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CONFORMED COPY

GEF TRUST FUND GRANT NUMBER TF057107

AD MEPSO Project Agreement

(Sustainable Energy Project)

between

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

and

AD PRENOS NA ELEKTRICNA ENERGIJA I UPRAVUVANJE SO
ELEKTROENERGETSKIOT SISTEM, VO DRZAVNA SOPSTVENOST,
SKOPJE (AD MEPSO)

Dated February 26, 2007

GEF TRUST FUND GRANT NUMBER TF057107

PROJECT AGREEMENT

AGREEMENT, dated February 26, 2007, between the INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) acting as an implementing agency of the Global Environment Facility (GEF) in respect of grant funds provided to the GEF Trust Fund by certain members of the Bank as participants of the GEF and AD PRENOS NA ELEKTRICNA ENERGIJA I UPRAVUVANJE SO ELEKTROENERGETSKIOT SISTEM, VO DRZAVNA SOPSTVENOST, SKOPJE (AD MEPSO) (the GEF Trust Fund Grant).

WHEREAS (A) by the GEF Trust Fund Grant Agreement of even date herewith between the former Yugoslav Republic of Macedonia (the Recipient) and the Bank (the GEF Grant Agreement), the Bank has agreed to make available to the Recipient an amount in various currencies equivalent to five million five hundred thousand Dollars (\$5,500,000), on the terms and conditions set forth in the GEF Grant Agreement, provided that AD MEPSO agrees to undertake such obligations as are set forth in this Agreement;

(B) by an AD MEPSO Subsidiary Financing Agreement to be entered into between the Recipient and AD MEPSO, a portion of the proceeds of the grant provided for under the GEF Grant Agreement will be made available to AD MEPSO on the terms and conditions set forth in said AD MEPSO Subsidiary Financing Agreement; and

(C) WHEREAS AD MEPSO, in consideration of the Bank's entering into the GEF Grant Agreement with the Recipient, has 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 terms defined in the GEF Grant Agreement, the Preamble to this Agreement and the General Conditions (as so defined) have the respective meanings therein set forth.

ARTICLE II

Execution of the Project

Section 2.01. (a) AD MEPSO declares its commitment to the objectives of the Project as set forth in Schedule 2 to the GEF Grant Agreement, and, to this end, shall carry out Part B of the Project, through the Energy Service Company (ESCO), with due diligence and efficiency and in conformity with appropriate technical, financial and environmental standards and energy efficiency practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) AD MEPSO shall make available, on a grant basis, the proceeds of the GEF Trust Fund Grant allocated from time to time to Categories 2 and 3 in the table set forth in paragraph 1 of Schedule 1 to the GEF Grant Agreement to ESCO (the ESCO Grant) under the ESCO Subsidiary Grant Agreement to be entered into between the AD MEPSO and ESCO, under terms and conditions which shall have been approved by the Bank.

(c) AD MEPSO shall exercise its rights under the ESCO Subsidiary Grant Agreement in such manner as to protect the interests of the Recipient and the Bank and to accomplish the purposes of the Project, and, except as the Bank shall otherwise agree, AD MEPSO shall not assign, abrogate or waive the ESCO Subsidiary Grant Agreement or any provision thereof.

Section 2.02. AD MEPSO shall carry out or cause to be carried out, respectively, the obligations set forth in Sections 9.04, 9.05, 9.06, 9.07, 9.08 and 9.09 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 Part B of the Project.

Section 2.03. AD MEPSO shall duly perform all its obligations under the AD MEPSO Subsidiary Financing Agreement. Except as the Bank and the Recipient shall otherwise agree, AD MEPSO shall not take or concur in any action which would have the effect of amending, abrogating, assigning or waiving the AD MEPSO Subsidiary Financing Agreement or any provision thereof.

Section 2.04. (a) AD MEPSO shall, at the request of the Bank, exchange views with the Bank and the Recipient with regard to progress of Part B of the Project, the performance of its obligations under this Agreement and under the AD MEPSO Subsidiary Financing Agreement, and other matters relating to the purposes of the grant.

(b) AD MEPSO shall promptly inform the Bank and the Recipient of any condition which interferes or threatens to interfere with the progress of Part B of the Project, the accomplishment of the purposes of the GEF Trust Fund Grant, or the performance by AD MEPSO of its obligations under this Agreement and/or under the AD MEPSO Subsidiary Financing Agreement.

Section 2.05. Except as the Bank shall otherwise agree, procurement of goods, works and services required for Part B of the Project to be financed out of the proceeds of the GEF Trust Fund Grant shall be governed by the provisions of Schedule 2 to this Agreement.

ARTICLE III

Management and Operations of AD MEPSO

Section 3.01. AD MEPSO shall, and shall cause ESCO to, carry out its operations and conduct its affairs in accordance with sound administrative, financial and environmental practices with qualified and experienced management assisted by competent staff in adequate numbers.

Section 3.02. AD MEPSO shall, and shall cause ESCO to, take out and maintain insurances with responsible insurers, or shall make other provisions satisfactory to the Bank for insurance against such risks and in such amounts as shall be consistent with appropriate practices.

Section 3.03. AD MEPSO shall, and shall cause ESCO to, at all times operate and maintain its equipment and other property, and from time to time, promptly as needed, make all necessary repairs and renewals thereof, all in accordance with sound engineering, financial and environmental practices.

ARTICLE IV

Financial Covenants

Section 4.01. (a) AD MEPSO shall maintain a financial management system, including records and accounts, and prepare financial statements, all in accordance with accounting standards acceptable to the Bank, consistently applied, adequate to reflect its operations and financial condition and to register separately the operations, resources and expenditures related to Part B of the Project.

(b) AD MEPSO shall:

- (i) have the records and accounts referred to in paragraph (a) of this Section including those for the Special Account for each Fiscal Year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank;
- (ii) have its records, accounts and financial statements (balance sheets, statements of income and expenses and related statements), including statements in respect of each Fiscal Year audited, in accordance with auditing standards acceptable to the Bank, consistently applied, by independent auditors acceptable to the Bank;

- (iii) furnish to the Bank and the Recipient as soon as available, but in any case not later than six (6) months after the end of each such year: (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year as so audited; and (B) an opinion on such statements and report of such audit, by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and
- (iv) furnish to the Bank and the Recipient such other information concerning such records, accounts and financial statements, and the audit thereof, and concerning said auditors, as the Bank may from time to time reasonably request.

Section 4.02. (a) Without limitation upon AD MEPSO's progress reporting obligations in this Agreement, AD MEPSO shall prepare and furnish to the Bank a Financial Monitoring Report in form and substance satisfactory to the Bank, which:

- (i) sets forth sources and uses of funds for Part B of the Project, both cumulatively and for the period covered by said report, showing separately funds provided under the GEF Trust Fund Grant, and explains variances between the actual and planned uses of such funds;
- (ii) describes physical progress in Project implementation, both cumulatively and for the period covered by said report, and explains variances between the actual and planned Project implementation; and
- (iii) sets forth the status of procurement under Part B of the Project, as at the end of the period covered by said report.

(b) The first Financial Monitoring Report shall be furnished to the Bank not later than forty-five (45) days after the end of the first calendar quarter after the Effective Date, and shall cover the period from the incurrence of the first expenditure under Part B of the Project through the end of such first calendar quarter; thereafter, each Financial Monitoring Report shall be furnished to the Bank not later than forty-five (45) days after each subsequent calendar quarter, and shall cover such calendar quarter.

ARTICLE V

Effective Date; Termination

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

Section 5.02. This Agreement and all obligations of the Bank and of AD MEPSO hereunder shall terminate on the date on which the GEF Grant Agreement shall terminate in accordance with its terms, and the Bank shall promptly notify AD MEPSO thereof.

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 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 address 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 Bank:

International Bank for
Reconstruction and Development
1818 H Street, NW
Washington, DC 20433
United States of America

Cable address:

INTBAFRAD
Washington, D.C.

Telex:

248423 (MCI) or
64145 (MCI)

Facsimile:

(202) 477-6391

For AD MEPSO :

Orce Nikolov b.b.
1000 Skopje

Facsimile:

Section 6.02. Any action required or permitted to be taken, and any document required or permitted to be executed, under this Agreement on behalf of AD MEPSO may be taken or executed by the President of the Management Board of AD MEPSO or such other person or persons as the President of the Management Board shall designate in writing, and AD MEPSO shall furnish to the Bank 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 the city of Skopje, as of the day and year first above written.

**INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT**

By /s/ Sandra Bloemenkamp

Authorized Representative

**AD PRENOS NA ELEKTRICNA ENERGIJA I
UPRAVUVANJE SO ELEKTROENERGETSKIOT
SISTEM, VO DRZAVNA SOPSTVENOST,
SKOPJE**

By /s/ Atanasko Tuneski

Authorized Representative

SCHEDULE 1

Implementation Program

1. AD MEPSO shall, and shall cause ESCO to, implement Part B of the Project in accordance with the provisions of the AD MEPSO Operational Manual, the Environmental Management Framework Document (EMFD), the Resettlement Policy Framework, and the ESCO Subsidiary Grant Agreement, and shall not amend, suspend, abrogate, repeal or waive any provision of the AD MEPSO Operational Manual, the EMFD, the Resettlement Policy Framework or the ESCO Subsidiary Grant Agreement without prior approval of the Bank.

2. (a) For the purposes of carrying out Part B.1 of the Project, AD MEPSO shall cause ESCO to provide technical assistance, as specified in the AD MEPSO Operational Manual, to Beneficiaries for the preparation of Energy Efficiency Investments, under contractual arrangements between ESCO and the Beneficiaries, whereby the Beneficiaries shall repay ESCO the amounts provided for technical assistance if and when an Energy Performance Service Contract for that respective Energy Efficiency Investment shall have been entered between ESCO and the respective Beneficiary.

(b) The funds received by ESCO from the repayments under contractual arrangements referred to in paragraph (a) of this Section, shall be reinvested into preparation and implementation of Energy Efficiency Investments, in accordance with the procedures set forth in the ESCO Subsidiary Grant Agreement.

3. (a) For the purposes of carrying out Part B.2 of the Project, AD MEPSO shall cause ESCO to provide to eligible Beneficiaries Sub-loans for approved Energy Efficiency Investments on the basis of an Energy Performance Service Contract to be entered into between ESCO and each Beneficiary under standard terms and conditions which shall have been agreed upon with AD MEPSO and the Bank and which shall include, *inter alia*:

- (i) a description of the Energy Efficiency Investment, together with the cost thereof;
- (ii) the implementation schedule and implementation arrangements for the Energy Efficiency Investment;
- (iii) the degree to which cost sharing, in accordance with the principles set forth in the AD MEPSO Operational Manual, shall be required to be made by the Beneficiary with respect to the financing of the Energy Efficiency Investment for the implementation of which assistance is provided to such Beneficiary under the Energy Performance Service Contract;

- (iv) the obligation of ESCO and the Beneficiary to enable representatives of AD MEPSO and the Bank, if the Bank shall so request, to visit the facilities or other activities to be financed under the Energy Performance Service Contract, and to verify the performance of the Energy Efficiency Investment upon completion of said Investment;
- (v) the terms and conditions under which the Beneficiaries shall repay ESCO for the financing provided for the Energy Efficiency Investment under the Energy Performance Service Contract financed from the proceeds of the GEF Trust Fund Grant; and
- (vi) the compliance of the Energy Efficiency Investments with the environmental guidelines in the EMFD.

(b) The funds received by ESCO from the repayments under contractual arrangements referred to in paragraph (a) of this Section, shall be reinvested into preparation and implementation of Energy Efficiency Investments, in accordance with the procedures set forth in the ESCO Subsidiary Grant Agreement.

4. AD MEPSO shall cause the ESCO to obtain the Bank's prior approval for the Energy Performance Service Contracts.

SCHEDULE 2**Procurement**Section I. General

A. All goods, works and services (other than consultants' services) shall be procured in accordance with the provisions of Section I of the "Guidelines: Procurement under IBRD Loans and IDA Credits" dated May 2004 (the Procurement Guidelines), and with the provisions of this Schedule.

B. All consultants' services shall be procured in accordance with Sections I and IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004 (the Consultant Guidelines), and with the provisions of this Schedule.

C. The capitalized terms used below in this Schedule to describe particular procurement methods or methods of review by the Bank of particular contracts, have the meanings ascribed to them in the Procurement Guidelines, or Consultant Guidelines, as the case may be.

Section II. Particular Methods of Procurement of Goods, Works and Services (other than Consultants' Services)

A. International Competitive Bidding. Except as otherwise provided in Part B of this Section, contracts shall be awarded on the basis of International Competitive Bidding. The provisions of paragraphs 2.55 and 2.56 of the Procurement Guidelines, providing for domestic preference in the evaluation of bids, shall apply to goods manufactured in the territory of the Recipient and works to be carried out by domestic contractors.

B. Other Procurement Procedures

1. Shopping. Goods and Works estimated to cost less than \$100,000 equivalent per contract and may be procured under contracts awarded on the basis of Shopping.

2. Commercial Practices. Goods and Works, including Supply and Installation contracts, estimated to cost less than \$350,000 equivalent per contract, required under Part B of the Project, may be procured in accordance with commercial practices acceptable to the Bank.

Section III. Particular Methods of Procurement of Consultants' Services

A. Quality- and Cost-based Selection. Except as otherwise provided in Part B of this Section, consultants' services shall be procured under contracts awarded on the basis of Quality- and Cost-based Selection. For purposes of paragraph 2.7 of the Consultant Guidelines, the short list of consultants for services estimated to cost less than \$100,000 equivalent per contract may comprise entirely national consultants.

B. Other Procedures

1. Quality-based Selection. Services for assignments which the Bank agrees meet the requirements set forth in paragraph 3.2 of the Consultant Guidelines may be procured under contracts awarded on the basis of Quality-based Selection in accordance with the provisions of paragraphs 3.1 through 3.4 of the Consultant Guidelines.

2. Selection Under a Fixed Budget. Services for assignments which the Bank agrees meet the requirements of paragraph 3.5 of the Consultant Guidelines may be procured under contracts awarded on the basis of a Fixed Budget in accordance with the provisions of paragraphs 3.1 and 3.5 of the Consultant Guidelines.

3. Least-cost Selection. Services for assignments which the Bank agrees meet the requirements of paragraph 3.6 of the Consultant Guidelines may be procured under contracts awarded on the basis of Least-cost Selection in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultant Guidelines.

4. Selection Based on Consultants' Qualifications. Services estimated to cost less than \$100,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1, 3.7 and 3.8 of the Consultant Guidelines.

5. Single Source Selection. Services for tasks in circumstances which meet the requirements of paragraph 3.10 of the Consultant Guidelines for Single Source Selection may, with the Bank's prior agreement, be procured in accordance with the provisions of paragraphs 3.9 through 3.13 of the Consultant Guidelines.

6. Individual Consultants. Services for assignments that meet the requirements set forth in the first sentence of paragraph 5.1 of the Consultant Guidelines may be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.2 through 5.3 of the Consultant Guidelines. Under the circumstances described in paragraph 5.4 of the Consultant Guidelines, such contracts may be awarded to individual consultants on a sole-source basis.

Section IV. Review by the Bank of Procurement Decisions

The Procurement Plan shall set forth those contracts which shall be subject to the Bank's Prior Review. All other contracts shall be subject to Post Review by the Bank.