

CONFORMED COPY

LOAN NUMBER 4433 HR

Project Agreement

(Railway Modernization and Restructuring Project)

between

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

and

HRVATSKE ZELJEZNICE

Dated January 20, 1999

LOAN NUMBER 4433 HR

PROJECT AGREEMENT

AGREEMENT, dated January 20, 1999, between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and HRVATSKE ZELJEZNICE (HZ).

WHEREAS (A) by the Loan Agreement of even date herewith between Republic of Croatia (the Borrower) and the Bank, the Bank has agreed to make available to the Borrower a loan in an amount equal to eighty-five million four hundred thousand Euro (EUR 85,400,000) on the terms and conditions set forth in the Loan Agreement, but only on condition that HZ agree to undertake such obligations toward the Bank as are set forth in this Agreement;

(B) as indicated in Preamble (A) to the Loan Agreement, the purpose of the Loan provided thereunder is to assist in the implementation of a program for the modernization and restructuring of HZ (the Program);

(C) for the implementation of the Program and identification of measures to be taken thereunder, HZ has prepared and furnished to the Bank an action plan, dated November 12, 1998 (the Action Plan); and

(D) by a subsidiary loan agreement to be entered into between the Borrower and HZ, the proceeds of the loan provided for under the Loan Agreement will be made available to HZ on the terms and conditions set forth in said Subsidiary Loan Agreement;

WHEREAS HZ, 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) HZ 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 the Project and other measures included in the Program with due diligence and efficiency and in conformity with appropriate administrative, financial, and engineering practices, 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 HZ shall otherwise agree, HZ shall carry out the Project in accordance with the Implementation Program set forth in Schedule 2 to this Agreement.

Section 2.02. Except as the Bank shall otherwise agree, procurement of goods 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) HZ 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, HZ 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 HZ, a plan for the future operation of the Project; and

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

Section 2.04. HZ shall duly perform all its obligations under the Subsidiary Loan Agreement. Except as the Bank shall otherwise agree, HZ 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 2.05. (a) HZ 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 under the Subsidiary Loan Agreement, and other matters relating to the purposes of the Loan.

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

#### ARTICLE III

## Management and Operations of HZ

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

Section 3.02. HZ 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 and administrative practices.

Section 3.03. HZ 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) HZ shall maintain a financial management system, including records and accounts, and prepare financial statements, all in accordance with accounting standards acceptable to the Bank, consistently applied and adequate to reflect its operations and financial condition and to register separately the operations, resources and expenditures related to the Project.

(b) HZ 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 standards acceptable to the Bank, 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 its financial statements for such year as so audited; and (B) an opinion on such statements and 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 and the audit thereof and concerning said auditors, as the Bank shall from time to time reasonably request.

Section 4.02. (a) Except as the Bank shall otherwise agree, and without limitation to any other financial measures to be taken in accordance with the Program, HZ shall not incur any debt (other than a debt incurred for the financing of the Project) unless a reasonable forecast of the revenues and expenditures of HZ shows that the ratio of the estimated net revenues of HZ to the estimated debt service requirements of HZ on all debt of the HZ including the debt to be incurred, shall be at least 1.0 in the fiscal year 1999 and at least 1.3 in each succeeding fiscal year.

(b) For the purposes of this Section:

(i) The term "debt" means any indebtedness of HZ 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 (including operating subsidiaries) 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) but excluding severance payment to employees of HZ.
- (v) 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.
- (vi) The term "reasonable forecast" means a forecast prepared by HZ not earlier than twelve months prior to the incidence of the debt in question, which both the Bank and HZ accept as reasonable and as to which the Bank has notified HZ 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 HZ.
- (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, without limitation to any other financial measures to be taken in accordance with the Program, HZ shall maintain ratios of total working expenses to total operating revenues not higher than those specified for each fiscal year indicated in Schedule 3 to this Agreement.

(b) Before October 15 in each of its fiscal years, HZ shall, on the basis of forecasts prepared by HZ 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 review shows that HZ would not meet the requirements set forth in paragraph (a) for HZ's fiscal years covered by such review, HZ shall promptly take all necessary measures (including, without limitation, proposing to the Borrower adjustments of the structure or levels of HZ's rates in order to meet such requirements.

(d) For the purposes of this Section:

(i) The term "total working expenses" means all expenses related to operations, including administration, adequate maintenance and taxes and payments in lieu of taxes, but excluding depreciation and non-cash charges.

(ii) The term "total operating revenues" means revenues from all sources related to operations.

Section 4.04. Except as the Bank may otherwise agree, the Borrower shall not undertake any railway investments (other than those financed by the Borrower according to the Railways Law) estimated to cost the equivalent of \$5,000,000 or more during the execution of the Project, unless the economic and financial rates of return for such investments estimated on the basis of analyses carried out in accordance with methodologies satisfactory to the Bank, shall each be greater than twelve percent (12%).

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

Section 5.03. All the provisions of this Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the General Conditions.

#### ARTICLE VI

##### Miscellaneous Provisions

Section 6.01. Any notice or request required or permitted to be given or made under this Agreement and any agreement between the parties contemplated by this Agreement shall be in writing. Such notice or request shall be deemed to have been duly given or made when it shall be delivered by hand or by mail, telegram, cable, telex or radiogram to the party to which it is required or permitted to be given or made at such party's address hereinafter specified or at such other address as such party shall have designated by notice to the party giving such notice or making such request. The addresses so specified are:

For the Bank:

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

Cable address:

INTBAFRAD  
Washington, D.C.

Telex:

248423 (MCI) or  
64145 (MCI)

For HZ:

Hrvatske Zeljeznice  
Mihnoviceva 12 10000 Zagreb Croatia

Facsimile:

38513783326

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 HZ, or by HZ on behalf of the HZ under the Loan Agreement, may be taken or executed by the General Manager or such other person or persons as the General Manager shall designate in writing, and HZ 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/ Christiaan J. Poortman  
Acting Regional Vice President  
Europe and Central Asia

HRVATSKE ZELJEZNICE

By /s/ Miomir Zuzul  
Authorized Representative

SCHEDULE 1

Procurement and Consultants' Services

Section I. Procurement of Goods

Part A: General

Goods 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

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.

(c) 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 Guarantor.

Part C: Other Procurement Procedures

1. International Shopping Goods estimated to cost less than \$400,000 equivalent per contract, up to an aggregate amount not to exceed \$3,000,000 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 estimated to cost less than \$100,000 equivalent per contract, up to an aggregate amount not to exceed \$200,000 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.

3. Direct Contracting

Goods which must be purchased from the original supplier to be compatible with existing equipment or are of a proprietary nature, may, with the Bank's prior agreement, be procured in accordance with the provisions of paragraph 3.7 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: (i) all contracts to be procured in accordance with the procedures referred to in Part B of this Section I; and (ii) the first contract to be procured in accordance with the procedures referred to in Part C (1) of this Section I, the procedures set forth in paragraphs 2 and 3 of Appendix I 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, revised in September 1997 (the Consultant Guidelines) and the following provisions of Section II of this Schedule.

Part B: Quality- and Cost-based Selection

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.

Part C: Other Procedures for the Selection of Consultants

1. Least-cost Selection

Services estimated to cost less than \$200,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultant Guidelines.

2. 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 5.3 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 for the employment of consulting firms, 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 for the employment of consulting firms, estimated to cost more than the equivalent of \$100,000, 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 consulting firm estimated to cost less than \$100,000 equivalent or for 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.

SCHEDULE 2

Implementation Program

1. HZ shall assign the general responsibility for Project implementation to the Restructuring Unit and shall, for this purpose, maintain the Restructuring Unit at least until completion of the Project with such staff, resources and terms of reference as shall be agreed upon from time to time with the Bank.

2. HZ shall implement the Project in accordance with an Action Plan agreed upon between the Bank and HZ, as the Action Plan may be amended from time to time with the agreement of the Bank and HZ.

3. HZ shall: (a) based on the Action Plan, prepare and furnish to the Bank, for its review and concurrence, by October 15 in each year during the period of Project implementation, a draft business plan (the Business Plan), with the approved version thereof to be submitted by February 15 of the following year. The Business Plan shall set forth: (i) the operational, financial and staffing targets to be achieved by HZ during the year concerned; (ii) the measures to be taken in implementation of such targets, including action to be taken in support thereof by ministries and other agencies of the Borrower; (iii) an estimate of severance payments to be made to employees of HZ in implementation of the Business Plan; and (iv) the indicators to be utilized by HZ for monitoring the implementation of the Business Plan.

4. HZ shall prepare and furnish to the Bank, starting in the first quarter of the year 1999, quarterly report on progress in the implementation of measures included in the Business Plan.

5. HZ shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the indicators set forth in the Business Plan, the carrying out of the Project and the Program and the achievement of the objectives thereof;



(b) prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, on or about October 1, 2000, 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 and the Program 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 Program and the achievement of the objectives thereof during the period following such date; and

(c) review with the Bank, by November 3, 2000, 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 implementation of the Project and the Program and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Bank views on the matter.

### SCHEDULE 3

#### Working Ratio

The following is the working ratio specified for purposes of Section 4.03 (a) of this Agreement:

Operational Targets	Fiscal Year			
	1999	2000	2001	2002
1. Ratio of total working expenses to total operating revenues (excluding in the calculation of revenues the amount of subsidies expected to be paid by the Borrower to HZ)	175%	165%	160%	155%

