

CONFORMED COPY

LOAN NUMBER 4324 UA

Project Agreement

(Kiev District Heating Improvement Project)

between

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

and

KIEVENERGO

Dated October 14, 1998

LOAN NUMBER 4324 UA

PROJECT AGREEMENT

AGREEMENT, dated October 14, 1998, between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and KIEVENERGO (Kievenergo).

WHEREAS (A) by the Loan Agreement of even date herewith between Ukraine (the Borrower) and the Bank, the Bank has agreed to make available to the Borrower an amount equal to two hundred million Dollars (\$200,000,000) on the terms and conditions set forth in the Loan Agreement, but only on condition that Kievenergo 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 Kievenergo the proceeds of the loan provided for under the Loan Agreement for Parts A, C.2 and C.4 of the Project will be made available to Kievenergo on the terms and conditions set forth in said Subsidiary Loan Agreement; and

WHEREAS Kievenergo, in consideration of the Bank's entering into the Loan Agreement with the Borrower, 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 several terms defined in the Loan Agreement, the Preamble to this Agreement and the General Conditions (as so defined) have the respective meanings therein set forth and the additional term, "Kievenergo Fiscal Year," shall mean the year that commences on January 1 and ends on December 31 of each calendar year.

ARTICLE II

Execution of the Project

Section 2.01. Kievenergo declares its commitment to the objectives of the Project as set forth in Schedule 2 to the Loan Agreement, and, to this end, shall carry out Parts A, C.2 and C.4 of the Project with due diligence and efficiency and in conformity with appropriate administrative, financial, engineering, environmental, technical and utility practices, and shall provide, or cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the said Parts of the Project.

Section 2.02. Kievenergo shall duly perform all its obligations under the Subsidiary Loan Agreement. Except as the Bank shall otherwise agree, Kievenergo 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.

Section 2.03. Except as the Bank shall otherwise agree, procurement of the goods, works and consultants' services required for Parts A, C.2 and C.4 of the Project and to be financed out of the proceeds of the Loan shall be governed by the provisions of the Schedule to this Agreement.

Section 2.04. (a) Kievenergo 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, works and services, plans and schedules, records and reports, maintenance and land acquisition, respectively) in respect of the Project Agreement.

(b) For the purposes of Section 9.07 of the General Conditions and without limitation thereto, Kievenergo 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 Bank and Kievenergo, a plan for the future operation of Parts A, C.2 and C.4 of the Project; and

(ii) afford the Bank a reasonable opportunity to exchange views with Kievenergo on said plan.

Section 2.05. (a) Kievenergo shall, at the request of the Bank, exchange views with the Bank with regard to progress of Parts A, C.2 and C.4 of the Project, the performance of its obligations under this Agreement and under the Subsidiary Loan Agreement, and other matters relating to the purposes of the Loan.

(b) Kievenergo shall promptly inform the Bank of any condition which interferes or threatens to interfere with the progress of the said Parts of the Project, the accomplishment of the purposes of Loan, or the performance by Kievenergo of its obligations under this Agreement and under the Subsidiary Loan Agreement.

Section 2.06. Kievenergo shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the indicators agreed upon between the Borrower and the Bank, the carrying out of Parts A, C.2 and C.4 of the Project and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Bank and furnish to the Bank by or before January 31 and July 31 of each year a semi-annual progress report which shall include, inter alia, information regarding overall progress of implementation of Parts A, C.2 and C.4 of the Project, costs of contracts concluded under the said Parts of the Project in the period covered by the report, list of

procurement actions undertaken, summary of financial performance of Kievenergo, status of Kievenergo's compliance with Project Agreement covenants, issues affecting implementation of the said Parts of the Project and evaluation of Kievenergo's compliance with performance indicators;

(c) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, on or about June 30, 2001, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of Parts A, C.2 and C.4 of the Project during the period preceding the date of said report and setting out the measures recommended to ensure the efficient carrying out of the said Parts of the Project and the achievement of the objectives of the Project during the period following such date; and

(d) review with the Bank, by September 30, 2001, or such later date as the Bank shall request, the report referred to in subparagraph (c) of this Section, and thereafter, take all measures required to ensure the efficient completion of Parts A, C.2 and C.4 of the Project and the achievement of the objectives of the Project, based on the conclusions and recommendations of the said report and the Bank's views on the matter.

ARTICLE III

Management and Operations of Kievenergo

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

Section 3.02. Kievenergo shall 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 engineering, financial, environmental and utility practices.

Section 3.03. Kievenergo shall take out and maintain with responsible insurers, or make other provision satisfactory to the Bank for, insurance against such risks and in such amounts as shall be consistent with appropriate practice.

ARTICLE IV

Financial Covenants

Section 4.01. (a) Kievenergo shall maintain records and accounts adequate to reflect in accordance with sound accounting practices its operations and financial condition and to register separately the operations, resources and expenditures related to Parts A, C.2 and C.4 of the Project.

(b) Kievenergo shall:

(i) have its records, accounts and financial statements (balance sheets, statements of income and expenses and related statements) and the records and accounts 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) 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: (A) certified copies of the financial statements referred to in paragraph (a) above 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 Bank shall have reasonably requested; and

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

(c) For all expenditures with respect to which withdrawals from the Loan Account were made on the basis of statements of expenditures, Kievenergo shall:

- (i) maintain, in accordance with paragraph (a) of this Section, records and accounts reflecting such expenditures;
- (ii) retain, until at least one year after the Bank has received the audit report for the fiscal year in which the last withdrawal from the Loan Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;
- (iii) enable the Bank's representatives to examine such records; and
- (iv) ensure that such records and accounts are included in the annual audit referred to in paragraph (b) of this Section and that the report of such audit contains a separate opinion by said auditors as to whether the statements of expenditures 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.

Section 4.02. (a) Except as the Bank shall otherwise agree, Kievenergo shall not incur any debt unless a reasonable forecast of the revenues and expenditures of Kievenergo shows that the estimated net revenues of Kievenergo for each fiscal year during the term of the debt to be incurred shall be at least 1.5 times the estimated debt service requirements of Kievenergo in such year on all debt of Kievenergo including the debt to be incurred.

(b) For the purposes of this Section:

- (i) The term "debt" means any indebtedness of Kievenergo 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

Kievenergo not earlier than twelve (12) months prior to the incurrence of the debt in question, which both the Bank and Kievenergo accept as reasonable and as to which the Bank has notified Kievenergo 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 Kievenergo.

(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 Bank.

Section 4.03. (a) Except as the Bank shall otherwise agree, Kievenergo shall maintain a ratio of current assets to current liabilities of not less than 1.2.

(b) Before October 1 in each of its fiscal years, Kievenergo shall, on the basis of forecasts prepared by Kievenergo and satisfactory to the Bank, review whether it 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 Bank the results of such review upon its completion.

(c) If any such review shows that Kievenergo would not meet the requirements set forth in paragraph (a) for Kievenergo's fiscal years covered by such review, Kievenergo shall promptly take all necessary measures (including, without limitation, adjustments of the structure or level of its heat and electricity tariffs) in order to meet such requirements.

(d) For the purpose of this Section:

(i) The term "current assets" means cash, all assets which could in the ordinary course of business be converted into cash within twelve (12) months, including accounts receivable, marketable securities, inventories and pre-paid expenses properly chargeable to operating expenses within the next fiscal year.

(ii) The term "current liabilities" means all liabilities which will become due and payable or could under circumstances then existing be called for payment within twelve (12) months, including accounts payable, customer advances, debt service requirements, taxes and payments in lieu of taxes, and dividends.

(iii) 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.

(iv) 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 Bank.

Section 4.04. Kievenergo shall take all actions required on its part to request NERC and the City of Kiev to establish electricity tariffs and heat tariffs for Kievenergo, respectively, at such levels as shall enable Kievenergo to cover the costs of production, transmission and distribution, operation and maintenance, interest payments, make allowances for depreciation and make contributions to its reserves and comply with the covenants set out in Sections 4.02 and 4.03 of this Project Agreement.

Section 4.05. Except as the Bank shall otherwise agree, Kievenergo shall reduce its overall accounts receivables for all customers, except for accounts receivables for budgetary organizations prior to January 1, 1998, to: (i) 175 days by December

31, 1998; (ii) 150 days by December 31, 1999; (iii) 130 days by December 31, 2000; (iv) 110 days by December 31, 2001; (v) 90 days by December 31, 2002; and (vi) 70 days by December 31, 2003, and thereafter maintain its overall accounts receivables at the 70 days level.

Section 4.06. By no later than the date of signature of the EBRD Loan by Ukraine and EBRD and related legal documents (the "Signature Date"), Kievenergo shall:

(a) conclude a debt restructuring agreement with KMDHC for repayment, over a period of one year, of Kievenergo's arrears to KMDHC outstanding as of the said Signature Date, and commence paying installments due to KMDHC pursuant to the said debt restructuring agreement; and

(b) make timely payments to KMDHC of the distribution fee for heat, payable to KMDHC at levels established from time to time by the City of Kiev.

Section 4.07. Beginning with its Fiscal Year 1999, Kievenergo shall prepare and furnish to the Bank on or about March 31 of each year during Project implementation, a financial report, containing its financial projections for the upcoming year.

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 Loan Agreement becomes effective.

Section 5.02. This Agreement and all obligations of the Bank and of Kievenergo thereunder shall terminate on the date on which the Loan Agreement shall terminate in accordance with its terms, and the Bank shall promptly notify Kievenergo thereof.

Section 5.03. All 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)

For Kievenergo:

5 Ivan Franko Square
Kyiv
Ukraine 252001

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 Kievenergo, may be taken or executed by the Chairman of the Board of Kievenergo or such other person or persons as the Chairman of the Board of Kievenergo shall designate in writing, and Kievenergo 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 District of Columbia, United States of America, as of the day and year first above written.

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Paul Siegelbaum

Acting Regional Vice President
Europe and Central Asia

KIEVENERGO

By /s/ Ivan V. Plachkov

Authorized Representative

SCHEDULE

Procurement and Consultants' Services

Section I. Procurement of Good and Works

Part A: General

Goods and works shall be procured in accordance with the provisions of Section I of the "Guidelines for Procurement under IBRD Loans and IDA Credits" published by the Bank in January 1995 and revised in January and August 1996 and September 1997 (the Guidelines) and the following provisions of Section I of this Schedule.

Part B: International Competitive Bidding

1. Except as otherwise provided in Part C of this Section, goods and works shall be procured under contracts awarded in accordance with the provisions of Section II of the Guidelines and paragraph 5 of Appendix 1 thereto.

2. The following provisions shall apply to goods and works to be procured under contracts awarded in accordance with the provisions of paragraph 1 of this Part B.

(a) Prequalification

Bidders for supply of goods and mechanical installations in the amounts of \$10,000,000 equivalent or more per contract shall be prequalified in accordance with the provisions of paragraphs 2.9 and 2.10 of the Guidelines.

(b) Preference for domestically manufactured goods

The provisions of paragraphs 2.54 and 2.55 of the Guidelines and Appendix 2 thereto shall apply to goods manufactured in the territory of the Borrower.

(c) Notification and Advertising

The invitation to prequalify or bid for each contract estimated to cost \$10,000,000 equivalent or more shall be advertised in accordance with the procedures applicable to large contracts under paragraph 2.8 of the Guidelines.

Part C: Other Procurement Procedures

1. International Shopping

Goods estimated to cost less than \$300,000 equivalent per contract, up to an aggregate amount not to exceed \$10,000,000 equivalent, may be procured under contracts awarded on the basis of international shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

2. National Shopping

Goods and works estimated to cost less than \$50,000 per contract, up to an aggregate amount not to exceed \$1,000,000 equivalent, may be procured under contracts awarded on the basis of national shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

Part D: Review by the Bank of Procurement Decisions

1. Procurement Planning

Prior to the issuance of any invitations to prequalify for bidding or to bid for contracts, the proposed procurement plan for the Project shall be furnished to the Bank for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Guidelines. Procurement of all goods and works shall be undertaken in accordance with such procurement plan as shall have been approved by the Bank, and with the provisions of said paragraph 1.

2. Prior Review

(a) With respect to each contract for goods and works procured in accordance with procedures set out in Part B of this Schedule the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

(b) With respect to each contract for goods or works estimated to cost the equivalent of \$50,000 or more, the following procedures shall apply:

(i) prior to the selection of any supplier under shopping procedures, Kievenergo shall provide to the Bank a report on the comparison and evaluation of quotations received;

(ii) prior to the execution of any contract procured under shopping procedures, Kievenergo shall provide to the Bank a copy of the specifications and the draft contract; and

(iii) the procedures set forth in paragraphs 2(f), 2(g) and 3 of Appendix 1 to the Guidelines shall apply.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Guidelines shall apply.

Section II. Employment of Consultants

Part A: General

Consultants' services shall be procured in accordance with the provisions of the Introduction and Section IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" published by the Bank in January 1997 and revised in September 1997 (the Consultant Guidelines) and the following provisions of Section II of this Schedule.

Part B: Quality- and Cost-based Selection

1. Except as otherwise provided in Part C of this Section, consultants' services shall be procured under contracts awarded in accordance with the provisions of Section II of the Consultant Guidelines, paragraph 3 of Appendix 1 thereto, Appendix 2 thereto, and the provisions of paragraphs 3.13 through 3.18 thereof applicable to quality- and cost-based selection of consultants.

2. The following provisions shall apply to consultants' services to be procured under contracts awarded in accordance with the provisions of the preceding paragraph. The short list of consultants for services for design and supervision under Parts C.2 and C.4 of the Project, estimated to cost less than \$200,000 equivalent per contract, may comprise entirely national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Part C: Other Procedures for the Selection of Consultants

1. Single Source Selection

Services for technical assistance under Part C.4 (i) of the Project, which are estimated to cost less than \$500,000 equivalent per contract, may, with the Bank's prior agreement, be procured in accordance with the provisions of paragraphs 3.8 through 3.11 of the Consultant Guidelines.

2. Individual Consultants

Services for activities stipulated under Parts C.2 and C.4 (i) of the Project that meet the requirements set forth in paragraph 5.01 of the Consultant Guidelines shall be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.1 through 5.3 of the Consultant Guidelines.

Part D: Review by the Bank of the Selection of Consultants

1. Selection Planning

Prior to the issuance to consultants of any requests for proposals, the proposed plan for the selection of consultants under the Project shall be furnished to the Bank for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Consultant Guidelines. Selection of all consultants' services shall be undertaken in accordance with such selection plan as shall have been approved by the Bank, and with the provisions of said paragraph 1.

2. Prior Review

(a) With respect to each contract estimated to cost the equivalent of \$200,000 or more, the procedures set forth in paragraphs 1, 2 and (other than the third subparagraph of paragraph 2(a)) and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(b) With respect to each contract estimated to cost the equivalent of \$100,000 or more, but less than the equivalent of \$200,000, the procedures set forth in paragraphs 1, 2 (other than the second subparagraph of paragraph 2(a)) and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(c) With respect to each contract for the employment of individual consultants estimated to cost the equivalent of \$50,000 or more, the qualifications, experience, terms of reference and terms of employment of the consultants shall be furnished to the Bank for its prior review and approval. The contract shall be awarded only after the said approval shall have been given.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Consultant Guidelines shall apply.

