

CONFORMED COPY

CREDIT NUMBER 3534 BOS

Federation/EPBiH/EPHZHB Project Agreement

(Third Electric Power Reconstruction Project)

between

INTERNATIONAL DEVELOPMENT ASSOCIATION

and

FEDERATION OF BOSNIA AND HERZEGOVINA

AND

ELEKTROPRIVREDA BOSNIA AND HERZEGOVINA

AND

ELEKTROPRIVREDA OF CROATIAN COMMUNITY OF
HERZEG-BOSNIA

Dated October 19, 2001

CREDIT NUMBER 3534 BOS

PROJECT AGREEMENT

AGREEMENT, dated as of October 19, 2001, between the INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association) and the FEDERATION OF BOSNIA AND HERZEGOVINA (the Federation), ELEKTROPRIVREDA BOSNIA AND HERZEGOVINA (EPBiH) and ELEKTROPRIVREDA OF CROATIAN COMMUNITY OF HERZEG-BOSNIA (EPHZHB).

WHEREAS (A) by the Development Credit Agreement of even date herewith between Bosnia and Herzegovina (the Borrower) and the Association, the Association has agreed to lend to the Borrower an amount in various currencies equivalent to twenty six million four hundred thousand Special Drawing Rights (SDR 26,400,000), on the terms and conditions set forth in the Development Credit Agreement, but only on condition that the Federation, EPBiH and EPHZHB agree to undertake such obligations toward the Association as are set forth in this Agreement;

(B) by a subsidiary credit agreement to be entered into between the Borrower and the Federation and EPBiH part of the proceeds of the Credit provided for under the Development Credit Agreement will be made available to EPBiH on terms and conditions set forth in said Subsidiary Credit Agreement; and

(C) by a subsidiary credit agreement to be entered into between the Borrower and the Federation and EPHZHB part of the proceeds of the Credit provided for under the Development Credit Agreement will be made available to EPHZHB on terms and conditions set forth in said Subsidiary Credit Agreement.

WHEREAS the Federation, EPBiH and EPHZHB in consideration of the Association's entering into the Development Credit Agreement with the Borrower, have agreed to undertake the obligations set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

Definitions

Section 1.01. Unless the context otherwise requires, the several terms defined in the Development Credit Agreement, the Preamble to this Agreement and in the General Conditions (as so defined) have the respective meanings therein set forth.

ARTICLE II

Execution of the Project

Section 2.01. (a) The Federation, EPBiH and EPHZHB declare their commitment to the objectives of the Project as set forth in Schedule 2 to the Development Credit Agreement, and, to this end, EPBiH shall carry out Part A of the Project, and EPHZHB shall carry out Part B of the Project with due diligence and efficiency and in conformity with appropriate administrative, financial, engineering, environmental and technical practices, and shall provide, or cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Association and the Federation, EPBiH and EPHZHB shall otherwise agree, the Federation, EPBiH and EPHZHB shall carry out the Project in accordance with the PIP and the Implementation Program set forth in the Schedule 1 to this Agreement.

Section 2.02. The Federation, EPBiH and EPHZHB shall carry out the obligations set forth in Sections 9.03, 9.04, 9.05, 9.06, 9.07 and 9.08 of the General Conditions (relating to insurance, use of goods and services, plans and schedules, records and reports, maintenance and land acquisition) in respect of the Federation/EPBiH/EPHZHB Project Agreement.

Section 2.03. The Federation, EPBiH and EPHZHB shall duly perform all their obligations under the Federation/EPBiH Subsidiary Credit Agreement and the Federation/EPHZHB Subsidiary Credit Agreement. Except as the Association shall otherwise agree, the Federation, EPBiH and EPHZHB shall not take or concur in any action which would have the effect of assigning, amending, abrogating or waiving the Federation/EPBiH Subsidiary Credit Agreement, or the Federation/EPHZHB Subsidiary Credit Agreement, or any provision thereof.

Section 2.04. (a) The Federation, EPBiH and EPHZHB shall, at the request of the Association, exchange views with the Association with regard to the progress of the Project, the performance of their respective obligations under this Agreement and under the Federation/EPBiH Subsidiary Credit Agreement or the Federation/EPHZHB Subsidiary Credit Agreement, and other matters relating to the purposes of the Credit.

(b) The Federation, EPBiH and EPHZHB shall promptly inform the Association of any condition which interferes or threatens to interfere with the progress of the Project, the accomplishment of the purposes of the Credit, or the performance by the Federation, EPBiH and EPHZHB of their respective obligations under this Agreement and under the Federation/EPBiH Subsidiary Credit Agreement and the Federation/EPHZHB Subsidiary Credit Agreement.

ARTICLE III

Management and Operations of EPBiH and EPHZHB

Section 3.01. EPBiH and EPHZHB shall each carry on its operations and conduct its affairs in accordance with sound administrative, financial, environmental, engineering and technical practices under the supervision of qualified and experienced management assisted by competent staff in adequate numbers.

Section 3.02. EPBiH and EPHZHB shall each at all times operate and maintain its plant, machinery, equipment and other property, and from time to time, promptly as needed, make all necessary repairs and renewals thereof, all in accordance with sound environmental, engineering, financial and technical practices.

Section 3.03. EPBiH and EPHZHB shall each take out and maintain with responsible

insurers, or make other provision satisfactory to the Association for, insurance against such risks and in such amounts as shall be consistent with appropriate practice.

ARTICLE IV

Financial Covenants

Section 4.01. (a) EPBiH and EPHZHB shall each establish and maintain a financial management system, including records and accounts, and prepare financial statements, in a format acceptable to the Association adequate to reflect the operations, resources and expenditures in connection with the carrying out of the Project.

(b) EPBiH and EPHZHB shall each:

(i) have its records, accounts, financial statements (balance sheets, statements of income and expenses and related statements) and cash flow for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Association;

(ii) furnish to the Association, as soon as available but in any case not later than six months after the end of each such year, (A) certified copies of its financial statements for such year as so audited, and (B) the report of such audit by said auditors, of such scope and in such detail as the Association shall have reasonably requested; and

(iii) furnish to the Association such other information concerning said records, accounts and financial statements as well as the audit thereof as the Association shall from time to time reasonably request.

Section 4.02. (a) Without limitation upon the provisions of Section 4.01 of this Agreement, EPBiH and EPHZHB shall each carry out a time-bound action plan acceptable to the Association for the strengthening of the financial management system referred to in paragraph (a) of said Section 4.01 in order to, not later than August 15, 2002, or such later date as the Association shall agree, prepare quarterly Project management reports, acceptable to the Association, each of which:

(i) (A) sets forth actual sources and applications of funds for the Project, both cumulatively and for the period covered by said report, and projected sources and applications of funds for Part A of the Project for the six-month period following the period covered by said report, and (B) shows separately expenditures financed out of the proceeds of the Credit during the period covered by said report and expenditures proposed to be financed out of the proceeds of the Credit during the six-month period following the period covered by said report;

(ii) (A) describes physical progress in Project implementation, both cumulatively and for the period covered by said report, and (B) explains variances between the actual and previously forecast implementation targets; and

(iii) sets forth the status of procurement under Part A and Part B of the Project and expenditures under contracts financed out of the proceeds of the Credit, as at the end of the period covered by said report.

(b) Upon the completion of the action plan referred to in paragraph (a) of this Section, EPBiH and EPHZHB shall each prepare, in accordance with guidelines acceptable to the Association, and furnish to the Association not later than forty-five (45) days after the end of each calendar quarter a Project Management Report for such period.

Section 4.03. (a) Except as the Association shall otherwise agree, EPBiH and EPHZHB shall each produce, for each fiscal year after the fiscal year ending on December 31, 2001, funds from internal sources equivalent to not less than forty percent (40%) of the annual average of its capital expenditures incurred or expected to be incurred, for the current, the previous fiscal year and subsequent fiscal year.

(b) For the purposes of this Section the term "capital expenditures" means all expenditures incurred on account of fixed assets, including interest charged to construction, related to operations.

(c) Before October 15 in each of their fiscal years, commencing in the calendar year 2001, EPBiH and EPHZHB shall, on the basis of forecasts prepared by EPBiH and EPHZHB, respectively, and satisfactory to the Association, review whether they would meet the requirements set forth in paragraph (a) in respect of such year and the next following fiscal year and shall furnish to the Association the results of each such review upon its completion.

(d) If any such review shows that EPBiH or EPHZHB would not meet the requirements set forth in paragraph (a) for the EPBiH's and EPHZHB's respective fiscal years covered by such review, EPBiH and EPHZHB shall promptly take all necessary measures (including, without limitation, adjustments of the structure or levels of its prices) in order to meet such requirements.

(e) For the purpose of this Section:

(i) The term "funds from internal sources" means the difference between:

(A) the sum of revenue from all sources related to operations, consumer deposits and consumer contributions in aid of construction, net non-operating income and any reduction in working capital other than cash; and

(B) the sum of all expenses related to operations, including administration, adequate maintenance and taxes and payments in lieu of taxes (excluding provision for depreciation and other non-cash operating charges), debt service requirements, all cash dividends and other cash distributions of surplus, increase in working capital other than cash and other cash outflows other than capital expenditures.

(ii) The term "net non-operating income" means the difference between:

(A) revenues from all sources other than those related to operations; and

(B) expenses, including taxes and payments in lieu of taxes, incurred in the generation of revenues in (A) above.

Section 4.04. (a) Except as the Association shall otherwise agree, EPBiH and EPHZHB shall each not incur any debt, unless a reasonable forecast of the revenues and expenditures of EPBiH or EPHZHB, as the case may be, shows that its estimated net revenues for each fiscal year during the term of the debt to be incurred shall be at least 1.5 times its estimated debt service requirements in such year on all of its debt including the debt to be incurred.

(b) For the purposes of this Section:

(i) The term "debt" means any indebtedness maturing by its terms more than one year after the date on which it is originally incurred.

(ii) Debt shall be deemed to be incurred: (A) under a loan contract or agreement or other instrument providing for such debt or for the modification of its terms of payment on the date of such contract, agreement or instrument; and (B) under a guarantee agreement, on the date the agreement providing for such guarantee has been entered into.

(iii) The term "net revenues" means the difference between:

(A) the sum of revenues from all sources related to operations and net non-operating income; and

(B) the sum of all expenses related to operations including administration, adequate maintenance, taxes and payments in lieu of taxes, but excluding provision for depreciation,

other non-cash operating charges and interest and other charges on debt.

- (iv) The term "net non-operating income" means the difference between:
 - (A) revenues from all sources other than those related to operations; and
 - (B) expenses, including taxes and payments in lieu of taxes, incurred in the generation of revenues in (A) above.
- (v) The term "debt service requirements" means the aggregate amount of repayments (including sinking fund payment if any) of, and interest and other charges on, debt.
- (vi) The term "reasonable forecast" means a forecast prepared by EPBiH or EPHZHB, as the case may be, not earlier than twelve months prior to the incurrence of the debt in question, which both the Association and EPBiH or the Association and EPHZHB, as the case may be, accept as reasonable and as to which the Association has notified EPBiH or EPHZHB, as the case may be, of its acceptability, provided that no event has occurred since such notification which has, or may reasonably be expected in the future to have, a material adverse effect on the financial condition or future operating results of EPBiH or EPHZHB, as the case may be.
- (vii) Whenever for the purposes of this Section it shall be necessary to value, in terms of the currency of the Borrower, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is, at the time of such valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate, on the basis of a rate of exchange acceptable to the Association.

Section 4.05. (a) EPBiH and EPHZHB and the Association shall, from time to time, at the request of either party, exchange views with regard to the EPBiH's or EPHZHB's electricity pricing policies, including the structure and level of electricity prices, and their plans in respect of the overall development of the electricity sector.

(b) EPBiH and EPHZHB agree, as long as they exercise control over the setting of prices, to establish price levels and structure for electricity which would: (i) allow EPBiH and EPHZHB, as the case may be, under conditions of efficient operation at reasonable levels of capacity utilization, to meet their financial obligations and their other obligations under this Agreement and make a reasonable contribution to future investment for expansion of capacity; (ii) be reasonably competitive with prices for electricity in other major countries; (iii) subject to the achievement of objectives (i) and (ii) above, reflect the relative costs of supply to the different consumer groups; and (iv) take into account the results of the social assessment study to mitigate the impact on the vulnerable segments of society.

Section 4.06. EPBiH and EPHZHB shall by June 30, 2002, each have its assets revalued and depreciation policies reviewed by qualified independent organizations satisfactory to the Association in accordance with terms of reference satisfactory to the Association.

Section 4.07. The Federation shall take all measures necessary to enable EPBiH and EPHZHB to carry out their obligations in this Article.

Section 4.08. EPBiH and EPHZHB shall review with the Association, by October 15 of each year commencing in calendar year 2001, their program of proposed capital expenditures for the following five years, and take the Association's views into consideration in finalizing said program.

ARTICLE V

Effective Date; Termination Cancellation and Suspension

Section 5.01. This Agreement shall come into force and effect on the date upon which the Development Credit Agreement becomes effective.

Section 5.02. (a) This Agreement and all obligations of the Association and of the Federation, EPBiH and EPHZHB thereunder shall terminate on the earlier of the following two dates:

- (i) the date on which the Development Credit Agreement shall terminate; or
- (ii) the date twenty years after the date of this Agreement.

(b) If the Development Credit Agreement terminates before the date specified in paragraph (a) (ii) of this Section, the Association shall promptly notify the Federation, EPBiH and EPHZHB of this event.

Section 5.03. All the provisions of this Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the General Conditions.

ARTICLE VI

Miscellaneous Provisions

Section 6.01. Any notice or request required or permitted to be given or made under this Agreement and any agreement between the parties contemplated by this Agreement shall be in writing. Such notice or request shall be deemed to have been duly given or made when it shall be delivered by hand or by mail, telegram, cable, telex, facsimile or radiogram to the party to which it is required or permitted to be given or made at such party's address hereinafter specified or at such other addresses as such party shall have designated by notice to the party giving such notice or making such request. The addresses so specified are:

For the Association:

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:

INTBAFRAD

477-6391

Washington, D.C.

Telex:

248423 (MCI) or

64145 (MCI)

Facsimile:

(202)

For the Federation:

Federation Ministry of Finance
Mehmeda Spahe 5
71000 Sarajevo
Bosnia and Herzegovina

Facsimile:

387 71 203

152

For the Elektorprivreda Bosnia and Herzegovina:

Elektroprivreda Bosnia and Herzegovina
EPBiH
Vilsonovo Setaliste 20
71000 Sarajevo
Bosnia and Herzegovina

Facsimile:

387 71 654

266

For Elektroprivreda of Croatian Community of Herzeg-Bosnia:

Elektroprivreda of Croatian Community of Herzeg-Bosnia
Ul. Mile Budaka 106

88000 Mostar
Bosnia and Herzegovina

Facsimile:

387 88 317

157

Section 6.02. (a) Any action required or permitted to be taken, and any documents required or permitted to be executed, under this Agreement on behalf of the Federation or by the Federation on behalf of the Borrower under the Development Credit Agreement, may be taken or executed by its Minister of Finance, or by such other person or persons as the Federation shall designate in writing, and the Federation shall furnish to the Association sufficient evidence of the authority and the authenticated specimen signature of each such person.

(b) Any action required or permitted to be taken, and any documents required or permitted to be executed, under this Agreement on behalf of EPBiH or by EPBiH on behalf of the Borrower under the Development Credit Agreement, may be taken or executed by its General Manager, or by such other person or persons as EPBiH shall designate in writing, and EPBiH shall furnish to the Association sufficient evidence of the authority and the authenticated specimen signature of each such person.

(c) Any action required or permitted to be taken, and any documents required or permitted to be executed, under this Agreement on behalf of EPHZHB or by EPHZHB on behalf of the Borrower under the Development Credit Agreement, may be taken or executed by its General Manager, or by such other person or persons as EPHZHB shall designate in writing, and EPHZHB shall furnish to the Association sufficient evidence of the authority and the authenticated specimen signature of each such person.

Section 6.03. This Agreement may be executed in several counterparts, each of which shall be an original, and all collectively but one instrument.

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

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Joseph Ingram

Authorized Representative

FEDERATION OF BOSNIA AND HERZEGOVINA

By /s/ Hasan Becirovic

Authorized Representative

ELEKTROPRIVREDA BOSNIA AND HERZEGOVINA

By /s/ Enver Kreso

Authorized Representative

ELEKTROPRIVREDA OF CROATIAN COMMUNITY OF HERZEG-BOSNIA

By /s/ Matan Zaric

Authorized Representative

SCHEDULE 1

Implementation Program

1. The Federation/EPBiH/EPHZHB shall, at least until the completion of the Project, maintain the Federation PIU, the EPBiH PIU and the EPHZHB PIU, respectively, with structures, functions and staffing satisfactory to the Association.

2. The Federation shall:

(a) undertake and complete by December 31, 2001, a comprehensive study of the sequence, extent and timing of the restructuring and privatization of EPBiH and EPHZHB, in accordance with terms of reference acceptable to the Association and by consultants acceptable to the Association; and

(b) develop and agree with the Association by February 28, 2002, a detailed restructuring and privatization action plan including an implementation schedule, followed by implementation of the agreed action plan, with no prior restructuring and privatization of EPBiH and EPHZHB taking place.

3. The Federation shall put into effect power sector restructuring and regulatory reform actions in accordance with the Policy Statement adopted by the Federation, including:

(a) establishment by December 31, 2001 of an independent Federation Energy Regulatory Commission;

(b) establishment by December 31, 2001 of an independent State Energy Regulatory Commission; and

(c) establishment by March 31, 2002 of an Independent System Operator.

4. EPBiH shall:

(a) maintain power distribution losses for the duration of the Project below 12% of electricity entering the distribution system;

(b) on rehabilitation of the high voltage transmission network under the Project, operate the power system, jointly with EPHZHB and EPRS, as a single control area according to the UCTE rules within the UCTE Control Block covering the territories of the Republic of Slovenia, the Republic of Croatia, and Bosnia and Herzegovina. In the event that the system of the Federal Republic of Yugoslavia (FRY) remains disconnected from the UCTE system, selected EPRS generating units could be isolated, if desired by EPRS, from the rest of the system in order to sell power to the FRY network;

(c) revise, jointly with EPHZHB and EPRS, the ZEK Book of Rules and the Grid Code to bring them into conformity with the policy statements and to remove discrepancies and overlaps between these two documents;

(d) by December 31, 2001, furnish to the Association for its review and approval, a plan and schedule covering the additional resources to be provided to ZEK to enable it to perform the functions assigned to it under the November 3, 1998 agreement to establish ZEK and to enable it to function as the Independent System Operator, and implement the plan as set forth in the said schedule;

(e) by June 30, 2002, have their assets revalued and depreciation policies reviewed by qualified independent organizations acceptable to the Association;

(f) by December 31, 2003, establish a management information system, including a financial management system based on international accounting standards, satisfactory to the Association;

(g) by December 31, 2001, furnish and agree with the Association, a revised implementation schedule for an environmental management plan and immediately thereafter implement the plan in accordance with said schedule; and

(h) make cash payments to the Kreka-Durdjevik, Banovici, Kakanj, Breza and Zenica Coal Mines, and other coal mines, of at least seventy-five percent (75%) of the value of coal consumed each month, starting January 1, 2002, and attaining one hundred percent (100%) cash payment by December 31, 2002.

5. EPHZHB shall:

(a) reduce and maintain power distribution losses to below 19% in calendar year 2002, 16% in 2003, and 12% in calendar year 2004 of electricity entering the distribution system;

(b) on rehabilitation of the high voltage network under the Project, operate the power system, jointly with EPBiH and EPRS, as a single control area according to the UCTE rules, within the UCTE Control Block, as defined in the UCTE rules, covering the territories of the Republic of Slovenia, the Republic of Croatia, and Bosnia and Herzegovina. In the event that the system of the Federal Republic of Yugoslavia (FRY) remains disconnected from the UCTE system, selected EPRS generating units could be isolated, if desired by EPRS, from the rest of the system in order to sell power to the FRY network;

(c) revise, jointly with EPBiH and EPRS, the ZEK Book of Rules and the Grid Code to bring them into conformity with the Policy Statement and to remove discrepancies and overlaps between these two documents;

(d) by December 31, 2001, furnish to the Association for its review and approval, a plan and schedule covering the additional resources to be provided to ZEK to enable it to perform the functions assigned to it under the November 3, 1998 agreement to establish ZEK and to enable it to function as the Independent System Operator, and implement the plan as set forth in the said schedule;

(e) by June 30, 2002, have its assets revalued and depreciation policies reviewed by independent auditors acceptable to the Association;

(f) by December 31, 2003, establish a management information system, including a financial management system based on international accounting standards, satisfactory to the Association; and

(g) furnish and agree with the Association by December 31, 2001, a revised implementation schedule for the environmental management plan and immediately thereafter implement the plan in accordance with the schedule.

6. For the purposes of this Schedule:

(a) the term "environmental management plan" means an instrument that details (a) the measures to be taken during the implementation and operation of a project to eliminate or offset adverse environmental impacts, or to reduce them to acceptable levels; and (b) the actions needed to implement these measures;

(b) the term "SCADA system" means a Supervisory Control and Data Acquisition system;

(c) the term "ZEK Book of Rules" means the by-laws governing the operations of ZEK; and

(d) the term "Grid Code" means the current edition of the technical regulations governing the use of the transmission network in Bosnia and Herzegovina.

