

CONFORMED COPY

LOAN NUMBER 3964 LV

DMEU Project Agreement

(Municipal Services Development Project)

among

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

and

THE CITY OF DAUGAVPILS

and

THE DAUGAVPILS MUNICIPAL ENTERPRISE UDENSVADS

Dated January 26, 1996

LOAN NUMBER 3964 LV

DMEU PROJECT AGREEMENT

AGREEMENT, dated January 26, 1996, between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) on the one hand and THE CITY OF DAUGAVPILS and THE DAUGAVPILS MUNICIPAL ENTERPRISE UDENSVADS (DMEU) on the other hand.

WHEREAS (A) by the Loan Agreement of even date herewith between REPUBLIC OF LATVIA (the Borrower) and the Bank, the Bank has agreed to make available to the Borrower an amount in various currencies equivalent to Twenty-Seven Million Three Hundred Thousand dollars (\$27,300,000), on the terms and conditions set forth in the Loan Agreement, but only on condition that the City of Daugavpils and DMEU agree to undertake such obligations toward the Bank as are set forth in this Agreement;

(B) by a subsidiary loan agreement to be entered into between the Borrower and DMEU which will be guaranteed by the City of Daugavpils, a portion of the proceeds of the loan provided for under the Loan Agreement will be relented to DMEU on the terms and conditions set forth in said Subsidiary Loan Agreement; and

WHEREAS the City of Daugavpils and DMEU, in consideration of the Bank's entering into the Loan 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 Loan Agreement and the General Conditions (as so defined) have the respective meanings therein set forth and the term "PMU" means the Project Management Unit established at DMEU and referred to in Section 2.07 of this Agreement.

ARTICLE II

Execution of Part B of the Project

Section 2.01 (a) The City of Daugavpils and DMEU declare their commitment to the objectives of the Project as set forth in Schedule 2 to the Loan Agreement, and, to this end, without any limitation or restriction upon any of its other obligations under the Project Agreement, DMEU shall carry out Part B of the Project with due diligence and efficiency and in conformity with appropriate administrative, financial, environmental, and engineering and water supply management practices, the City of Daugavpils shall take or cause to be taken all action, including the provision of funds, facilities, services and other resources necessary or appropriate to enable DMEU to perform such obligations, and DMEU shall provide, promptly as needed, the funds, facilities, services and other resources, required for the Project.

(b) The City of Daugavpils shall enter into a contract satisfactory to the Bank with the DMEU regarding the terms and conditions under which water and wastewater services will be provided by the DMEU to the City of Daugavpils.

(c) The City of Daugavpils shall exercise its rights under the contract specified in paragraph (b) of this Article in such manner as to protect the interests of the Borrower, the City of Daugavpils and the Bank and to accomplish the purposes of the Loan, and, except as the Bank shall otherwise agree, the City of Daugavpils shall not assign, amend, abrogate or waive such contract or any provision thereof.

Section 2.02. Without limitation upon the generality of the obligations of the City of Daugavpils set forth in Section 2.01 of this Agreement, the City of Daugavpils shall:

(a) enable DMEU to comply with its obligations set forth in Sections 3.02, 3.03 and 3.04 of this Agreement through maintaining user charges at the requisite levels through periodic adjustments made on the basis of a formula for calculation of tariff increases in real terms agreed with the Bank;

(b) permit DMEU to disconnect customers, as necessary, in order to enable DMEU to comply with its obligations set forth in Section 3.05 of this Agreement relating to the reduction of collection period for accounts receivable to 60 days commencing with the year 1997; and

(c) take all action required on its part for the reorganization of DMEU in accordance with Section 2.08 of this Agreement.

Section 2.03. Except as the Bank shall otherwise agree, procurement of the goods, works and consultants' services required for Part B of the Project and to be financed out of the proceeds of the Loan shall be governed by the provisions of

Schedule 4 to the Loan Agreement.

Section 2.04 (a) The City of Daugavpils and DMEU shall carry out 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, respectively) in respect of the Project Agreement and Part B of the Project.

(b) For purposes of Section 9.08 of the General Conditions, and without limitation thereto, the City of Daugavpils and DMEU shall:

- (i) prepare, on the basis of guidelines acceptable to the Bank, and furnish to the Bank 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, a plan for the future operation of Part B of the Project; and
- (ii) afford the Bank a reasonable opportunity to exchange views with the Borrower, the City of Daugavpils and DMEU on said plan.

Section 2.05 (a) DMEU shall duly perform all its obligations under the Subsidiary Loan Agreement. Except as the Bank shall otherwise agree, the City of Daugavpils and DMEU shall not take or concur in any action which would have the effect of amending, abrogating, assigning or waiving the Subsidiary Loan Agreement or any provision thereof.

(b) The City of Daugavpils shall provide an unconditional guarantee for the repayment of the principal, interest and other charges due under the DMEU Subsidiary Loan Agreement.

Section 2.06 (a) The City of Daugavpils and DMEU shall, at the request of the Bank, exchange views with the Bank with regard to the progress of Part B of the Project, the performance of their obligations under this Agreement and under the Subsidiary Loan Agreement, and other matters relating to the purposes of the Loan.

(b) The City of Daugavpils and DMEU shall promptly inform the Bank 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 Loan, or the performance by the City of Daugavpils and DMEU of their obligations under this Agreement and under the Subsidiary Loan Agreement.

Section 2.07 (a) During the execution of the Project, DMEU shall: (a) maintain the PMU with (i) functions and responsibilities acceptable to the Bank, including coordination with PCU in preparation of the report referred to in Section 3.05 (b) of the Loan Agreement, and (ii) staff, in adequate numbers, with qualifications, experience and terms of reference satisfactory to the Bank; and

(b) take all measures necessary to comply with all relevant environmental requirements of the Borrower governing the activities undertaken in carrying out Part B of the Project as well as with an environmental monitoring plan for Part B of the Project agreed with the Bank.

Section 2.08 (a) By January 1, 1997, DMEU shall furnish to the Bank its proposed plan for reorganization of the legal structure of DMEU for review and comments; and

(b) by December 31, 1997, take all action required to implement the said reorganization plan taking into account the comments and suggestions received from the Bank.

ARTICLE III

Financial Covenants

Section 3.01 (a) DMEU shall maintain or cause to be maintained records and accounts adequate to reflect in accordance with sound accounting practices the operations, resources and expenditures of DMEU.

(b) DMEU shall:

- (i) have the records and accounts referred to in paragraph (a) of this Section for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank;
- (ii) furnish to the Bank as soon as available, but in any case not later than six (6) months after the end of each such year, the report of such audit by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and
- (iii) furnish to the Bank such other information concerning said records and accounts and the audit thereof as the Bank shall from time to time reasonably request.

Section 3.02 (a) Except as the Bank shall otherwise agree, DMEU shall, for each fiscal year after fiscal year ending on December 31, 1996 generate funds from internal sources equivalent to at least 1.3 times the debt service requirements of DMEU for the relevant fiscal year on all debt of DMEU.

(b) For the purposes of Section 3.02 (a):

- (i) The term "funds from internal sources" means the difference between:
 - (A) the sum of (m) revenues from all sources related to operations, (n) net non-operating income and (o) any reduction in working capital other than cash; and
 - (B) the sum of all expenses related to operations, including (x) administration, maintenance, taxes and payments in lieu of taxes (excluding provision for depreciation and other non-cash operating charges), and (y) any 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 such revenues.
- (iii) The term "working capital other than cash" means the difference between (a) current assets excluding cash and (b) current liabilities at the end of each fiscal year.

- (iv) The term "current assets excluding cash" means all assets other than cash which could in the ordinary course of business be converted into cash within 12 months, including accounts receivable, marketable securities, inventories and prepaid expenses properly chargeable to the operating expenses within the next fiscal year.
- (v) The term "current liabilities" means all liabilities which will become due and payable or could under circumstances then existing be called for payment within 12 months, including accounts payable, customer advances, debt service requirements, taxes and payments in lieu of taxes, and dividends.
- (vi) The term "debt service requirements" means the aggregate amount of repayments (including sinking fund payments, if any) of, and interest and other charges, on debt.
- (vii) The term "capital expenditures" means all expenditures incurred on account of fixed assets.

Section 3.03 (a) Except as the Bank shall otherwise agree, DMEU shall, for each fiscal year after fiscal year ending December 31, 1996, have a net income greater than zero.

(b) For the purposes of Section 3.03 (a):

- (i) The term "net income" means "net operating income".
- (ii) The term "net operating income" means total operating revenues less total operating expenses.
- (iii) The term "total operating revenues" means revenues from all sources related to operations.
- (iv) The term "total operating expenses" means all expenses related to operations, including administration, adequate maintenance, taxes and payments in lieu of taxes, and provision for depreciation on a straight-line basis at a rate of not less than 4% per annum of the average current gross value of DMEU's fixed assets, or other basis acceptable to the Bank, but excluding interest and other charges on debt.
- (v) The average current gross value of DMEU's fixed assets shall be calculated as one half (1/2) of the sum of the gross value of DMEU's fixed assets at the beginning and at the end of the fiscal year, as valued from time to time in accordance with sound and consistently maintained methods of valuation satisfactory to the Bank.
- (vi) The term "current net value of DMEU's fixed assets" means the gross value of DMEU's fixed assets less the amount of accumulated depreciation, as valued from time to time in accordance with sound and consistently maintained methods of valuation satisfactory to the Bank.

Section 3.04 (a) Except as the Bank shall otherwise agree, DMEU shall, earn for each of its fiscal years after its

fiscal year ending on December 31, 1996, an annual return of not less than 1.5% of the average current net value of DMEU's fixed assets.

(b) For the purposes of Section 3.04 (a):

- (i) The annual return shall be calculated by dividing DMEU's net operating income for the fiscal year in question by one half (1/2) of the sum of the current net value of DMEU's fixed assets at the beginning and at the end of that fiscal year.
- (ii) The term "net operating income" means total operating revenues less total operating expenses.
- (iii) The term "total operating revenues" means revenues from all sources related to operations.
- (iv) The term "total operating expenses" means all expenses related to operations, including administration, adequate maintenance, taxes and payments in lieu of taxes, and provision for depreciation on a straight-line basis at a rate of not less than 4% per annum of the average current gross value of DMEU's fixed assets, or other basis acceptable to the Bank, but excluding interest and other charges on debt.
- (v) The average current gross value of DMEU's fixed assets shall be calculated as one half (1/2) of the sum of the gross value of DMEU's fixed assets at the beginning and at the end of the fiscal year, as valued from time to time in accordance with sound and consistently maintained methods of valuation satisfactory to the Bank.
- (vi) The term "current net value of DMEU's fixed assets" means the gross value of DMEU's fixed assets less the amount of accumulated depreciation, as valued from time to time in accordance with sound and consistently maintained methods of valuation satisfactory to the Bank.

Section 3.05. Except as the Bank shall otherwise agree, commencing with the year 1997, DMEU shall reduce the collection period for its accounts receivable to 60 days.

ARTICLE IV

Effective Date; Termination;
Cancellation and Suspension

Section 4.01. This Agreement shall come into force and effect on the date upon which the Loan Agreement becomes effective.

Section 4.02. This Agreement and all obligations of the Bank, the City of Daugavpils and of DMEU thereunder shall terminate on the date on which the Loan Agreement shall terminate in accordance with its terms, and the Bank shall promptly notify the City of Daugavpils and DMEU thereof.

Section 4.03. All the provisions of this Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the General Conditions.

ARTICLE V

Miscellaneous Provisions

Section 5.01. 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, N.W.
Washington, D.C. 20433
United States of America

Cable address:

INTBAFRAD
Washington, D.C.

Telex:

248423 (RCA)
82987 (FTCC)
64145 (WUI) or
197688 (TRT)

For The City of Daugavpils::

Kr. Valdemara iela 1
Daugavpils LV-5400
Latvia

For DMEU:

Udensvada iela 3
Daugavpils LV-5400
Latvia

Section 5.02. Any action required or permitted to be taken, and any document required or permitted to be executed, under this Agreement on behalf of the City of Daugavpils and DMEU may be taken or executed by the Chairman of the City Council of the City of Daugavpils for the City of Daugavpils and the Director of the DMEU for the DMEU, or such other person or persons as the Chairman of the City Council of the City of Daugavpils or the Director of the DMEU respectively shall designate in writing, and DMEU shall furnish to the Bank sufficient evidence of the authority and the authenticated specimen signature of each such person.

Section 5.03. 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 District of Columbia, United States of America, as of the day and year first above written.

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Basil G. Kavalsky
Acting Regional Vice President
Europe and Central Asia

THE CITY OF DAUGAVPILS

By /s/ Ojars Kalnins
Authorized Representative

THE DAUGAVPILS MUNICIPAL ENTERPRISE UDENSVADS

By /s/ Ojars Kalnins
Authorized Representative

