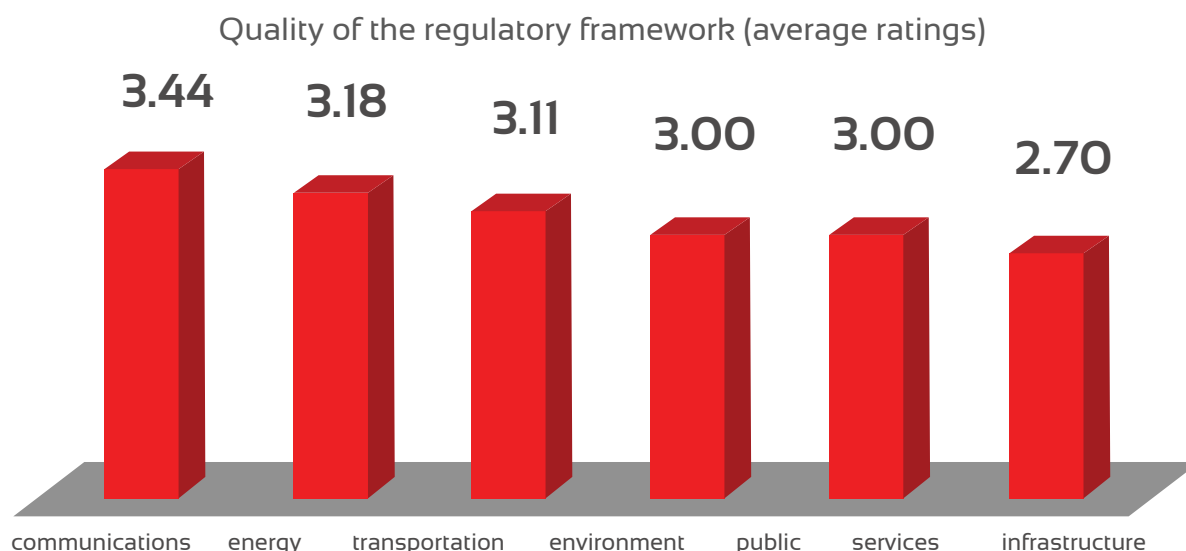
2. SECTORIAL COVERAGE OF SOE

2.1. SECTORIAL SPECIFICITIES

The sectorial regulation of non-company entities consists in special sectorial laws such as the Energy Act, the Forestry Act, the Law on Maritime Areas, Inland Waterways and Ports of the Republic of Bulgaria, the Railway Transport Act, the Regulation of Water Supply and Sewerage Services Act, the Civil Aviation Act, etc.

There are also a number of strategies for the development of relevant industries, for example, the Strategy for Development of the Transport System of the Republic of Bulgaria Until 2020; the Strategy for Development of Railway Transport in the Republic of Bulgaria and the Plan for Recovery and Development of “Holding BDZ EAD” for the Period 2015-2022; the National Strategy for Development of the Forestry Sector in the Republic of Bulgaria for the Period 2013-2020, etc.

Below is an illustration of the respondents’ evaluations of the regulation in each sector covered by the survey.



The interviews and discussions highlighted the respondents' belief that the problem is not the legal regulation - which is consistent with the current trends and EU regulations (for example, experts report that the Energy Act meets all necessary requirements) - but there are no control mechanisms for ensuring compliance with the regulations and there is a lack of synchronization of the various laws and regulations.

2.2. OVERVIEW OF SELECTED COMPANIES:

Table 1. Summarized information on the selected SOEs in Bulgaria

Company name	Size in 2014		Level of governance	Ownership structure
	Staff	Revenue (€ M.)		
Holding BDZ EAD (State Railway Company)	10 125	194	Central	100% Ministry of Transport, Information Technologies and Communications (MTITC)
NEC EAD (National Electric Company)	2 185	1 520	Central	100% Bulgarian Energy Holding (100% Ministry of the Economy)
Bulgargas EAD	49	787	Central	100% Bulgarian Energy Holding (100% Ministry of the Economy)
Bulgarian Posts EAD	10 794	66	Central	100% MTITC
Sofia Airport EAD	2 137	34.4	Municipal	100% MTITC
Port of Varna EAD	1 620	33.7	Central	100% MTITC
VIK Ruse OOD (Public Waters and Sewerage)	508	9.5	Municipal	51% Ministry of Regional Development and Public Works + 49% Municipalities

Toplofikacia Sofia EAD (District Heating Company)	2 354	254	Municipal	100% Sofia Municipality
Metropolitan EAD	1 572	28.7	Municipal	100% Sofia Municipality
The Southwest State Company	1 600	10.3	Municipal	100% Ministry of Agriculture and Foods
Avtomagistrali EAD		5.7	Central	100% Ministry of Regional Development and Public Works

The selected Bulgarian state-owned enterprises and companies¹¹ are very diverse, varying considerably in both staff numbers and revenue. There is no variation concerning one indicator, namely the ownership structure. In all cases it is 100% public, whether it is owned by a central government body (or by a company which is 100% state-owned) or by a local authority. None of them have any private minority shareholders. In general, this is characteristic of all enterprises in which the state or a local authority holds a majority stake – the state shares ownership with private entities only if it has a minority stake in a company. This in itself is critical to the way state-owned enterprises behave under the existing framework.

Additionally, in none of the cases is there any specific mechanism for monitoring, oversight or public control of the activity of these businesses, outside of the existing regulation described in the first part of the report.

Many of the surveyed enterprises exercise monopolies (NEC, Bulgargas, Sofia Airport, Port of Varna, VIK Ruse, Toplofikacia Sofia, Avtomagistrali). In other cases, there is competition – Bulgarian Posts, the Southwestern State Enterprise, Metropolitan (since there are alternatives, including private, for transport in Sofia). In the case of BDZ, the market position is mixed: part of the holding (BDZ Passenger Services Ltd.) is a monopoly, while the other (BDZ Freight Services Ltd.) competes with private businesses.

In terms of management challenges, all companies are in a state of indeterminacy regarding their management. This includes lack of clearly stated reasons motivating state ownership of the enterprise; vague selection criteria for the appointment of managerial staff; lack of definite performance metrics and indicators; lack of clear methods of evaluating the company's activity. In all cases, this leads to reduced efficiency and to opening opportunities for state capture and replacing the hypothetical public interest with private or personal interests (see below).

Some specific problems of individual enterprises are also of great significance. In the case of BDZ, this involves a history of decapitalizations and a lack of reforms, which jeopardize the operation of the enterprise and significantly restrict the current management's capacity for developing strategies and solving problems. This weakness is combined with a relatively frequent change of management, literally with every change of the ruling political party, as well as very serious levels of debt. The role of the state as the owner in this case is made increasingly difficult by the need to comply with European Union rules on state aid and the fact that many of the planned reforms must await approval by the EU authorities.

¹¹. Attached are the profiles of each of the enterprises evaluated based on the survey responses to seven key indicators.

In the case of NEC and Bulgargas, problems occur at several levels because they are held by a parent company (Bulgarian Energy Holding Company, 100% owned by the Ministry of Energy). Firstly, the very structure of the holding company effectively creates cross-subsidizing between different subsidiaries, so that the profitable ones end up financing the unprofitable ones, and thus the profitable ones reduce their growth rate, while the unprofitable have no incentive to reform. Secondly, while the holding's substantial debt is generated primarily by one of its subsidiaries (NEC), it is shared by all subsidiaries, even those that do not generate debt (Bulgargas). A third very important feature in the case of the Bulgarian Energy Holding is the serious interference in its strategic and tactical position by a powerful market player from a foreign country in the face of Gazprom and Atomstroyexport. There is clear evidence that one way or another these foreign companies, owned by a foreign state, intentionally influence the decisions made at the level of the holding company and at the level of NEC and Bulgargas and, thus, interfere with their management. There is no doubt that this is a case of state capture of a Bulgarian SOE by a foreign state, in which the hypothetical Bulgarian public interest is replaced by the interest of foreign businesses and foreign power players.

When SOEs are facing competition from private businesses, weaknesses in government management negatively impact efficiency and profitability in the long term. This applies to Bulgarian Posts and BDZ Freight Services. In these cases, the state as an owner is considerably slower in terms of capital investment and the implementation of efficiency-enhancing practices and innovations, which has resulted in a clear downward trend in market share of the respective companies over the years. These circumstances make the question of the necessity of the state's involvement in the respective production processes even more pressing, but the structure of state ownership leaves this issue principally unanswerable, leading simply to reproduction of inefficiency.

Sofia Airport EAD is the largest state-owned airport in the country and a hub for the national carrier – Bulgaria Air, owned by one of the largest economic conglomerates in the country, which currently has a debt towards the airport. In 2011, the International Court of Arbitration in Paris ordered the airport to pay a large sum of money to Kuwaiti-Saudi firm MAK/ADMAK as a result of a contract signed in 2003 for the construction of a new runway, which was completed in 2006. The delay in the construction of the runway was due to a delay in the procedures for land acquisition for the runway.¹² Currently, the airport owes 71.2 million BGN; 25.5 million BGN seized in the non-operational bank CCB are irretrievably lost. According to a report in *Capital* from 01.07.2017, *"state-run 'Sofia Airport' is increasing revenues, but because it devalued its 25.5 million BGN loan from Corporate Commercial Bank (CCB), it wraps up 2016, an otherwise strong year in flights and passengers, with 13.8 million in losses."* The airport follows the "model" of most state-owned enterprises: with the change of government comes a change in leadership, which postpones payment of the debt. There is evidence of a conflict of interest, the Executive Director of the airport in the period 2006-2010 and briefly appointed again by the government in 2017 Plamen Stanchev Dimitrov is co-founder of the company Cargo Handling Services, which is a registered company delivering ground handling services. Plans for concession of the airport are cancelled by one government and renewed by the next. However, the purpose of the concession is not to strengthen the airport, but to

12. The case is described in "Case Law" attachments.

repay the debts of BDZ. Of the expected revenue of at least 1.2 billion BGN, 550 million would go to the payment of the debts of BDZ, says Finance Minister V. Goranov in 2016. The government of 2017 stops the concession on the grounds that the public interest was not well protected, and this decision is supported by trade unions. At the moment, renewal of the concession offers is again on the agenda. The airport website is designed entirely for passengers; there is no information available about the company.

Port of Varna EAD since 1996 has the status of port operator (port services under article 116, paragraph 2, line 2 and line 3 of LMSIWPRB), port for public transport of national importance and outer border of the European Union as of 2007. Its capital stock is in the amount of 8, 493, 571 BGN, distributed in 8, 493, 571 registered shares, each with a value of 1 BGN. The site reports that Port of Varna EAD is the only port in the Black Sea region with a successfully implemented and internationally certified Integrated management system, covering all aspects of the activities of the organization related to quality (ISO 9001:2008), environment (ISO 14001:2004), occupational health and safety (BS OHSAS 18001:2007). The company meets the requirements of the ISPS Code. Varna East and Varna West Port Terminals have a Certificate for Operational Fitness. The website contains a lot of information, including information on public procurement – announcements, procedures, contracts. The biggest scandal involving the port was in 2001, when, as head of the Board of Directors 21-year old Delyan Peevski was appointed - one of the most controversial figures in Bulgarian public life, dismissed soon because of lack of education credentials. According to the German researcher Jürgen Roth, the port is “run” by the economic conglomerate TIM. There are statements in the interviews that illegal and unregistered cargo (to and from Bulgaria) pass through it, but so far there are no official legal proceedings. The port’s website is currently a model for transparency. The questionnaires qualified it as being subject to state intervention to the highest degree.

Toplofikacia Sofia EAD is a municipally-owned enterprise. This is the only company whose executive director received a sentence, for financial violations revealed in 2006. There were charges of money laundering, tax evasion and mismanagement, but only the mismanagement and excessive waste charges were confirmed. The former CEO Valentin Dimitrov is currently serving a three-year sentence. It is claimed that the CEO committed asset fraud (draining the company assets) through parallel import of unnecessary equipment at prices several times higher than those already delivered by the World Bank and the International Bank for Reconstruction and Development. After the arrest of the director in 2006, a letter by Dimitrov from custody was released to the press, in which he was seeking the assistance of certain individuals, some mentioned by initials only. The letter contains the text *“What happened to the help from R. Ovch.! I have always helped him so far!!!”* hinting at links to an eminent party leader of the Bulgarian Socialist Party and a former Minister. Without being direct evidence, this is a sign of party and state interference in the company and a sign of corruption. Currently, the website of Toplofikacia is also a model for transparency – everything is uploaded, including the company’s financial statements from 2013 onwards; all licenses, certificates, legal regulation, etc. This may be the result of the court sentence.

Southwest State Enterprise DP (SSE DP) was established on the grounds of Art. 163 of the Forestry Act, in conjunction with Order No. RD 49-106 of 13.04.2011 and Order No. RD

49-210 of 04.06.2011 of the Minister of Agriculture and Foods. The enterprise manages the public forest territories in seven administrative areas – Blagoevgrad, Kyustendil, Sofia city, Sofia province, Pazardzhik, Pernik and Lovech. It includes 40 territorial units, of which 35 public forest reserves and 5 public hunting reserves. The total area of forest areas included in the Southwest State enterprise is 934 968 hectares, of which 686 310 are state forest areas (73.4%).

There is evidence of clientelistic practices and lobbying (in the interviews and in the media). Starting out in a managerial position in the summer of 2012, Eng. Damyan Damyanov was Director of SSE DP between 2014 and 2017. He is the former head of the state hunting ground "Vitoshko - Studena", a former employee of State Security and - according to the information system DAXY - he is part of the management of the *"Bulgarian Game Association"* along with Valentin Zlatev from Lukoil, Hristo Stoichkov, Todor Batkov, and others. In 2009, while he was Director of state-owned hunting area *"Vitoshko-Studena"*, employee reports place Damyanov under audit by the inspectorate of the Executive Forest Agency and the Public Financial Inspection Agency. The audit covered the period from the beginning of 2005 until 30.06.2009 and because of violations in public procurement contracts he was issued 24 sanctions for administrative violations, as well as one for the hunting area as a legal entity. After some time, he was removed from his position as the Director of the hunting area 'Vitoshko-Studena", but was replaced by his wife Sashka Damyanova. As of 30 June 2017, SSE DP has a new director, Hristo Rangelov, aged 30.

Avtomagistrali EAD was established in 1994, registered under the Commerce Law. In the beginning, ownership rights were exercised by the Minister of Transport, and as of 1997 by the Ministry of Regional Development and Public Works. Its scope of activity is the maintenance of highways in the country and operation of road projects, and their respective bases and facilities. The public procurement contracts are of considerable values, and according to some media reports, they are not always announced through open tenders. This company also undergoes regular change of management with the change of governments – since 2009 at least five executive directors have been replaced. Two of them, including the current director, are former associates of the State Security services. Some of them were fired or dismissed after major highway accidents, e.g. a snow blockade that left thousands of people stranded on Hemus highway in 2012 and the collapse of Echemishka Tunnel in February 2017.

As we noted, **Metropolitan EAD** is the state-owned enterprise rated best by respondents. We see this as no coincidence, due to the following: firstly, Metropolitan provides an important service to all citizens of Sofia. However, secondly, it is in competition with other modes of transport. Thirdly, it is under the control of the municipality, and since 2005 there have been no changes in the mayor's political support (GERB). Fourthly, whether because of the lack of political changes, or thanks to the professional competence recognised by many, the Executive Director of Metropolitan, Prof. Stoyan Bratoev has been in office since 1999, a unique longevity for this type of position. He has been working in the Metro business his entire life; he graduates with a major in *"Bridges and tunnels"* from Saint Petersburg University, specializing in *"Tunnels and Undergrounds"*. Until 1982 he was technical manager of one of the first metro stations in Sofia; a part-time

lecturer since 1996 and as of 2012 a Professor at the University of Mining and Geology "St. Ivan Rilski", authoring many publications in this field. It is worth noting that he is the only manager of a company included in our list who responded to our questionnaire in writing. The company is also partially funded by EU programmes. It is certified for quality and the certification is posted on the site: *"Metropoliten has introduced and put into practice a system of quality management, which includes operation of Sofia Metro and investment activities (organizing survey, design, construction, and investment control over the new metro sections), in compliance with the requirements of BDS EN ISO 9001:2008"* (certificate, registration number TRBA 100 0690, issued by TUV Rheinland.) The website is well maintained, with plenty of information, announcements of public procurement bids, procedures and implementation of public contracts; financial statements are not available.

3. IN-DEPTH CASE ANALYSIS OF STATE CAPTURE AND CLIENTELISM

3.1. CAPTURE MECHANISMS DESCRIBED IN THE IN-DEPTH INTERVIEWS AND OTHER DOCUMENTED SOURCES

The existence of all problems and challenges concerning management and operation of state-owned enterprises in Bulgaria creates a favourable environment for their capture and subordination to interests other than the collective interests of the citizens. Fieldwork in the case of Bulgaria shows several different types of such capture in the country.

The first type of capture noted is perhaps not among the most pertinent or thoroughly analysed, but may be of particular importance in the context of former socialist countries. It can be defined as *"ideological"* capture and consists in utilizing the existence of and especially the monopoly position of state-owned enterprises to promote a particular ideology at the expense of other ideologies regarding the preferred order of social relations in a society and in a specific context. In the public domain, often, the very fact that the state has always participated as owner of an enterprise in a given area of business, and that it is indeed a monopoly, preventing any empirical observations of private enterprises in that area, is used as an argument favouring state involvement as the natural solution for all contexts in the given society, while arguments that other arrangements of social relations in this area may be desirable or even possible are rejected *a priori*.

Thus, the very existence of SOEs, which in the context of a former socialist country is the only historical experience in a number of areas of production, serves as the ideological basis for their continued existence, as well as an ideological attack on alternative ideas and proposals. In the public eye, this gives a definite advantage to a specific set of ideological positions at the expense of alternative ideas, and, effectively, state enterprises are being captured and used for the purposes of validation and success of these ideologies at the expense of others in public debate. In this way, the rationale for the existence of the enterprise to serve a public interest is undercut, and instead it serves to impose a particular ideology in public debate.

Secondly, respondents outlined the possibility of political capture of state-owned enterprises. This can be defined as exploiting the existence and management of SOEs for the attainment of political and power-related purposes. State property and the status of certain politically affiliated government bodies as owners of companies may be used for political purposes such as coercing the adoption of certain policies associated with those currently in power, or coercing votes for a political candidate, or establishing a public image that contributes to re-election, even if it is to the long-term economic detriment of an enterprise or company. In these cases, the aim of re-electing certain players in political elections at the expense of the ability for others to be elected, displays the objective served by some state enterprises and companies with regard to public interest.

Another example of this type of capture is the use of SOEs with the aim of gaining access to decision-making positions affecting the management and regulation of the state and its policies as a whole. A particularly vivid illustration of such an approach of reaching decision making positions via state-owned enterprises is the strategy employed by trade unions in Bulgaria. They use the citizens' historically acute sensitivity concerning the protection of "*labour*" from the attacks of "*capital*" to impose mass and monopolistic membership in a given syndicate of as many SOE employees as possible. This is in contrast to the private sector, where private owners are not willing to serve such causes, because it is clear to them how this can harm competitiveness and financial and economic indicators. These two priorities are of considerably less importance in state-owned enterprises and companies and their heads are significantly more likely to allow the mass presence of unions. As a result, the membership of trade unions in Bulgaria is almost completely dominated by the state sector.

In turn, this wide membership is the only reason for the trade unions to sit on the National Council for Tripartite Cooperation, involving the State, trade unions and employers. Despite its purely advisory role under the law, *de facto* this body is also used by trade unions and by employers as a mechanism for imposing their preferred policies and decisions on society as a whole. In short, it is used as a means to exercise power over society.

The power of trade unions in state-owned enterprises is also utilized to exercise power, i.e. by coercing independent persons to obey orders and decisions. This means the opportunity for a Minister of a given sector to administratively extend collective agreements to all enterprises in the sector, even those whose workers explicitly refuse such a collective agreement. So, as long as there is even one SOE in a sector of the economy with strong unionization, they are able to negotiate a specific collective agreement from a position of strength and then, through pressure on the Minister, to impose this type of labour contract on the entire sector, i.e. exercise power over it, including all other employers and employees.

In this form of capture, rather than serving some public interest, and at the expense of their ability to do so, state-owned enterprises are used to promote political interests and the power ambitions of select groups and organizations.

Third arises the possibility of establishing party capture through the SOEs. This type of

capture is distinguished from the political-power type described above in that it explicitly aims to solve certain issues of party building for specific parties. Here the structures of government enterprises primarily serve the career development and job placement of people loyal to or important to the party. This type of capture follows well established traditions of clientelism, such as access to economic resources – which in this case through state ownership of certain companies is used to promote the interests of the clients. An especially illustrative example in this respect is the trend for changes in political power to be accompanied by changes in the management of SOEs, which in turn is followed by the replacement of lower-level staff. The higher management levels of enterprises and companies provide the faithful party cadres with both high wages and a platform to develop business relationships and a network of influence. The issue at lower levels is simply to ensure pay for party loyalists.

The main problem with this practice is that the selection of the people is not on the basis of merit as entrepreneurs, managers, or employees, but on the basis of their biography and political allegiance. Insofar as the financial and economic success of the company, and presumably the achievement of the social or national cause it is tasked with, depend on the staff's business and economic prowess as opposed to their party affiliation and loyalty, such a skewed selection inevitably causes inefficiency and suboptimal outcomes. The tendency for frequent partisan staff changes in SOEs produces a similar consequence.

Ultimately, the availability of an opportunity for parties in power to use state-owned enterprises to build and reward party loyalty and clientele support also entails that no party is impartial to the question of whether a given economic activity needs (from the point of view of some public interest) to be done through the state, or can be left to the normal private market relations. Even if, in the abstract, the impartial response to this question favours privatisation, the possibility of party capture tilts the scales towards the socially inefficient state-dominated solution, which, in the long run, wastes scarce public resources. In this form of capture, individual party interests usurp the state-owned enterprises and displace the hypothetical public interest that should be served.

The next form of capture drawn from the Bulgarian experience is corporate capture. In it certain private businesses take advantage of state-owned enterprises to ensure their own profitability at the expense of the state. These are well known schemes of preferential binding of state enterprises with certain suppliers or preferential treatment of certain clients. This type of capture happens primarily when public procurement contracts are set up to enable the offeror to manipulate the procedures and ensure the selection of pre-determined participants. There many cases of procurements conducted by SOEs where it is widely known in advance who the tender is designed for, and who, and on what conditions, will win. In general, the result is that the state enterprise buys more expensive and lower-quality materials and means of production than it would in conditions of fair competition. In turn, this means that its spending inflates while generating profits for preferred suppliers, and its own financial and economic results decline accordingly.

With respect to the preferential treatment of clients, perhaps its most common form is the selective decision of the state enterprise or company not to seek repayment of

the debts of some of the clients. When this happens, the state enterprise effectively finances its private client for a period of time, which can be very long, and the debt is often rendered uncollectible. If such behaviour is selective, it puts different clients under different conditions and corrupts the competitive environment down the production chain, thus introducing global inefficiency in the allocation of resources in the economy. Therefore, such behaviour of state-owned enterprises not only negatively affects their own financial and economic results but also impairs the efficiency of the sector as a whole.

In this form of capture, the interests of certain private players that share production chains with state-owned enterprises replace the hypothetical public interest which those enterprises should pursue.

Finally, a fifth form of capture of state-owned enterprises and companies is purely private, in which select individuals use some of the features of these businesses to their personal advantage. The main features which allow for abuse are lack of clear objectives, lack of responsibilities, lack of and assessment of outcomes and economic efficiency. This lax environment significantly enables possibilities of more or less sheltered personal enrichment/personal gains. They range from misuse/misappropriation of the resources of the undertaking or company to achieve personal benefits to outright theft and asset fraud of the business's stockpiles. In some cases, the resources of the state enterprise or company are purposefully misappropriated (drained) and channelled into parallel private companies (although usually hidden) owned by people within the state enterprise. When this private capture occurs, it negatively affects the financial and economic efficiency of the business. In this case, the hypothetical public interest that a state enterprise should pursue is traded for purely personal interests and individual gains.

3.2. CAPTURE MECHANISMS IDENTIFIED BY JUDICIAL OR AUDIT INVESTIGATIONS RESULTING IN FINAL COURT RULINGS OR FINANCIAL CORRECTIONS

Case title	Case Against Valentin Dimitrov, former CEO of Toplofikacia Sofia EAD
Summary Case details (company involved, sector of activity, accusations, damages)	<p>SOE involved and sector of activity: Toplofikacia Sofia EAD Toplofikacia Sofia EAD is the single owned stock district heating company serving the City of Sofia, Bulgaria.</p> <p>Accusations: The former CEO of Toplofikacia was indicted on three separate accounts: currency crimes, money laundering and mismanagement (excessive waste of company assets), including through malfeasance in office and violation of the Public Procurement Act in 17 contracts for advertising materials. He was acquitted of the first two accounts for currency crimes and money laundering.</p> <p>Damages: Mismanagement of company assets in the amount of 325 693.95 BGN and asset misappropriation fraud (draining) as CEO of Toplofikacia for almost 6 million BGN (cca. 3 million EUR.)</p>

Key facts of the case – incidents, key actors, description of the criminal mechanism set in place (max. 250 words)

Key actors: Valentin Dimitrov, former CEO of Toplofikacia –Sofia.

Description of the Criminal mechanism:

Valentin Dimitrov is the defendant in several cases. He was acquitted in two and received conviction in the third case.

1. The first is a currency fraud case. Dimitrov is accused of executing financial transactions on the territory of Kufstein (Austria) in the period from 20.10.1999 to 25.06.2003 which he failed to report, in violation of the Bulgarian law. During this period Dimitrov made transactions for 4 868 155 BGN. The First Instance Court found Dimitrov guilty, but after the case reached the Sofia City Court, the court file disappeared. Three years afterwards the case is returned to the prosecution but the judge's instructions are highly questionable. According to the investigation, the delay is intentional in order for some of the money transfers for which Dimitrov is accused to benefit from the statute of limitation.

2. In the summer of 2009 the Supreme Administrative Court sentences Dimitrov at the first instance to 14 years of imprisonment for money laundering and orders the confiscation of his personal property for asset misappropriation fraud of Toplofikacia in the amount of 6 million BGN. The court judgment however is very poorly written (in fact, it is copied from the indictment). Therefore, the decision is overturned and the sentence is overruled by the Sofia Administrative Court at the second instance in 2012.

3. The third case concerns mismanagement and waste of assets owned by the company. In its decision, the Supreme Court of Cassation states that "the accused failed to exercise due care for the management, protection and proper use of the company assets entrusted to him." The charges are for waste (careless expenditure and consumption), more concretely for „daily deliveries of large quantities of food and non-food products, in an assortment and variety of articles incompatible with the company's [work], delivered predominantly to Valentin Dimitrov's personal office. [...] The accused has neglected his duties for due care, protection and proper use of the assets entrusted to him when he signed a lease for a new vehicle LEXUS RX-300 despite the already available 200 company automobiles, as well as in signing a contract with the advertising agency Ultra Net EOOD in violation of the public procurement regulations and without preliminary requests for price quotes which resulted in paying the supplier additional 66, 455.60 BGN above the average market price."

The Prosecutor's Office has successfully proven that in the period 2003-2006 the former CEO was making luxury purchases, which he reported as „business expenses". Some of these involved, for example, a jet, a jacuzzi, huge amounts of confectionery, expensive cheeses, alcohol, various accessories, medicines, nutritional supplements. In 2005 alone over 52 000 BGN were spent on such purchases, while the District Heating Company had serious difficulties in collecting receivables from its debtors for the same period.

On July 5, 2017, the Sofia City Court denied Valentin Dimitrov's motion for early release on the grounds that he did not show rehabilitation.

Decisions (if available) Sentences/ fines/ confiscation and freezing of assets (max 200 words)

Court decision/Trial ongoing:

Decision of the Supreme Court of Cassation from November 2015 confirming the verdict of the first two instances. Dimitrov was sentenced to three years' imprisonment which was reduced by one year on account of the time he spent in detention.

Against Valentin Dimitrov there is an administrative sanction in force. In the spring of 2011, the Supreme Administrative Court finally confirmed the tax-audit act, according to which Dimitrov had to pay 1, 417, 023 BGN in fines.

Confiscation/freezing of assets: For one of the cases in 2009 the court ordered confiscation of Dimitrov's entire property, but in 2012 the Sofia Administrative Court overruled it at the second instance.

Key consequences or implications of the case (max. 200 words) Similar cases and decision /administrative measures	<p>Similar cases and/or cases derived from the initial investigations:</p> <p>In one of the cases the prosecution investigates Krassimir Georgiev and his business in the energy sector. For a short time Georgiev was a business partner with the mother of Valentin Dimitrov in the company "Bansko Properties 2". The investigation found a money transfer from Georgiev's company to a bank account of the former CEO of Toplofikacia in Austria. Ultimately, however, the investigation against Krassimir Georgiev was terminated because he claimed the transfer was a loan.</p> <p>Administrative measures taken by SOE: -</p> <p>Administrative measures tutelary authority: -</p> <p>Policy measures - preventive (if available) -</p>
Details on the company involved (political links – of the company and/or suppliers other contracts with the state, operational	<p>Data on the company involved:</p> <p>Details about suppliers:</p> <p>Political links (company/suppliers): After Dimitrov's arrest in 2006, a letter he sent from the detention facility reached the press. In the letter Dimitrov is asking some individuals for help, but citing only their initials. The letter reads: "What happened also with [the promised help from] R. Ovch! I have helped him so far!!! ", alluding to connections with an infamous party leader of the Bulgarian Socialist Party who is also a former minister. This is, without being direct evidence, a sign of political and state interference in the company, as well as a sign of corruption.</p> <p>Other contracts with the state:</p> <p>Still on the market: yes</p>

Case title	Case Ref. No 15178 / EC / GZ / GFG, MAK / ADMAK against Sofia Airport EAD
Summary Case details (company involved, sector of activity, accusations, prejudice)	<p>SOE involved and sector of activity:</p> <p>Sofia Airport, Transportation</p> <p>Accusations: Sofia Airport owes the Kuwaiti-Saudi association MAK / ADMAK money for the construction of a runway due under a contract signed in 2003; the construction work was completed in 2006. The delay in the runway construction was due to protracted procedures for land acquisition in Bulgaria.</p> <p>Prejudice: Sofia Airport must pay 71.2 million BGN; 25.5 million BGN of the company's frozen assets are lost after the Cooperative and Commercial Bank (CCB) went bankrupt.</p>
Key facts of the case – incidents, key actors, description of the criminal mechanism set in place (max. 250 words)	<p>Key actors: Sofia Airport (SA), Kuwaiti-Saudi association MAK / ADMAK</p> <p>Description of the Criminal mechanism: This is a case of non-payment of money owed due to mismanagement and careless use of the company assets. One of the reasons for this situation are the frequent changes of the top management of SA. Hoping to win the case in the Bulgarian courts, in full awareness of the fact that this is not possible with a standing ruling of the International Court of Arbitration (ICA), SA decides to hire the Aviora Consult law firm, bypassing the Bulgarian public procurement law. The law firm also works for Mr Delyan Peevski, a notorious public figure. SA paid the law firm 610,000 BGN (VAT excluded).</p>

**Decisions (if available)
Sentences/ fines/
confiscation and
freezing of assets
(max 200 words)**

Court decision:

On 28.09.2011, the Tribunal of the International Court of Arbitration at the International Chamber of Commerce in Paris issued a final arbitration judgement Ref. No 15178 / EC / GZ / GFG, according to which Sofia Airport EAD must pay to MAK / ADMAK the following amounts: the sum of USD 30, 253, 617.06 (after deduction of the amount for damages, set at USD 166, 337); interest based on different amounts of the said sum (the amount of LIBOR plus 1.5%), calculated for various payment periods; USD 390,000 representing the portion of the deposit for arbitration costs paid by the plaintiffs; GBP 4,997,582.77 representing the litigation costs incurred by the plaintiffs. The Court also ordered SA to pay immediately to MAK / ADAC the two Guarantees issued by Gulf.

Sofia Airport filed an appeal, but three Bulgarian courts (Sofia City Court, Sofia Court of Appeals and the Supreme Court of Cassation, which issued a final decision dated 03.02.2017) confirmed ICA's ruling. Consequently, SA has to pay 71.2 million BGN to MAK/ADAC. This amount comprises 46.4 million BGN for the principal, almost 10 million BGN in interest, 11.5 million BGN for lawyers' fees of the plaintiff (which comes close to 5 million GBP), additional court fees as well as 3 million BGN in VAT.

Confiscation/ freezing of assets:

The bank accounts of SA in 3 Bulgarian banks are frozen. One of these accounts is in the bankrupt Corporate and Commercial Bank from which SA lost 28.6 million BGN. SA also incurred losses from interest in the amount of 10 million BGN. In 2016 a complaint of MAK / ADAC stopped the concession procedure for Sofia Airport until the debts are repaid.

**Key consequences or
implications of the case
(max. 200 words)
Similar cases and
decision/ administrative
measures**

Similar cases and/or cases derived from the initial investigations

Administrative measures taken by SOE:

Paradoxically, this situation and the heavy debts of SA have led to plans for expansion of the airport and to increase in the company's profits.

Administrative measures - tutelary authority:

Pending are plans for concession of the Airport, which successive governments have either put on hold or pushed forward. However, these plans have nothing to do with stabilizing SA but aim to pay off the debts of the state-owned Bulgarian Railway Company (BDZ). According to a statement from 2016 by V. Goranov, the finance minister, the reported profit of the airport's concession is expected to reach 1.2 billion BGN of which 550 million will be used to cover the debts of BDZ. In 2017, the caretaker government cancelled the concession procedures on the grounds that the public interest is not well protected; the decision was supported by the trade unions. Currently, new plans for concession of SA are discussed.

Policy measures - preventive (if available)

Details on the company involved (political links – of the company and/or suppliers other contracts with the state, operational

Data on the company involved:

Sofia Airport is the biggest Bulgarian airport and a key junction for the national carrier, Bulgaria Air (owned by one of the biggest Bulgarian economic groups, TIM.) There is an ongoing conflict between the Airport and Bulgaria Air because of past due fees which Bulgaria Air has failed to pay and the airport's plans to raise airport fees.

Details about suppliers:

Kuwait-Saudi association MAK / ADMAK (joint venture of Mohammed Abdulmohsin Al-Kharafi & Sons and Admak General Contracting Company)

Political links (company/suppliers):

The key problem is the airport's unpaid debts and the lack of feasible repayment options. Currently, the airport is profitable, but repaying this debt will melt off its assets. The court case has led to further losses, is also due to the frequent changes in the airport management made by successive governments. Instead of solving the problem, each new government has only postponed the case.

The case of the Sofia Airport is also an example of how management decisions for state-owned enterprises are made, that is, to solve a problem in another state-owned company. In this case, the concession of Sofia Airport will pay off the debts of BDZ.

Other contracts with the state:

Still on the market:

Yes

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