

CONFORMED COPY

CREDIT NUMBER 3503 MOG

Development Credit Agreement

(Energy Project)

between

MONGOLIA

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated August 02, 2001

CREDIT NUMBER 3503 MOG

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated August 02, 2001, between MONGOLIA (the Borrower) and the INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS (A) the Borrower, having satisfied itself as to the feasibility and priority of the Project described in Schedule 2 to this Agreement, has requested the Association to assist in the financing of the Project;

(B) Parts A and B of the Project will be carried out by the Energy Authority of Mongolia (Energy Authority) with the Borrower's assistance and, as part of such assistance, the Borrower will make available to the Energy Authority part of the proceeds of the Credit as provided in this Agreement; and

WHEREAS the Association has agreed, on the basis, inter alia, of the foregoing, to extend the Credit to the Borrower upon the terms and conditions set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Development Credit Agreements" of the Association, dated January 1, 1985 (as amended through October 6,

1999), (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 wherever used in this Agreement:

(a) "Aimag Utilities" means, collectively, entities responsible for providing electricity and heat services at the Aimag (Provincial) level, and successors thereto, and "Aimag Utility" means any of the Aimag Utilities.

(b) "Category" means a category of items as set forth in the table in paragraph 1 of Schedule 1 to this Agreement.

(c) "Energy Authority" and the acronym "EA" mean the Implementing Agency of Government established by Resolution No. 300, dated December 5, 1996, issued by the Minister of Infrastructure pursuant to Parliamentary Resolution No. 40 of December 1996, on Administrative Structure of Government, responsible for implementing the energy policy of the Ministry of Infrastructure throughout Mongolia, and any successor thereto.

(d) "Energy Law" means the law on electricity and heat supply and distribution, approved by the Borrower's Parliament on February 1, 2001.

(e) "Energy Regulatory Authority" means the entity to be established pursuant to the Energy Law to regulate the generation, distribution, transmission and supply of energy in the Borrower's territory.

(f) "Ministry of Infrastructure" and "MI" mean the Borrower's Ministry of Infrastructure, and any successor thereto.

(g) "Ministry of Finance and Economy" and "MOFE" mean the Borrower's Ministry of Finance and Economy, and any successor thereto.

(h) "Phase 1 Selected Aimag Utilities" means Selected Aimag Utilities participating in Part B.2 of the Project, listed in the Annex to Schedule 2 to this Agreement, as such Annex may be amended from time to time.

(i) "Project Agreement" means the agreement between the Association and the Energy Authority of even date herewith, as the same may be amended from time to time, and such term includes all schedules and agreements supplemental to the Project Agreement.

(j) "Project Management Report" means each report prepared in accordance with Section 4.02 of the Project Agreement.

(k) "Project Implementation Unit" and the acronym "PIU" mean the unit established within the Energy Authority in 2000, for purposes of overall coordination of the Project activities.

(l) "Respective Part of the Project" means: (i) in respect of UBEDO, Part A of the Project; (ii) in respect of Dornod Aimag Utility, Part B.1 of the Project; and (iii) other Selected Aimag Utilities, Project activities under Part B.2 or Part B.3 of the Project, as the case may be.

(m) "Selected Aimag Utilities" means, collectively, the Aimag Utilities that meet the selection criteria for participation in the carrying out of Part B of the Project, in accordance with the provisions of Section 3.08 of this Agreement and successors thereto, and "Selected Aimag Utility" means any of the Selected Aimag Utilities.

(n) "Subsidiary Loan Agreement" means the agreement to be entered into between the Borrower and the Energy Authority pursuant to Section 3.01 of this Agreement, as the same may be amended from time to time with the prior concurrence of the Association, and such term includes all schedules to the Subsidiary Loan

Agreement.

(o) "Special Account" means the account referred to in Section 2.02 (b) of this Agreement.

(p) "Ulaanbaatar Electricity Distribution Office" and the acronym "UBEDO" mean the affiliate of the Energy Authority responsible for the distribution of electricity throughout the city of Ulaanbaatar, and any successor thereto.

ARTICLE II

The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Development Credit Agreement, an amount in various currencies equivalent to twenty-three million four hundred thousand Special Drawing Rights (SDR 23,400,000).

Section 2.02. (a) The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Association shall so agree, to be made) in respect of the reasonable cost of goods and services required for the Project described in Schedule 2 to this Agreement and to be financed out of the proceeds of the Credit.

(b) The Borrower may, for the purposes of the Project, open and maintain in Dollars a special deposit account in a commercial bank on terms and conditions satisfactory to the Association, including appropriate protection against set-off, seizure or attachment. Deposits into, and payments out of the Special Account shall be made in accordance with the provisions of Schedule 3 to this Agreement.

Section 2.03. The Closing Date shall be December 31, 2006 or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such later date.

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty days after the date of this Agreement (the accrual date) to the respective dates on which amounts shall be withdrawn by the Borrower from the Credit Account or canceled; and (ii) at the rate set as of the June 30 immediately preceding the accrual date and at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of June 30 in each year shall be applied from the next date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent (3/4 of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment charges and service charges shall be payable semiannually on April 15 and October 15 in each year.

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semi-annual installments payable on each April 15 and each October 15, commencing October 15, 2011, and ending on April 15, 2041. Each installment to and including the installment payable on April 15, 2021

shall be one percent (1%) of such principal amount, and each installment thereafter shall be two percent (2%) of such principal amount.

(b) Whenever: (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three consecutive years the level established annually by the Association for determining eligibility to access the Association's resources; and (ii) the Bank shall consider the Borrower creditworthy for Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by: (A) requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid; and (B) requiring the Borrower to commence repayment of the principal amount of the Credit as of the first semiannual payment date referred to in paragraph (a) above falling six months or more after the date on which the Association notifies the Borrower that the events set out in this paragraph (b) have occurred, provided, however, that there shall be a grace period of a minimum of five years on such repayment of principal.

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(d) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of the United States of America is hereby specified for the purposes of Section 4.02 of the General Conditions.

ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, without any limitation or restriction upon any of its other obligations under the Development Credit Agreement, shall:

(i) carry out Part C of the Project through the Ministry of Infrastructure with due diligence and efficiency and in conformity with appropriate administrative, financial and utilities practice, and provide promptly as needed, the funds, facilities, services and other resources required for said Part C of the Project; and

(ii) cause the Energy Authority, and any successor thereto, to perform in accordance with the provisions of the Project Agreement all the obligations of the Energy Authority therein set forth; shall take and cause to be taken all action, including the provision of funds, facilities, services and other resources, necessary or appropriate to enable the Energy Authority to perform its obligations under the Project Agreement; and shall not take or permit to be taken any action which would prevent or interfere with such performance.

(b) To these ends, the Borrower shall make available to the Energy Authority part of the proceeds of the Credit up to the aggregate amount allocated from time to time to the Categories (1)(a), (1)(b), (1)(c), (2)(a), (2)(b) and (2)(c), under a subsidiary loan agreement to be entered into between the Borrower and the Energy Authority, under terms and conditions acceptable to the Association which shall include the following:

(i) interest at a rate of four per cent (4%) per annum on the principal amount so made available to the Energy Authority and outstanding from time to time, shall accrue from the day immediately following the end of the grace period mentioned in (ii) below;

(ii) the principal amount shall be repaid by the Energy Authority over a period of twenty (20) years, including a grace period of eight (8) years, and shall be the equivalent in Dollars (determined as of the date of respective withdrawals from the Credit Account or payment out of the Special Account) of the respective SDR amounts; and

(iii) the Electricity Authority shall, out of the part of the proceeds of the Credit so made available to it, re-lend: (A) to UBEDO, for purposes of carrying out Part A of the Project, an amount of SDR equal to the amount allocated from time to time Categories (1)(a) and (2)(a); and (B) to the Selected Aimag Utilities, for purposes of carrying out Part B of the Project, an aggregate amount of SDR equal to the amount allocated from time to time to Categories (1)(b), (1)(c), (2)(b) and (2)(c).

(c) The Borrower shall exercise its rights under the Subsidiary Loan Agreement in such manner as to protect the interest of the Borrower and the Association and to accomplish the purposes of the Credit, and except as the Association shall otherwise agree, the Borrower shall not assign, amend, abrogate or waive the Subsidiary Loan Agreement or any provision thereof.

Section 3.02. Except as the Association shall otherwise agree, procurement of the goods and consultants' services required for the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 1 to the Project Agreement.

Section 3.03. The Borrower and the Association hereby agree that 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, respectively) in respect of Parts A and B of the Project shall be carried out by the Energy Authority pursuant to Section 2.03 of the Project Agreement.

Section 3.04. Unless otherwise agreed by the Association, the Borrower shall:

(a) by November 30, 2001, prepare and furnish to the Association a time-bound action plan for restructuring its electric power and heat supply sector, including measures to enhance private sector participation therein, and the establishment of an energy regulatory entity with functions, powers and responsibilities satisfactory to the Association, to implement and enforce the Borrower's Energy Law, develop any necessary subsidiary legislation, undertake electricity tariff level and rate structure analysis, financial analysis for power utilities regulation, and transition to market-based electricity distribution systems taking into account Mongolia's characteristics; and

(b) thereafter, taking into account the Association's comments, if any, implement such time-bound action plan.

Section 3.05. Unless otherwise agreed by the Association, the Borrower shall, by June 30, 2002, furnish to the Association, for its review and comments, a time-bound action plan to ensure the financing of the full cost of electricity services in the various Aimags participating in the Project; and thereafter, taking into account the Association's comments, if any, implement such time-bound action plan.

Section 3.06. Unless otherwise agreed by the Association, the Borrower shall, by June 30, 2002, furnish to the Association, for its review and comments, a time-bound action plan to restructure the residential electricity tariff to provide for block rates reflecting increasing unit rates for increasing consumption categories; and thereafter, taking into account the Association's comments, if any, implement such time-bound action plan.

Section 3.07. Without limitation to the provisions of Section 3.01 of this Agreement, the Borrower shall take all such action as shall be necessary to ensure that the Energy Authority shall be able comply with its financial obligations set forth in the Project Agreement, in particular Section 4.03 therein, including regular

adjustments to electricity and heat prices charged by the Energy Authority and timely payment for electricity and heat services provided by the Energy Authority to facilities and companies owned by the Borrower.

Section 3.08. The Borrower shall, and shall cause the Energy Authority to, select Aimag Utilities to participate in the carrying out of Part B of the Project pursuant to criteria satisfactory to the Association.

Section 3.09. For the purposes of Section 9.06 of the General Conditions and without limitation thereto, the Borrower shall:

(a) prepare, on the basis of guidelines acceptable to the Association and furnish to the Association 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 Association, a plan for the continued achievement of the Project's objectives; and

(b) afford the Association a reasonable opportunity to exchange views with the Borrower on said plan.

ARTICLE IV

Financial Covenants

Section 4.01. (a) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of statements of expenditure, the Borrower shall:

(i) maintain or cause to be maintained in accordance with sound accounting practices, records and separate accounts reflecting such expenditures;

(ii) ensure that all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures are retained until at least one year after the Association has received the audit report for the fiscal year in which the last withdrawal from the Credit Account was made; and

(iii) enable the Association's representatives to examine such records.

(b) The Borrower shall:

(i) have the records and accounts referred to in paragraph (a) (i) of this Section and those for the Special Account 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 the report of such audit by said auditors, of such scope and in such detail as the Association shall have reasonably requested, including a separate opinion by said auditors as to whether the statements of expenditure submitted during such fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawals; and

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

ARTICLE V

Remedies of the Association

Section 5.01. Pursuant to Section 6.02 (1) of the General Conditions, the following additional events are specified:

(a) The Energy Authority shall have failed to perform any of its obligations under the Project Agreement;

(b) As a result of events which have occurred after the date of the

Development Credit Agreement, an extraordinary situation shall have arisen which shall make it improbable that the Energy Authority will be able to perform its obligations under the Project Agreement;

(c) Either the Energy Law of Mongolia dated February 1, 2001, or the Resolution No. 300 of the Minister of Infrastructure dated December 5, 1996, shall have been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of the Energy Authority to perform any of its obligations under the Project Agreement; and

(d) The Borrower or any other authority having jurisdiction shall have taken any action for the dissolution or disestablishment of the Energy Authority or for the suspension of its operations.

Section 5.02. Pursuant to Section 7.01 (d) of the General Conditions, the following additional events are specified:

(a) the event specified in paragraph (a) of Section 5.01 of this Agreement shall occur and shall continue for a period of sixty days after notice thereof shall have been given by the Association to the Borrower; and

(b) any event specified in paragraphs (c) and (d) of Section 5.01 of this Agreement shall occur.

ARTICLE VI

Effective Date; Termination

Section 6.01. The following events are specified as additional conditions to the effectiveness of the Development Credit Agreement within the meaning of Section 12.01 (b) of the General Conditions:

(a) the Subsidiary Loan Agreement has been executed on behalf of the Borrower and the Energy Authority; and

(b) the Energy Authority has entered into project implementation arrangements satisfactory to the Association, with UBEDO, Dornod Aimag Utility, and each of the Phase 1 Selected Aimag Utilities in regard to Parts A, B.1 and B.2 of the Project, respectively, in accordance with the provisions of paragraph 2 of Schedule 2 to the Project Agreement.

Section 6.02. The following are specified as additional matters, within the meaning of Section 12.02 (b) of the General Conditions, to be included in the opinion or opinions to be furnished to the Association:

(a) that the Project Agreement has been duly authorized or ratified by the Energy Authority, and is legally binding upon the Energy Authority in accordance with its terms;

(b) that the Subsidiary Loan Agreement has been duly authorized or ratified by the Borrower and the Energy Authority and is legally binding upon the Borrower and the Energy Authority in accordance with its terms; and

(c) that the project implementation arrangements between the Energy Authority and, respectively, UBEDO, Dornod Aimag Utility and each of the Phase 1 Selected Aimag Utilities have been duly executed and are legally binding upon the parties thereto in accordance with their terms.

Section 6.03. The date one hundred twenty (120) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VII

Representative of the Borrower; Addresses

Section 7.01. The Minister of Finance and Economy of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministry of Finance and Economy
United Nations Street - 5/1
Ulaanbaatar - 210646
Mongolia

Facsimile:

976- 11- 320247
976- 11- 325887

For the Association:

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

Cable address:

INDEVAS
Washington, D.C.

Telex:

248423 (MCI) (1-202) 477-6391
64145 (MCI)

Facsimile:

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

MONGOLIA

By /s/ Chultemiin Ulaan

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Ian C. Porter

Authorized Representative

SCHEDULE 1

Withdrawal of the Proceeds of the Credit

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Credit, the allocation of the amounts of the Credit to each Category and the percentage of expenditures for items so to be financed in each Category:

Category	Amount of the Credit Allocated (Expressed in SDR Equivalent)	% of Expenditures to be Financed
(1) Goods:		
(a) under Part A of the Project of (ex- 75% expenditures other items procured locally	12,650,000	100% of foreign expenditures, 100% local expenditures factory cost) and of local for
(b) under Parts B (1) and B (2) of the Project	4,700,000	

(c) under Part B (3) of the Project	2,570,000	
(2) Consultants' services and training:		100%
(a) under Part A of the Project	1,800,000	
(b) under Parts B (1) and B (2) of the Project	300,000	
(c) under Part B (3) of the Project	300,000	
(d) under Part C of the Project	150,000	
(3) Unallocated	930,000	
TOTAL	23,400,000	

2. For the purposes of this Schedule:

(a) the term "foreign expenditures" means expenditures in the currency of any country other than that of the Borrower for goods or services supplied from the territory of any country other than that of the Borrower; and

(b) the term "local expenditures" means expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of:

(a) payments made for expenditures prior to the date of this Agreement; and

(b) payments made for expenditures under: (i) Categories (1)(a) and (2)(a) until UBEDO has established a Project working group satisfactory to the Association in accordance with the provisions of paragraph 2(a) of Schedule 2 to the Project Agreement; (ii) Categories (1)(b) and (2)(b) until each of Dornod Aimag Utility and the Phase 1 Selected Aimag Utilities has established its respective Project working group satisfactory to the Association in accordance with the provisions of paragraph 2(a) of Schedule 2 to the Project Agreement; and (iii) Categories (1)(c) and (2)(c) until the Energy Authority has entered in project implementation arrangements with at least two additional Selected Aimag Utilities in accordance with the provisions of paragraph 2 of Schedule 2 to the Project Agreement, and said Selected Aimag Utilities have established their respective Project working groups satisfactory to the Association in accordance with the provisions of paragraph 2(a) of Schedule 2 to the Project Agreement.

4. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures for: (a) goods under contracts costing less than \$150,000 equivalent each; (b) consultants' services under contracts awarded to consulting firms costing less than \$100,000 equivalent each; (c) consultants' services under contracts awarded to individual consultants costing less than \$50,000 equivalent each; and (d) training; all under such terms and conditions as the Association shall specify by notice to the Borrower.

SCHEDULE 2

Description of the Project

The objective of the Project is to assist the Borrower to: (i) reduce electricity system losses and improve service reliability in electricity distribution in Ulaanbaatar and selected Aimag (provincial) centers; (ii) improve revenue collections in the electricity distribution system; and (iii) build up institutional capacity to move toward a more commercial and market-based energy sector.

The Project consists of the following parts, subject to such modifications thereof as the Borrower and the Association may agree upon from time to time to achieve such objectives:

PART A: Ulaanbaatar Electricity Distribution System

1. Implementation of a program to reduce technical losses and improve reliability of electricity services in the city of Ulaanbaatar, consisting of:

(a) Installation of additional low- and mid-voltage lines and 10/.4 kilovolt (kV) transformers; installation of additional distribution substations; reconfiguration of existing low- and mid-voltage lines to balance loads on existing transformers; and replacement of under-loaded transformers.

(b) Rehabilitation of the Dornod 1 substation through the removal of the existing transformers, reconductoring of two 35kV overhead lines with a 10kV overhead line, and installation of a new 10 kV underground line from the Tuul substation.

(c) Improvement of low-voltage lines by reconductoring existing smaller conductors with larger conductors and replacing bare conductors with insulated ones.

(d) Improvement of the reliability and safety of the distribution system through the provision of spare parts, safety equipment and measurement tools.

2. Implementation of a program to reduce non-technical loss consisting of:

(a) Improvement of the metering system for residential customers through the installation of meters for residential customers in Ger areas who do not currently have meters; transfer of metering functions in apartment buildings from the housing companies to UBEDO; and replacement of customer-owned meters with meters owned by UBEDO.

(b) Improvement of the metering system for commercial and industrial customers, including installation of meters for those customers which do not currently have meters and improvement of connections on metering circuits.

(c) Installation of new meters with current 10kV transformers where metering is inadequate.

3. Implementation of a program of institutional strengthening consisting of:

(a) Reengineering of UBEDO's business procedures, including establishment of a meter management division, computerization of customer information and account management system, changes in meter reading, billing and money collection procedures, implementation of public information and consultation campaigns on the business reengineering initiatives.

(b) Strengthening of the technical, financial and management capacity of UBEDO to operate as a commercial power distribution entity.

PART B: Aimag Center Electric Power Systems

1. Rehabilitation and improvement of the electricity and heat distribution system of the city of Choibalsan in Dornod Aimag, including installation of new meters, meter boxes and connection materials, reconfiguration and reconductoring of low-voltage lines, provision of key switchgear for transformer stations, replacement of corroded heat pipelines, installation of pumps, replacement of valves and fittings, provision of tools and spare parts, and provision of technical assistance and training.

2. Implementation of a program to improve service reliability and reduce electricity losses in the electricity distribution system of selected Aimag Utilities, consisting of: reconfiguration and reconductoring of the electricity distribution lines, reconfiguration of transformers, replacement of switchgears in transformer stations, provision of electricity meters, meter boxes, connection materials and ancillary equipment, provision of transportation, communication and electricity measurement equipment, and provision of technical assistance and training.

3. Implementation of a program to improve service reliability and reduce electricity losses in the electricity distribution systems of up to eight additional selected Aimag Utilities, consisting of: reconfiguration and reconductoring of the electricity distribution lines, replacement of transformers, switchgears and power poles, provision of electricity meters and related ancillary equipment, provision of transportation, communication and electricity measurement equipment, and provision of technical assistance and training.

PART C: Technical Assistance for Electricity Sector Reform

Support for the development of the Energy Regulatory Authority through the provision of technical assistance and training.

* * *

The Project is expected to be completed by June 30, 2006.

ANNEX TO SCHEDULE 2

Phase 1 Selected Aimags Utilities
Participating in Part B.2 of the Project

1. Omnogovi Aimag Utility
2. Bayan-Hongor Aimag Utility
3. Govialtai Aimag Utility
4. Zavkhan Aimag Utility
5. Hovsgol Aimag Utility
6. Sukhbaatar Aimag Utility

SCHEDULE 3

Special Account

1. For the purposes of this Schedule:

(a) the terms "eligible Categories" means Categories 1 and 2 set forth in the table in paragraph 1 of Schedule 1 to this Agreement;

(b) the term "eligible expenditures" means expenditures in respect of the reasonable cost of goods and services required for the Project and to be financed out of the proceeds of the Credit allocated from time to time to the eligible Categories in accordance with the provisions of Schedule 1 to this Agreement; and

(c) the term "Authorized Allocation" means an amount equivalent to \$500,000 to be withdrawn from the Credit Account and deposited into the Special Account pursuant to paragraph 3(a) of this Schedule, provided, however, that unless the Association shall otherwise agree, the Authorized Allocation shall be limited to an amount equivalent to \$200,000 until the aggregate amount of withdrawals from the Credit Account plus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions shall be equal to or exceed the equivalent of SDR 1,500,000.

2. Payments out of the Special Account shall be made exclusively for eligible expenditures in accordance with the provisions of this Schedule.

3. After the Association has received evidence satisfactory to it that the Special Account has been duly opened, withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:

(a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the Association a request or requests for deposit into the Special Account of an amount or amounts which do not exceed the aggregate amount of the Authorized Allocation. On the basis of such request or requests, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount or amounts as the Borrower shall have requested.

(b) (i) For replenishment of the Special Account, the Borrower shall furnish to the Association requests for deposits into the Special Account at such intervals as the Association shall specify.

(ii) Prior to or at the time of each such request, the Borrower shall furnish to the Association the documents and other evidence required pursuant to paragraph 4 of this Schedule for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Association shall, on behalf of

the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account for eligible expenditures.

All such deposits shall be withdrawn by the Association from the Credit Account under the respective eligible Categories, and in the respective equivalent amounts, as shall have been justified by said documents and other evidence.

4. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the Association shall reasonably request, furnish to the Association such documents and other evidence showing that such payment was made exclusively for eligible expenditures.

5. Notwithstanding the provisions of paragraph 3 of this Schedule, the Association shall not be required to make further deposits into the Special Account:

(a) if, at any time, the Association shall have determined that all further withdrawals should be made by the Borrower directly from the Credit Account in accordance with the provisions of Article V of the General Conditions and paragraph (a) of Section 2.02 of this Agreement;

(b) if the Borrower shall have failed to furnish to the Association, within the period of time specified in Section 4.01 (b) (ii) of this Agreement, any of the audit reports required to be furnished to the Association pursuant to said Section in respect of the audit of the records and accounts for the Special Account;

(c) if, at any time, the Association shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account pursuant to the provisions of Section 6.02 of the General Conditions; or

(d) once the total unwithdrawn amount of the Credit allocated to the eligible Categories, minus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions with respect to the Project, shall equal the equivalent of twice the amount of the Authorized Allocation.

Thereafter, withdrawal from the Credit Account of the remaining unwithdrawn amount of the Credit allocated to the eligible Categories shall follow such procedures as the Association shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Association shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for eligible expenditures.

6. (a) If the Association shall have determined at any time that any payment out of the Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Schedule; or (ii) was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association: (A) provide such additional evidence as the Association may request; or (B) deposit into the Special Account (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment or the portion thereof not so eligible or justified. Unless the Association shall otherwise agree, no further deposit by the Association into the Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Association shall have determined at any time that any amount outstanding in the Special Account will not be required to cover further payments for eligible expenditures, the Borrower shall, promptly upon notice from the Association, refund to the Association such outstanding amount.

(c) The Borrower may, upon notice to the Association, refund to the Association all or any portion of the funds on deposit in the Special Account.

(d) Refunds to the Association made pursuant to paragraphs 6 (a), (b) and (c) of this Schedule shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the relevant provisions.

