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CONFORMED COPY

LOAN NUMBER 4743 BUL

Loan Agreement

(Second Programmatic Adjustment Loan)

between

REPUBLIC OF BULGARIA

and

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

Dated June 17, 2004

LOAN NUMBER 4743 BUL

LOAN AGREEMENT

AGREEMENT, dated June 17, 2004 between REPUBLIC OF BULGARIA (the Borrower) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS (A) pursuant to the Loan Agreement dated February 21, 2003 (Loan No. 7158 BUL), the Bank has provided assistance to the Borrower in support of the first phase of the Borrower's program of actions, objectives and policies designed to achieve and sustain structural adjustment of the Borrower's economy during the period of 2002-2005 (the Program) as such program was described in the letter, dated December 20, 2002, from the Borrower to the Bank;

(B) the Bank has received from the Borrower a letter, dated May 3, 2004: (i) describing its macro-economic framework and the Program, as revised since the date of the letter referred to in (A) above, which Program consists of actions taken under the first phase referred to in (A) above, and actions and policies that the Borrower has already taken and adopted, in a satisfactory manner, as described in Section I of Schedule 3 to this Agreement, or intends to take and adopt in the near future (the Second Phase of the Program), as well as actions and policies that the Borrower intends to take and adopt prior to the subsequent phases of the Program; (ii) declaring the Borrower's commitment to the execution of the Program; and (iii) requesting assistance from the Bank in support of the Program during the execution thereof;

(C) on the basis, *inter alia*, of the foregoing, the Bank has decided in support of the Second Phase of the Program to provide such assistance to the Borrower by making the Loan in two tranches as hereinafter provided;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Loan and Guarantee Agreements for Single Currency Loans" of the Bank dated May 30, 1995 (as amended through October 6, 1999) with the modifications set forth in Schedule 4 to this Agreement (the General Conditions), constitute an integral part of this Agreement.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) “Anti-corruption Program for 2004-2005” means the Borrower’s anti-corruption program approved by the Borrower’s Council of Ministers’ Minutes of Proceeding No. 48, dated December 4, 2003;

(b) “Anti-corruption Strategy for 2002-2003” means the Borrower’s anti-corruption strategy approved by the Borrower’s Council of Ministers’ Decision No. 671, dated October 1, 2001;

(c) “Anti-discrimination Law” means the Borrower’s anti-discrimination law adopted on September 16, 2003 (State Gazette No. 86 of September 30, 2003);

(d) “Civil Service Law” means the Borrower’s civil service law adopted on June 16 and July 21, 1999 (State Gazette No. 67 of July 27, 1999) and amended on October 15, 2003 (State Gazette No. 95 of October 28, 2003);

(e) “Deposit Account” means the account referred to in Section 2.02 of this Agreement;

(f) “Energy Law” means the Borrower’s energy law adopted on November 26, 2003 (State Gazette No. 107 of December 9, 2003);

(g) “Financial Supervision Commission” means the commission established pursuant to the Financial Supervision Commission Law, adopted on January 22, 2003 (State Gazette No. 8 of January 28, 2003);

(h) “Labor Code” means the Borrower’s labor code adopted on March 21, 1986 (State Gazettes No. 26 of April 1, 1986, and No. 27 of April 4, 1986) and amended on February 12, 2003 (State Gazette No. 18 of February 25, 2003);

(i) “Mandatory Social Insurance Code” means the Borrower’s mandatory social insurance code adopted on December 2, 1999 (State Gazette No. 110 of December 17, 1999) and amended on July 23, 2003 (State Gazette No. 67 of July 29, 2003);

(j) “Social Security Code” means the Borrower’s social security code adopted on July 23, 2003 (State Gazette No. 67 of July 29, 2003);

(k) “Supreme Judicial Council” means the council established pursuant to the Constitution of the Republic of Bulgaria and the Judiciary Act adopted on July 14, 1994 (State Gazette No. 59 of July 22, 1994) as amended; and

(l) “Voluntary Supplementary Pension Insurance Act” means the Borrower’s voluntary supplementary pension insurance act adopted on July 7, 1999 (State Gazette No. 65 of July 20, 1999) and repealed on July 23, 2003 (State Gazette No. 67 of July 29, 2003).

ARTICLE II

The Loan

Section 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in this Agreement, an amount equal to one hundred twenty three million seven hundred thousand Euro (€123,700,000).

Section 2.02. (a) Subject to the provisions of paragraphs (b), (c) and (d) of this Section, the Borrower shall be entitled to withdraw the proceeds of the Loan from the Loan Account in support of the Second Phase of the Program.

(b) The Borrower shall open, prior to furnishing to the Bank the first request for withdrawal from the Loan Account, and thereafter maintain in the Bulgarian National Bank, a deposit account in Euro on terms and conditions satisfactory to the Bank. All withdrawals from the Loan Account shall be deposited by the Bank into the Deposit Account.

(c) The Borrower undertakes that the proceeds of the Loan shall not be used to finance expenditures excluded pursuant to the provisions of Schedule 1 to this Agreement. If the Bank shall have determined at any time that any proceeds of the Loan shall have been used to make a payment for an expenditure so excluded, the Borrower shall, promptly upon notice from the Bank: (i) deposit into the Deposit Account an amount equal to the amount of said payment; or (ii) if the Bank shall so request, refund such amount to the Bank. Amounts refunded to the Bank upon such request shall be credited to the Loan Account for cancellation.

(d) No withdrawals shall be made from the Loan Account after the aggregate of the proceeds of the Loan withdrawn from the Loan Account shall have reached the equivalent of €103,700,000, unless the Bank shall be satisfied, after an exchange of views as described in Section 3.01 of this Agreement based on evidence satisfactory to the Bank:

- (A) with the progress achieved by the Borrower in the carrying out of the Program;
- (B) that the macroeconomic policy framework of the Borrower is satisfactory, as measured on the basis of indicators agreed between the Borrower and the Bank; and
- (C) that the actions described in Section II of Schedule 3 to this Agreement have been taken.

If, after said exchange of views, the progress achieved by the Borrower in respect of subparagraphs (A), (B) and (C) above is not acceptable to the Bank, the Bank may give notice to the Borrower to that effect and, if within 90 days after such notice, the Borrower

shall not have taken steps acceptable to the Bank, in respect of said sub-paragraphs (A), (B) and (C) above, then the Bank may, by notice to the Borrower, cancel the unwithdrawn amount of the Loan or any part thereof.

Section 2.03. The Closing Date shall be December 31, 2004, or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower of such later date.

Section 2.04. The Borrower shall pay to the Bank a front-end fee in an amount equal to one percent (1%) of the amount of the Loan. On or promptly after the Effective Date, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amount of such fee.

Section 2.05. The Borrower shall pay to the Bank a commitment charge at the rate of three-fourths of one percent ($3/4$ of 1%) per annum on the principal amount of the Loan not withdrawn from time to time.

Section 2.06. (a) The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time, at a rate for each Interest Period equal to LIBOR Base Rate plus LIBOR Total Spread.

(b) For the purposes of this Section:

- (i) "Interest Period" means the initial period from and including the date of this Agreement to, but excluding, the first Interest Payment Date occurring thereafter, and after the initial period, each period from and including an Interest Payment Date to, but excluding the next following Interest Payment Date.
- (ii) "Interest Payment Date" means any date specified in Section 2.07 of this Agreement.
- (iii) "LIBOR Base Rate" means, for each Interest Period, the London interbank offered rate for six-month deposits in Euro for value the first day of such Interest Period (or, in the case of the initial Interest Period, for value the Interest Payment Date occurring on or next preceding the first day of such Interest Period), as reasonably determined by the Bank and expressed as a percentage per annum.
- (iv) "LIBOR Total Spread" means, for each Interest Period: (A) three-fourths of one percent ($3/4$ of 1%); (B) minus (or plus) the weighted average margin, for such Interest Period, below (or above) the London interbank offered rates, or other reference rates, for six-month deposits, in respect of the Bank's outstanding borrowings or portions thereof allocated by the Bank to fund single currency loans or portions thereof made by it that

include the Loan; as reasonably determined by the Bank and expressed as a percentage per annum.

(c) The Bank shall notify the Borrower of the LIBOR Base Rate and the LIBOR Total Spread for each Interest Period, promptly upon the determination thereof.

(d) Whenever, in light of changes in market practice affecting the determination of the interest rates referred to in this Section 2.06, the Bank determines that it is in the interest of its borrowers as a whole and of the Bank to apply a basis for determining the interest rates applicable to the Loan other than as provided in said Section, the Bank may modify the basis for determining the interest rates applicable to the Loan upon not less than six (6) months' notice to the Borrower of the new basis. The new basis shall become effective on the expiry of the notice period unless the Borrower notifies the Bank during said period of its objection thereto, in which case said modification shall not apply to the Loan.

Section 2.07. Interest and other charges shall be payable semiannually in arrears on April 15 and October 15 in each year.

Section 2.08. The Borrower shall repay the principal amount of the Loan in accordance with the amortization schedule set forth in Schedule 2 to this Agreement.

ARTICLE III

Particular Covenants

Section 3.01. (a) The Borrower and the Bank shall from time to time, at the request of either party, exchange views on the progress achieved in carrying out the Program and the actions specified in Schedule 3 to this Agreement.

(b) Prior to each such exchange of views, the Borrower shall furnish to the Bank for its review and comment a report on the progress achieved in carrying out the Program, in such detail as the Bank shall reasonably request.

(c) Without limitation upon the provisions of paragraph (a) of this Section, the Borrower shall exchange views with the Bank on any proposed action to be taken after the disbursement of the Loan which would have the effect of materially reversing the objectives of the Program, or any action taken under the Program including any action specified in Schedule 3 to this Agreement.

Section 3.02. Upon the Bank's request, the Borrower shall:

(a) have the Deposit Account audited in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank;

(b) furnish to the Bank as soon as available, but in any case not later than six (6) months after the date of the Bank's request for such audit, a certified copy of the report of such audit by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and

(c) furnish to the Bank such other information concerning the Deposit Account and the audit thereof as the Bank shall have reasonably requested.

ARTICLE IV

Additional Event of Suspension

Section 4.01. Pursuant to Section 6.02 (p) of the General Conditions, the following additional event is specified, namely, that a situation has arisen which shall make it improbable that the Program, or a significant part thereof, will be carried out.

ARTICLE V

Effective date

Section 5.01. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VI

Representative of the Borrower; Addresses

Section 6.01. The Minister of Finance of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministry of Finance
102 Rakovski Street
Sofia, 1040
Republic of Bulgaria

Cable address:	Telex:	Facsimile:
Ministry of Finance Sofia	22727	(359) 2-9806863

For the Bank:

International Bank for
Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:	Telex:	Facsimile:
INTBAFRAD Washington, D.C.	248423 (MCI) or 64145 (MCI)	(202) 477-6391

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in Sofia, Republic of Bulgaria, as of the day and year first above written.

REPUBLIC OF BULGARIA

By /s/ Milen Veltchev

Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Anand K. Seth

Authorized Representative

SCHEDULE 1

Excluded Expenditures

For purposes of Section 2.02 (c) of this Agreement, the proceeds of the Loan shall not be used to finance any of the following expenditures:

1. expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;
2. expenditures for goods or services supplied under a contract which any national or international financing institution or agency other than the Bank or the Association shall have financed or agreed to finance, or which the Bank or the Association shall have financed or agreed to finance under another loan or a credit;
3. expenditures for goods included in the following groups or subgroups of the Standard International Trade Classification, Revision 3 (SITC, Rev.3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev.3 (1986) (the SITC), or any successor groups or subgroups under future revisions to the SITC, as designated by the Bank by notice to the Borrower:

<u>Group</u>	<u>Subgroup</u>	<u>Description of Items</u>
112	-	Alcoholic beverages
121	-	Tobacco, unmanufactured, tobacco refuse
122	-	Tobacco, manufactured (whether or not containing tobacco substitutes)
525	-	Radioactive and associated materials
667	-	Pearls, precious and semiprecious stones, unworked or worked
718	718.7	Nuclear reactors, and parts thereof; fuel elements (cartridges), non-irradiated, for nuclear reactors
728	728.43	Tobacco processing machinery
897	897.3	Jewelry of gold, silver or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)

<u>Group</u>	<u>Subgroup</u>	<u>Description of Items</u>
971	-	Gold, non-monetary (excluding gold ores and concentrates)

4. expenditures for goods intended for a military or paramilitary purpose or for luxury consumption;

5. expenditures for environmentally hazardous goods (for purposes of this paragraph the term “environmentally hazardous goods” means goods, the manufacture, use or import of which is prohibited under the laws of the Borrower or international agreements to which the Borrower is a party, and any other goods designated as environmentally hazardous by agreement between the Borrower and the Bank);

6. expenditures: (a) in the territories of any country which is not a member of the Bank or for goods procured in, or services supplied from, such territories; or (b) on account of any payment to persons or entities, or any import of goods, if such payment or import is prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations; and

7. expenditures under a contract in respect of which the Bank determines that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Loan during the procurement or execution of such contract, without the Borrower having taken timely and appropriate action satisfactory to the Bank to remedy the situation.

SCHEDULE 2

Amortization Schedule

<u>Date Payment Due</u>	<u>Payment of Principal (Expressed in Euro)*</u>
On each April 15 and October 15	
beginning on October 15, 2009 through October 15, 2020	5,155,000
on April 15, 2021	5,135,000

* The figures in this column represent the amount in Euro to be repaid, except as provided in Section 4.04 (d) of the General Conditions.

SCHEDULE 3

Actions under the Second Phase of the Program

Section I: Actions Referred to in Recital (B) of the Preamble to this Agreement

Macroeconomic Framework

1. The Borrower has implemented prudent macroeconomic policy centered on the currency board arrangement and contributing to solid growth performance, and has maintained a satisfactory macroeconomic framework, consistent with the core objectives of the Program, including: (a) an estimated fiscal deficit of 0 percent of the Gross Domestic Product (GDP) for calendar year 2003; (b) satisfactory income policy; (c) a 12-month inflation rate, as of December 2003, of 5.6 percent; (d) an estimated external current account deficit of less than 8.5 percent of GDP in calendar year 2003; and (e) public debt to GDP of 47.9 percent, as of December 31, 2003.

Structural Reforms

2. The Borrower has completed privatization or liquidation of large state owned enterprises agreed with the Bank.

3. The Borrower has enacted the Energy Law compliant with the EU electricity and gas directives.

4. The Borrower has reduced its railway labor force by 10% compared to the level at the end of calendar year 2001.

Business Environment

5. The Borrower has eliminated 40 and modified 50 regulatory regimes governing the economic activity of enterprises in accordance with the program for eliminating and restructuring regulatory regimes, prepared by the inter-ministerial working group on business environment improvement through streamlining regulatory regimes, approved by its Council of Ministers on June 7, 2002.

6. The Council of Ministers has approved amendments to the Labor Code satisfactory to the Bank, and the Borrower has enacted the Anti-discrimination Law.

Financial Sector

7. The Borrower has enacted the Social Security Code consolidating the Mandatory Social Insurance Code and the Voluntary Supplementary Pension Insurance Act and

strengthened the governance of the private pension funds and the supervision capacity of the Financial Supervision Commission and introduced a general prohibition of related party activities.

Improving Governance

8. The Council of Ministers has approved an updated medium term public administration reform strategy and an action plan to secure a merit based and depoliticized public administration, provide incentives for performance and service orientation, introduce optimization of government structures, and strengthen accountability and transparency in service delivery.

9. The Borrower has enacted amendments to the Civil Service Law and the Council of Ministers has approved the related legal framework to make open competition mandatory for all external recruitment to career civil servant positions, require that the vacancies to be filled through internal recruitment be based on credible merit based procedures, and establish clear criteria to determine which posts are to be advertised externally.

10. The Council of Ministers has approved and widely disseminated its first annual progress report on the implementation of its Anti-corruption Program for 2002-2003 and has approved the Anti-corruption Program for 2004-2005, including sectoral anti-corruption strategies for education and health, and the Supreme Judicial Council has approved an anti-corruption program for the judiciary.

11. The Borrower has adopted the legal framework governing the accountability framework for judges.

Social Protection

12. The Borrower has submitted to its Council for Economic Policy the concept for an education reform strategy and the initial action plan designed to improve quality of learning and teaching while strengthening equity, and to improve resource management and fiscal efficiency.

13. The Borrower has implemented measures to improve coverage and efficiency of social assistance programs.

Section II: Actions Referred to in Section 2.02 (d) (C) of this Agreement

1. The Borrower has made significant progress towards completion of privatization of Bulgartabak in line with the approved privatization strategy and timetable.

2. The Borrower has made satisfactory progress in implementing the restructuring strategy to be approved by the Supervisory Board of the Bulgartabak Holding.

SCHEDULE 4

Modifications of General Conditions

For the purposes of this Agreement, the provisions of the General Conditions are modified as follows:

- (a) Section 2.01, paragraph 18, is modified to read:

“‘Project’ means the Second Phase of the Program, referred to in the Preamble to the Loan Agreement, in support of which the Loan is made”;
- (b) A new definition of “Derivatives Agreement” is inserted in Section 2.01:

“‘Derivatives Agreement’ means any derivatives agreement entered into between the Bank and the Borrower or the Guarantor for the purpose of documenting and confirming one or more derivatives transactions between the Bank and the Borrower or the Guarantor, as such agreement may be amended from time to time. Derivatives Agreement includes all schedules, annexes and agreements supplemental to the Derivatives Agreement.”
- (c) Section 4.01 is modified to read:

“Except as the Bank and the Borrower shall otherwise agree, withdrawals from the Loan Account shall be made in the currency of the deposit account specified in Section 2.02 of the Loan Agreement.”
- (d) Section 5.01 is modified to read:

“The Borrower shall be entitled to withdraw the proceeds of the Loan from the Loan Account in accordance with the provisions of the Loan Agreement and of these General Conditions”;
- (e) The last sentence of Section 5.03 is deleted.
- (f) Section 6.02, sub-paragraphs (a), (b) and (c) are amended as follows:

“(a) The Borrower shall have failed to make payment (notwithstanding the fact that such payment may have been made by the Guarantor or a third party) of principal or interest or any other amount due to the Bank or the Association: (i) under the Loan Agreement, or (ii) under any other loan or guarantee agreement between the Bank and the Borrower, or (iii) under any Derivatives Agreement, or (iv) in consequence of any guarantee or other financial obligation of any kind extended by the Bank to any third party with the agreement of the

Borrower, or (v) under any development credit agreement between the Borrower and the Association.

(b) The Guarantor shall have failed to make payment of principal or interest or any other amount due to the Bank or the Association: (i) under the Guarantee Agreement, or (ii) under any other loan or guarantee agreement between the Guarantor and the Bank, or (iii) under any Derivatives Agreement, or (iv) in consequence of any guarantee or other financial obligation of any kind extended by the Bank to any third party with the agreement of the Guarantor, or (v) under any development credit agreement between the Guarantor and the Association.

(c) The Borrower or the Guarantor shall have failed to perform any other obligation under the Loan Agreement, the Guarantee Agreement or any Derivatives Agreement.”

(g) Section 7.01, sub-paragraphs (c), (d) and (e) are amended to read as follows:

“(c) A default shall occur in the payment by the Borrower of principal or interest or any other amount due to the Bank or the Association: (i) under any other loan or guarantee agreement between the Bank and the Borrower, or (ii) under any Derivatives Agreement, or (iii) in consequence of any guarantee or other financial obligation of any kind extended by the Bank to any third party with the agreement of the Borrower, or (iv) under any development credit agreement between the Borrower and the Association, and such default shall continue for a period of thirty days.

(d) A default shall occur in the payment by the Guarantor of principal or interest or any other amount due to the Bank or the Association: (i) under any loan or guarantee agreement between the Guarantor and the Bank, or (ii) under any Derivatives Agreement, or (iii) in consequence of any guarantee or other financial obligation of any kind extended by the Bank to any third party with the agreement of the Guarantor, or (iv) under any development credit agreement between the Guarantor and the Association, under circumstances which would make it unlikely that the Guarantor would meet its obligations under the Guarantee Agreement, and such default shall continue for a period of thirty days.

(e) A default shall occur in the performance of any other obligation on the part of the Borrower or the Guarantor under the Loan Agreement, the Guarantee Agreement or any Derivatives Agreement, and such

default shall continue for a period of sixty days after notice thereof shall have been given by the Bank to the Borrower and the Guarantor.”

(h) Section 9.07 (c) shall be modified to read:

“(c) Not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Bank, the Borrower shall prepare and furnish to the Bank a report, of such scope and in such detail as the Bank shall reasonably request, on the execution of the part of the Program referred to in the Preamble to the Loan Agreement, the performance by the Borrower and the Bank of their respective obligations under the Loan Agreement and the accomplishment of the purposes of the Loan.”; and

(i) Section 9.05 is deleted and Sections 9.06, 9.07 (as modified above), 9.08 and 9.09 are renumbered, respectively, Sections 9.05, 9.06, 9.07 and 9.08.