

Public Disclosure Authorized

CONFORMED COPY

LOAN NUMBER 4730-IN

Project Agreement

(Karnataka Urban Water Sector Improvement Project)

between

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

and

STATE OF KARNATAKA

Dated February 18, 2005

LOAN NUMBER 4730-IN

PROJECT AGREEMENT

AGREEMENT, dated February 18, 2005, between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and STATE OF KARNATAKA (Karnataka).

WHEREAS (A) by the Loan Agreement of even date herewith between India (the Borrower) and the Bank, the Bank has agreed to make a loan to the Borrower in the amount of thirty nine million five hundred thousand Dollars (\$39,500,000), on the terms and conditions set forth in the Loan Agreement, but on condition that Karnataka agree to undertake such obligations toward the Bank as are set forth in this Agreement; and

WHEREAS Karnataka, 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.

ARTICLE II

Execution of the Project

Section 2.01. (a) Karnataka declares its commitment to the objective of the Project as set forth in Schedule 2 to the Loan Agreement, and, to this end, shall carry out the Project through KUIDFC, with due diligence and efficiency and in conformity with appropriate administrative, financial, technical and engineering practices, and with due regard to social and environmental considerations, and shall provide, or cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) of this Section, and except as the Bank and Karnataka shall otherwise agree, Karnataka shall carry out the Project in accordance with the Implementation Program set forth in Schedule 2 to this Agreement, the EMP and the RF.

Section 2.02. Except as the Bank shall otherwise agree, procurement of the goods, works and consultants' services required for the Project and to be financed out of the proceeds of the Loan shall be governed by the provisions of Schedule 1 to this Agreement.

Section 2.03. (a) Karnataka 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.

(b) For the purposes of Section 9.07 of the General Conditions and without limitation thereto, Karnataka 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 Karnataka, a plan designed to ensure the continued achievement of the Project's objective; and
- (ii) afford the Bank a reasonable opportunity to exchange views with Karnataka on said plan.

Section 2.04. (a) Karnataka shall, at the request of the Bank, exchange views with the Bank with regard to progress of the Project, the performance of its obligations under this Agreement, and other matters relating to the purposes of the Loan.

(b) Karnataka shall promptly inform the Bank of any condition which interferes or threatens to interfere with the progress of the Project, the accomplishment of the objective of the Loan, or the performance by Karnataka of its obligations under this Agreement.

Section 2.05. Karnataka shall issue a Government Order (the Second Karnataka Government Order), setting forth detailed guidelines acceptable to the Bank for the implementation of the Project, including details of the terms and conditions of financing provided under the Loan, fund flow arrangements, the respective roles and responsibilities of UDD, KUIDFC, KUWSDB and Participating ULBs in the implementation of the Project, principles and methodology governing the establishment of tariffs, and guidelines for the separation of UWS accounts from those of other municipal services.

Section 2.06. Karnataka shall make available to KUIDFC in a timely manner the proceeds of the Loan made available to Karnataka by the Borrower for the purposes of the Project, as well as additional funds as required from Karnataka's own resources to cover Karnataka's share of the cost of the Project.

ARTICLE III

Financial Covenants

Section 3.01. (a) Karnataka shall cause KUIDFC to maintain a financial management system, including records and accounts, and prepare financial statements, in accordance with consistently applied accounting standards acceptable to the Bank, adequate to reflect its operations and financial condition and to register separately the operations, resources and expenditures related to the Project.

(b) Karnataka shall cause KUIDFC to:

- (i) have the financial statements referred to in paragraph (a) of this Section for each Fiscal Year (or other period agreed to by the Bank) audited, in accordance with consistently applied auditing standards acceptable to the Bank, 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 Fiscal Year (or such other period agreed to by the Bank), (A) certified copies of the financial statements referred to in paragraph (a) of this Section, for such Fiscal Year (or such other period agreed to by the Bank) as so audited, and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to the Bank; and
- (iii) furnish to the Bank such other information concerning such records, accounts and the audit of such financial statements, and concerning said auditors, as the Bank may from time to time reasonably request.

Section 3.02. (a) Karnataka shall cause KUIDFC to 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 the Project, both cumulatively and for the period covered by said report, showing separately funds provided under the Loan, 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 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 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 the period not covered by the previous Financial Monitoring Report until the end of such calendar quarter.

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 and of Karnataka thereunder shall terminate on the date on which the Loan Agreement shall terminate in accordance with its terms, and the Bank shall promptly notify Karnataka thereof.

Section 4.03. All these 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, telex or facsimile 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. Deliveries made by facsimile transmission shall also be confirmed by mail. 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:	Telex:	Facsimile:
6391	INTBAFRAD Washington, D.C.	248423 (MCI) or 64145 (MCI)	(202) 477-

For Karnataka

Chief Secretary
Government of Karnataka
Karnataka, India

	Facsimile:
25672304	91-44-

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 Karnataka, or by Karnataka on behalf of the Borrower under the Loan Agreement, may be taken or executed by the Chief Secretary of Karnataka or such other person or persons as the Chief Secretary shall designate in writing, and the Chief Secretary 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 New Delhi, India, as of the day and year first above written.

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Michael Carter

Country Director, India

STATE OF KARNATAKA

By /s/ P. Ravi Kumar

Authorized Representative

SCHEDULE 1

Procurement

Section I. Procurement of Goods 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, September 1997 and January 1999 (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 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 to be procured under contracts awarded in accordance with the provisions of paragraph 1 of this Part B.

(a) Grouping of Contracts

To the extent practicable, contracts for goods shall be grouped in bid packages estimated to cost \$500,000 equivalent or more each.

(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.

Part C: Other Procurement Procedures

1. National Competitive Bidding

Goods estimated to cost less than \$500,000 equivalent per contract, and works, may be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines.

2. International or National Shopping

Goods estimated to cost less than \$50,000 equivalent per contract may be procured under contracts awarded on the basis of international or national shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

3. Procurement of Small Works

Works estimated to cost less than \$100,000 equivalent per contract may be procured under lump-sum, fixed-price contracts awarded on the basis of quotations obtained from three (3) qualified domestic contractors in response to a written invitation. The invitation shall include a detailed description of the works, including basic specifications, the required completion date, a basic form of agreement acceptable to the Bank, and relevant drawings, where applicable. The award shall be made to the contractor who offers the lowest price quotation for the required work, and who has the experience and resources to complete the contract successfully.

Part D: Review by the Bank of Procurement Decisions

1. Procurement Planning

Prior to the issuance of any invitations 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. The procurement plan shall be updated every six months during the execution of the project and each updated plan shall be furnished to the Bank for its review and approval.

2. Prior Review

With respect to each contract for goods or works estimated to cost \$500,000 or more the procedures set forth in paragraphs 2 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 Sections I and 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, January 1999 and May 2002 (the Consultant Guidelines), paragraph 1 of Appendix 1 thereto, Appendix 2 thereto and the following provisions of this Section.

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, and the provisions of paragraphs 3.13 through 3.18 thereof applicable to quality- and cost-based selection of consultants.

2. The following provision shall apply to consultants' services to be procured under contracts awarded in accordance with the provisions of the preceding paragraph: the short list of NGOs and consultants for services estimated to cost less than \$500,000 equivalent per contract may comprise entirely national consultants in accordance with the provisions of paragraph 2.7 and footnote 8 of the Consultant Guidelines.

Part C: Other Procedures for the Selection of Consultants

1. Individual Consultants

Services for tasks that meet the requirements set forth in paragraph 5.1 of the Consultant Guidelines shall be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.1 through 5.4 of the Consultant Guidelines.

2. Selection Based on Consultants' Qualifications

Services for the establishment of a Karnataka State Urban Water Supply Council, development of UWS investment and tariff frameworks, and design and implementation of the legal and regulatory framework, under Part A.1 (a), (d) and (e) of the Project, respectively, 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 and 3.7 of the Consultant Guidelines.

3. Single Source Selection

Legal consultants' services and services for third party inspection under Parts A.1 and B.1 of the Project, respectively, estimated to cost less than \$100,000 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.

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

1. Selection Planning

A plan for the selection of consultants, which shall include contract cost estimates, contract packaging, and applicable selection criteria and procedures, shall be furnished to the Bank for its review and approval prior to the issuance to consultants of any requests for proposals. Such plan shall be updated every six (6) months during the execution of the Project, and each such updated plan shall be furnished to the Bank for its review and approval. Selection of all consultants' services shall be undertaken in accordance with such selection plan (as updated from time to time) as shall have been approved by the Bank.

2. Prior Review

(a) With respect to each contract for the employment of consulting firms estimated to cost the equivalent of \$100,000 or more, the procedures set forth in paragraphs 2, 3 and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(b) With respect to each contract for the employment of individual consultants estimated to cost the equivalent of \$50,000 or more, the report on the comparison of the qualifications and experience of candidates, and 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. The provisions of paragraph 3 of Appendix 1 to the Consultant Guidelines shall also apply to such contracts.

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.

SCHEDULE 2

Implementation Program

Institutional Provisions

1. Karnataka shall establish a high-level committee at the state level, comprising senior representatives of UDD, KUIDFC and KUWSDB, to coordinate sector policy, drive the policy reform process and exercise oversight functions under Part A of the Project.

2. Karnataka shall cause KUIDFC to:

(a) establish a project management unit (PMU), whose mandate, terms of reference and composition shall be acceptable to the Bank, to be responsible for day-to-day execution of the Project, including management of procurement and disbursement activities, consolidation of annual work programs and budgets, preparation and production of annual progress reports and financial statements, and monitoring and evaluation of the Project.

(b) ensure that:

(i) PMU shall be headed by a Project Director, who shall be assisted by a Finance Manager, a procurement specialist, a social/environmental specialist and other suitably qualified and experienced staff in adequate numbers; and

(ii) the positions of Project Director, Finance Manager, procurement specialist and social/environmental specialist shall be kept filled at all times by persons having qualifications and experience acceptable to the Bank.

3. Pursuant to the terms of the Second Karnataka Government Order, Karnataka shall ensure that:

(a) for purposes of implementation of Part B.1 of the Project, KUWSDB shall be responsible, on terms and conditions acceptable to the Bank, for the planning, design and construction supervision of physical investments and, where appropriate, for the operation of the constructed facilities;

(b) for purposes of implementation of Parts A.1 and A.2 of the Project, UDD shall be responsible, on terms and conditions acceptable to the Bank, for the design and implementation of UWS reform measures; and

(c) pending the establishment of the Karnataka State Urban Water Supply Council, a technical sector policy team attached to KUIDFC, and reporting to UDD, shall be established and thereafter maintained to design and implement state-level UWS reform measures.

Operational Provisions

4. Karnataka shall:

(a) adopt a Project Implementation Plan in form and substance acceptable to the Bank, giving details of all operational guidelines and procedures as shall have been agreed with the Bank for the implementation, monitoring and supervision of the Project; and

(b) carry out the Project in accordance with procedures set out in the Project Implementation Plan, and, except as the Bank shall otherwise agree, shall not amend or waive any provision thereof, if such amendment or waiver may, in the opinion of the Bank, materially or adversely affect the implementation of the Project.

5. Karnataka shall cause KUIDFC, acting on its own behalf and on behalf of Participating ULBs, to conclude an agreement (OC Agreement), on terms and conditions which shall be acceptable to the Bank, with an Operator Consultant (OC) acceptable to the Bank, for the management, operation and maintenance of the water supply system in the Demonstration Zones under Part B.3 of the Project.

Work Programs, Midterm Review and Reports

6. Karnataka shall cause KUIDFC to:

(a) submit to the Bank, not later than March 31 of each year, beginning on March 31, 2005, for review and comments, a proposed annual work program and budget, giving details of its proposed work program activities and budget estimates for the Project for the forthcoming Fiscal Year; and

(b) proceed thereafter to implement the annual work program and budget, taking into account any comments thereon as the Bank may have made.

7. Not later than forty five (45) days after the end of each calendar quarter, beginning not later than forty five (45) days after the end of the first calendar quarter after the Effective Date, Karnataka shall cause KUIDFC to submit to the Bank consolidated quarterly reports on the progress of the Project, according to a format acceptable to the Bank and set forth in the Project Implementation Plan.

8. The Borrower shall:

(a) implement policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with indicators satisfactory to the Bank, the carrying out of the Project and the achievement of the objective thereof;

(b) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, on or about March 31, 2006, 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 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 Project and the achievement of the objective thereof during the period following such date; and

(c) review with the Bank, by June 30, 2006, or such later date as the Bank shall request, the report referred to in paragraph (b) of this Section, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objective thereof, based on the conclusions and recommendations of the said report and the Bank's views on the matter.

Environment and Social Safeguards Management

9. Without limitation upon the provisions of paragraph 7 of this Schedule, Karnataka shall submit to the Bank quarterly progress reports on compliance with social and environmental safeguard measures under the Project, giving details of measures taken in furtherance of the EMP, RF and RPs, conditions, if any, which interfere or threaten to interfere with the smooth implementation of the EMP, RF and RPs, and remedial measures taken or required to be taken to address such conditions.

10. Karnataka shall ensure that:

(a) the Project shall, as far as reasonably practicable, be implemented on publicly-owned land, using exclusively land free from squatters, encroachments or other encumbrances, and without recourse to compulsory acquisition of land, forcible eviction or involuntary resettlement of persons; and

(b) where unavoidable, land acquisition shall be kept to the strict minimum, and shall be undertaken in accordance with guidelines and procedures consistent with the RF and set forth in the RP, including baseline census and socioeconomic survey information, applicable compensation rates and standards, implementation schedules for resettlement activities and detailed cost estimates.

Financial Provisions

11. (a) Karnataka shall ensure that:
- (i) not later than June 30, 2005, a tariff design study shall be completed in respect of each Demonstration Zone; and
 - (ii) promptly after achievement of the goal of continuous water supply in each Demonstration Zone, and based on the results of the study referred to in paragraph (i) of this subparagraph, the Participating ULB shall adopt and thereafter implement a volumetric tariff structure acceptable to the Bank, including relevant cost recovery targets and appropriate mechanisms to address the needs of the poor and low-income groups.
- (b) For the purposes of this paragraph:
- (i) “volumetric tariff structure” means a tariff structure which provides for consumers to be charged according to actual water volumes consumed;
 - (ii) “relevant cost recovery target” means a cost recovery target of not less than 50% of operations and maintenance (O&M) costs, and progressively rising to not less than 80% of O&M costs by the end of the implementation period of the Project; and
 - (iii) “O&M costs” means actual expenses to operate and maintain the UWS services, including power and chemicals, salaries and wages, repair and maintenance, and other administrative costs, but not including the Operator Consultant’s fees.
12. Karnataka shall ensure that, not later than June 30, 2005:
- (a) a proposal for the creation of the Karnataka State Urban Water Supply Council shall have been presented to the competent authorities for adoption; and
 - (b) an investment framework and tariff policy for the urban water sector of Karnataka shall have been adopted.