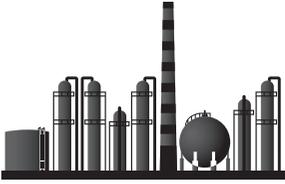


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THE GALATA GAS STORAGE PROJECT IN BULGARIA

The project for the second gas storage project in Bulgaria, namely the Galata gas storage project, is among the most important priorities of the energy sector of the country during the last 15 years or at least this is the impression from when we read the strategic documents of the sector. From a financial point of view the project is undoubtedly feasible. From a legal point of view the implementation of the project is possible upon the fulfillment of one legal option provided under the existing gas production concession agreement and upon the fulfillment of two conditions, which are stipulated in the Bulgarian legislation.





The Energy Strategy from 1999 provided for investments in securing the “long-term aims of the country ... including in the security of supply”. The Galata concession production agreement signed in June 2001, which is the first production agreement for substantial quantities of natural gas to be produced in the Bulgaria’s section of the Black Sea provides that upon mutual consent the production from the site could be terminated prior to the depletion of the deposit and prior to the expiry of the term of the agreement, which is 2026. Such termination could be done with the purpose of transformation of the site from a gas production to gas storage facility under terms and conditions for the use of the gas storage, which need to be agreed prior to the start of the transformation.

The Energy Strategy from 2002 goes further and points out the specific condition for the development of the gas sector “the transparent and sustainable regulatory regime” with the aim of “increase of the security of the supply” of the natural gas. The lack of substance of these declared priorities and the lack of fulfillment of the legal options has been clearly felt by all of us in January 2009, when the lack of a second gas storage facility and the lack of investment in the existing one in “Chiren” led to huge losses for our country during the first short gas crisis between Russia and Ukraine. As a result of this the declared priorities has indeed increased and the new Energy Strategy from 2011, as adopted by both the Government and the Parliament

specifically pointed out that “the Republic of Bulgaria will imply its best efforts to ... construct the second gas storage facility at Galata”, but even for those who are not following the gas regulatory matters in Bulgaria it is quite clear that this project has been practically frozen by series of Bulgarian Governments.

From economical point of view the project is undoubtedly feasible, as for its developments there is no need of any public funds to be spent (for a project exceeding 100 million EUR investment), it will increase by 300 percent the existing gas storage capacity of Bulgaria and its implementation could start immediately and to be completed within the next 2 years or so.

From legal point of view the implementation of the project is possible upon the fulfillment of one legal option provided under the existing gas production concession agreement and upon the fulfillment of two conditions, which are stipulated in the Bulgarian legislation.

The contractual option

The contractual option for the transformation of the Galata production field into a gas storage facility, as provided to the parties of the Concession production agreement to terminate the production and to negotiate the terms and conditions for the transformation of the gas production field into gas storage has been outlined above. This contractual option has been provided to the parties to the Galata

production agreement and if interpreted in relation to the other provisions of the agreement does not provide the right of the concessioners to (i) unilaterally terminated the production of natural gas and in principle to terminate the implementation of their contractual obligations in accordance with the Galata production concession agreement and/or (ii) to undertake unilaterally the transformation of the production concession into a gas storage facility. The transformation of the production concession could be implemented just only upon having the terms and conditions for the transformation agreed in advance between the parties to the Galata concession agreement. For the time being despite of the declared priorities by the Government and the Parliament, the Grantor of the concession rights has not expressed any willingness to exercise this contractual option. The legal authorities in Bulgaria also confirm that “the Concessions act does not provide for the option of any unilateral amendments to the concession agreement” (prof. Ivan Rushev, “The Concession agreement”, Sofia 1999, page 523).

If for a moment we assume that the written priorities of the Bulgarian Government and the real such are aligned, then the legislation provides for two follow up conditions for the implementation of the project.

The two procedural steps

The transformation of the production

Even for those who are not following the gas regulatory matters in Bulgaria, it is quite clear that this project has been practically frozen by several Bulgarian Governments



facility into a gas storage facility could be done in accordance with the applicable Bulgarian legislation upon the fulfillment of the following two procedural steps: (i) amendment to the existing production concession agreement, thus allowing the termination of the production of natural gas and transformation of the concession rights for production into concession rights for construction and exploitation of a gas storage facility, and (ii) provision of gas storage license to the concessionaires for maintenance of a gas storage facility in accordance with the Energy Act.

The amendment

The transformation of the concession could be completed by means of the amendment to the concession agreement on the grounds of the Concession Act (art. 70, para. 4, points 2, 3 and 5). The concession agreement has to be amended by means of an annex, which needs to be negotiated between the Government (the Minister of economy and energy) and the concessionaires. The parties will need to follow the terms and conditions, which are adopted in advance by the Government to the annex of the concession agreement for the purpose of the transformation of the concession. In accordance with the applicable Concessions Act such an amendment of a concession agreement with a preliminary approved terms and conditions by the Government, and initiated by the Ministry of economy and energy has been successfully undertaken in the case of the Decision for the Medet

tailings (Decision of the Government No 81 dated 7 February 2007 for providing the consent for the amendment to the concession agreement for the “Medet Tailings” on the grounds of art. 70, para. 4, points 2 and 3 of the Concessions act as published in the State Gazette, issue 16 dated 20 February 2007). In accordance with the Bulgarian legislation in order to apply for a gas storage license in the continental shelf of Bulgaria one need to have the only legitimate form of rights as granted under a valid concession agreement.

From the technical data, which are available to the Ministry of economy and energy it is evident that it is objectively it is impossible for the object of the concession agreement to continue to be actively utilized in accordance to its purpose and in such a way the amendment to the concession agreement could be made under the terms and conditions of art. 70, para. 4, point 2 of the Concessions act. The legal authorities explain this development as a “status in which the activities, which are being implemented under the scope of the concession agreement have been seriously affected” (Meglena Kuneva, “Comments and practices under the Concessions act”, Sofia 2000, page 223.). The amendment to the applicable laws is one additional ground for the transformation of the concession agreement in accordance with art. 70, para. 4, point 3 of the Concessions act. The Concessions act has been signed under the repealed Concessions act, which is providing



additions grounds for the transformation of the concession rights.

It should be noted that even in case that there is an agreement reached for the transformation of the concession rights, the concessionaires could become operators of the gas storage facility at Galata just in case that they have been given a permission for the construction and exploitation of a gas storage facility in accordance with the terms and conditions of the Energy Act.

A license provided by SEWR

In accordance with art. 21 of the Energy Act all licenses for gas storage shall be issued by the SEWRC. We need to take into consideration that there is no precedent for the issuance of a license for gas storage offshore Bulgaria, but there is such precedent for the onshore facility at “Chiren”. A necessary precondition for the issuance of such a license is the availability of rights by the applicant to the energy object (in accordance with art. 40, para. 1, point 2 of the Energy act), which could be property right, the right of use or construction right (art. 40, para. 2 in relation to art. 39, para. 3 of the Energy act).

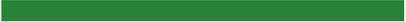
The gas storage facility is located in the Bulgarian continental shelf where Bulgaria is exercising its sovereign rights. In accordance with the Bulgarian legislation the concession agreements are providing to the concessionaires the rights to exploit the resources and in order for the transformation of the concession rights to

be successfully completed the state will need to provide the concessionaires with concession rights for the construction and exploitation of the gas storage facility and upon the amendment to the concession agreement the concessionaires will need to be provided with a license issued by the SEWRC in order for the concessionaires to become operators of the Galata gas storage facility.

In accordance with art. 172 of the Energy act the operator of the gas storage facility will need to provide access to the gas storage facility to third parties under equal terms and conditions. The access to the gas storage facility could be rejected in the following cases: (i) lack of capacity; (ii) if the access could lead to exceeding the technical limitations of the object; and (iii) in case where the access could lead to lack of implementation of the obligations to the society. The gas storage is considered to be a deal related with natural gas in accordance with art. 173 of the Energy act and a party to such a deal shall be the operator of the gas storage facility, i.e. the Galata concessionaires. In accordance with art. 185 of the Energy act the orders of the transmission system operator of the gas pipeline (Bulgartransgaz EAD) shall be followed by the operator of the gas storage facility. In accordance with art. 195 of the Energy act the operator of the gas storage shall take a decision about the position and the type of the metering devices, as necessary for the commercial deals related to the gas supply and gas storage.

Main conclusion

The construction of the second Bulgarian gas storage facility at Galata site is not only feasible and extremely important for the security of the gas supplies in a country, which is 90% dependent unilaterally dependent on the gas supplies from Russia, but also it is quite easy to be accomplished from legal perspective. The implementation of the outlined above legal terms and conditions for the construction of the future object are additionally made simpler by the fact that there are similar precedents, for the amendment to the concession agreement, as well as for the licensing of the first Bulgarian gas storage facility “Chiren”. The existing substantial administrative capacity at the Ministry of economy and energy of Bulgaria, as well as with the SEWRC additionally contribute to the opportunities for the implementation of the project in extremely tight deadlines in case that there is a real political will, which is expressed very clearly in all strategic documents of the energy sector in Bulgaria.



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