

Public Disclosure Authorized

CONFORMED COPY

CREDIT NUMBER 4397-AZ

Financing Agreement

(Second National Water Supply and Sanitation Project)

between

REPUBLIC OF AZERBAIJAN

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated September 5, 2008

CREDIT NUMBER 4397-AZ

FINANCING AGREEMENT

AGREEMENT dated September 5, 2008, entered into between REPUBLIC OF AZERBAIJAN (“Recipient”) and INTERNATIONAL DEVELOPMENT ASSOCIATION (“Association”). The Recipient and the Association hereby agree as follows:

ARTICLE I - GENERAL CONDITIONS; DEFINITIONS

- 1.01. The General Conditions (as defined in the Appendix to this Agreement) constitute an integral part of this Agreement.
- 1.02. Unless the context requires otherwise, the capitalized terms used in this Agreement have the meanings ascribed to them in the General Conditions or in the Appendix to this Agreement.

ARTICLE II - FINANCING

- 2.01. The Association agrees to extend to the Recipient, on the terms and conditions set forth or referred to in this Agreement, a credit in an amount equivalent to eighteen million eight hundred thousand Special Drawing Rights (SDR 18,800,000) (variously, “Credit” and “Financing”) to assist in financing the project described in Schedule 1 to this Agreement (“Project”).
- 2.02. The Recipient may withdraw the proceeds of the Financing in accordance with Section IV of Schedule 2 to this Agreement.
- 2.03. The Maximum Commitment Charge Rate payable by the Recipient on the Unwithdrawn Financing Balance shall be one-half of one percent (1/2 of 1%) per annum.
- 2.04. The Service Charge payable by the Recipient on the Withdrawn Credit Balance shall be equal to three-fourths of one percent (3/4 of 1%) per annum.
- 2.05. The Payment Dates are April 15 and October 15 in each year.
- 2.06. The principal amount of the Credit shall be repaid in accordance with the repayment schedule set forth in Schedule 3 to this Agreement.

- 2.07. The Payment Currency is Dollars.

ARTICLE III - PROJECT

- 3.01. The Recipient declares its commitment to the objectives of the Project. To this end, the Recipient shall cause Components A.1, B.1 and C.1 of the Project to be carried out by the Azersu, and Components A.2, B.2 and C.2 of the Project to be carried out by the SAWMA in accordance with the provisions of Article IV of the General Conditions and the Project Agreement III and Project Agreement IV.
- 3.02. Without limitation upon the provisions of Section 3.01 of this Agreement, and except as the Recipient and the Association shall otherwise agree, the Recipient shall ensure that the Project is carried out in accordance with the Project Operational Manual and the provisions of Schedule 2 to this Agreement.

ARTICLE IV - REMEDIES OF THE ASSOCIATION

- 4.01. The Additional Events of Suspension consist of the following:
- (a) The Azersu's Legislation has been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of the Azersu to perform any of its obligations under the Project Agreement III.
 - (b) The SAWMA's Legislation has been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of the SAWMA to perform any of its obligations under the Project Agreement IV.
 - (c) The Project Operational Manual has been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of the Azersu and/or the SAWMA to perform any of their obligations under the Project Agreement III and Project Agreement IV.
- 4.02. The Additional Event of Acceleration consists of the following:

Any event specified in Section 4.01 of this Agreement occurs and is continuing for a period of 60 days after notice of the event has been given by the Association to the Recipient.

ARTICLE V - EFFECTIVENESS; TERMINATION

- 5.01. The Additional Conditions of Effectiveness consist of the following:
- (a) The Azersu Subsidiary Agreement has been executed on behalf of the Recipient and the Azersu.
 - (b) The SAWMA Subsidiary Agreement has been executed on behalf of the Recipient and the SAWMA.
 - (c) The revised Project Operational Manual has been adopted by the Azersu and the SAWMA.
 - (d) The Azersu has appointed all the necessary members in the PIU within its International Relations & Development Department (IRDD), including one more procurement officer, in accordance with terms of reference and qualifications acceptable to the Association.
 - (e) The SAWMA has appointed all the necessary members in its PIU, including one procurement consultant, in accordance with the terms of reference and qualifications acceptable to the Association.
 - (f) The Recipient has ensured that the contracts with suitably qualified construction management firms for Parts A.1 and A.2 of the Project have been signed, with terms and conditions acceptable to the Association.
 - (g) The Loan Agreement has been executed and delivered and all conditions precedent to its effectiveness or to the right of the Recipient to make withdrawals thereunder, except only the effectiveness of the Financing Agreement, have been fulfilled.
- 5.02. The Additional Legal Matters consist of the following:
- (a) The Azersu Subsidiary Agreement has been duly authorized or ratified by the Recipient and the Azersu and is legally binding upon the Recipient and the Azersu in accordance with its terms.
 - (b) The SAWMA Subsidiary Agreement has been duly authorized or ratified by the Recipient and the SAWMA, and is legally binding upon the Recipient and the SAWMA in accordance with its terms.
 - (c) The Project Agreement III has been duly authorized or ratified by the Azersu, and is legally binding upon the Azersu in accordance with its terms.

(d) The Project Agreement IV has been duly authorized or ratified by the SAWMA, and is legally binding upon the SAWMA in accordance with its terms.

5.03. The Effectiveness Deadline is the date one hundred twenty (120) days after the date of this Agreement.

ARTICLE VI - REPRESENTATIVE; ADDRESSES

6.01. The Recipient's Representative is the Minister of Finance.

6.02. The Recipient's Address is:

Ministry of Finance
83 Samed Vurgun Street
Baku AZ1022
Republic of Azerbaijan

Telex:

142116 BNKSL

6.03. The Association's Address is:

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

Cable:

Telex:

Facsimile:

INDEVAS
Washington, D.C.

248423 (MCI)

1-202-477-6391

AGREED at Baku, Republic of Azerbaijan, as of the day and year first above written.

REPUBLIC OF AZERBAIJAN

By /s/ Samir Sharifov

Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Gregory Jedrzejczak

Authorized Representative

SCHEDULE 1

Project Description

The objective of the Project is to improve the availability, quality, reliability and sustainability of water supply and sanitation services of the Recipient.

The Project consists of the following parts:

Component A: Rayon Investment

1. Rehabilitation and extension of water supply and sewerage systems, as well as facilities for water, wastewater and sludge treatment in the Selected Rayons in Azersu's Service Areas.
2. Rehabilitation and extension of water supply and sewerage systems, as well as facilities for water, wastewater and sludge treatment in the Selected Rayons in SAWMA's Service Areas.

Component B: Institutional Modernization

1. Capacity building and modernization of Azersu and its subsidiary companies, through: (a) the provision of training for management, financial management, customer service, procurement, preventive maintenance and other subjects pertinent to effective and efficient management of the utilities; (b) development of performance monitoring, preventive maintenance and leak detection and repair; and (c) design and technical support for construction management, including procurement support and contract supervision for the investments.
2. Capacity building and modernization of the SAWMA, through: (a) the provision of training for management, financial management, customer service, procurement, preventive maintenance and other subjects pertinent to effective and efficient management of the utilities; (b) development of performance monitoring, preventive maintenance and leak detection and repair; and (c) design and technical support for construction management, including procurement support and contract supervision for the investments.

Component C: Project Management

1. Strengthening of the management capacity of the Azersu to monitor and administer implementation of the Project, including audit.
2. Strengthening of the management capacity of the SAWMA to monitor and administer implementation of the Project.

SCHEDULE 2

Project Execution

Section I. Implementation Arrangements

A. Institutional Arrangements

1. The Recipient shall cause the Azersu to undertake the responsibility with regard to the financial management, financial reporting and audits for the Project.
2. The Recipient shall cause the Azersu to ensure that all goods, works and services required for the carrying out of Components A.1, B.1 and C.1 of the Project and to be financed out of the proceeds of the Credit shall be procured in accordance with the provision of Section III of Schedule 2 to the Financing Agreement.
3. The Recipient shall cause the SAWMA to ensure that all goods, works and services required for the carrying out of Components A.2, B.2 and C.2 of the Project and to be financed out of the proceeds of the Credit shall be procured in accordance with the provision of Section III of Schedule 2 to the Financing Agreement.
4. The Recipient shall ensure that the Azersu and the SAWMA shall retain, during the implementation of Components A.1 and A.2 of the Project, the services of a construction management company satisfactory to the Association until the Association's assessment has determined that the Azersu and/or the SAWMA have the capacity to take over such a responsibility independently.

B. Azersu Subsidiary Agreement

1. To facilitate the carrying out of the Azersu's Respective Part of the Project, the Recipient shall make part of the proceeds of the Credit available to the Azersu under a subsidiary agreement between the Recipient and the Azersu, under terms and conditions agreed by the Association ("Azersu Subsidiary Agreement").
2. The Recipient shall exercise its rights under the Azersu Subsidiary Agreement in such manner as to protect the interests of the Recipient and the Association and to accomplish the purposes of the Credit. Except as the Association shall otherwise agree, the Recipient shall not assign, amend, abrogate or waive the Azersu Subsidiary Agreement or any of its provisions.

C. SAWMA Subsidiary Agreement

1. To facilitate the carrying out of the SAWMA's Respective Part of the Project, the Recipient shall make part of the proceeds of the Credit available to the SAWMA

under a subsidiary agreement between the Recipient and the SAWMA, under terms and conditions agreed by the Association (“SAWMA Subsidiary Agreement”).

2. The Recipient shall exercise its rights under the SAWMA Subsidiary Agreement in such manner as to protect the interests of the Recipient and the Association and to accomplish the purposes of the Credit. Except as the Association shall otherwise agree, the Recipient shall not assign, amend, abrogate or waive the SAWMA Subsidiary Agreement or any of its provisions.

D. Anti-Corruption

The Recipient shall ensure that the Project is carried out in accordance with the provisions of the Anti-Corruption Guidelines.

E. Safeguards

1. The Recipient shall cause the Azersu and SAWMA, for their Respective Parts of the Project, to ensure that all measures necessary for the carrying out of the EMP, FEA and RPF shall be taken in a timely manner.
2.
 - (a) In case any activities under the Project involve any use of water from existing dams or dams under construction, the Recipient shall ensure that the Azersu and/or the SAWMA shall, for their Respective Parts of the Project, arrange for one or more independent dam specialists, acceptable to the Association, to: (i) inspect and evaluate the safety status of the existing dam or dam under construction, its appurtenances, and its performance history; (ii) review and evaluate the owner's operation and maintenance procedures; and (iii) provide a written report of findings and recommendations for any remedial work or safety-related measures necessary to upgrade the existing dam or dam under construction to an acceptable standard of safety, prior to commencing any such activities.
 - (b) The Recipient shall ensure that the Azersu and/or the SAWMA shall carry out their Respective Parts of the Project in accordance with the recommendations set forth in the report referred to in subparagraph (iii) above.

Section II. Project Monitoring, Reporting and Evaluation

A. Project Reports

1. The Recipient shall monitor and evaluate the progress of the Project and prepare Project Reports in accordance with the provisions of Section 4.08 of the General Conditions and on the basis of the indicators agreed with the Association. Each Project Report shall cover the period of one calendar semester, and shall be furnished to the Association not later than one month after the end of the period covered by such report.

B. Financial Management, Financial Reports and Audits

1. The Recipient shall maintain or cause to be maintained a financial management system in accordance with the provisions of Section 4.09 of the General Conditions.
2. Without limitation on the provisions of Part A of this Section, the Recipient shall prepare and furnish to the Association as part of the Project Report not later than forty-five (45) days after the end of each calendar quarter, interim unaudited financial reports for the Project covering the quarter, in form and substance satisfactory to the Association.
3. The Recipient shall have its Financial Statements audited in accordance with the provisions of Section 4.09 (b) of the General Conditions. Each audit of the Financial Statements shall cover the period of one fiscal year of the Recipient. The audited Financial Statements for each such period shall be furnished to the Association not later than six (6) months after the end of such period.

Section III. Procurement

A. General

1. **Goods and Works.** All goods and works required for the Project and to be financed out of the proceeds of the Financing shall be procured in accordance with the requirements set forth or referred to in Section I of the Procurement Guidelines, and with the provisions of this Section.
2. **Consultants' Services.** All consultants' services required for the Project and to be financed out of the proceeds of the Financing shall be procured in accordance with the requirements set forth or referred to in Sections I and IV of the Consultant Guidelines, and with the provisions of this Section.
3. **Definitions.** The capitalized terms used below in this Section to describe particular procurement methods or methods of review by the Association of

particular contracts, refer to the corresponding method described in the Procurement Guidelines, or Consultant Guidelines, as the case may be.

B. Particular Methods of Procurement of Goods and Works

1. **International Competitive Bidding.** Except as otherwise provided in paragraph 2 below, goods and works shall be procured under contracts awarded on the basis of International Competitive Bidding.
2. **Other Methods of Procurement of Goods and Works.** The following table specifies the methods of procurement, other than International Competitive Bidding, which may be used for goods and works. The Procurement Plan shall specify the circumstances under which such methods may be used:

Procurement Method
<p>(a) National Competitive Bidding, subject to the following additional provisions:</p> <ul style="list-style-type: none"> (i) there shall be no eligibility restrictions based on nationality of bidder; (ii) pre-qualification shall not be used for simple works procurement and shall be conducted only for large works contracts; (iii) entities in which the State or a State official owns a shareholding of whatever size shall not be invited to participate in tenders for the Government unless they are and can be shown to be legally and financially autonomous and operate under commercial law; (iv) no national preferences may be applied on the basis of the origin of products or labor; (v) joint venture partners shall be jointly and severally liable for their obligations; (vi) no “participation fee” shall be required of bidders for the purchase of bidding documents. The only charge shall be equivalent to the cost of producing (copying) the bidding documents; (vii) in the evaluation of bids, bids may not be rejected where they differ substantially from the estimated prices calculated by the procuring entity, except where the bid prices exceed the available budget; (viii) rebidding shall not be carried out without prior approval of the Association; (ix) works contracts of more than eighteen (18) months’ duration shall include appropriate price adjustment provisions; and (x) prior approval of the Association shall be required for any modification in the contract scope and conditions during implementation.
<p>(b) Shopping</p>

C. Particular Methods of Procurement of Consultants’ Services

1. **Quality- and Cost-based Selection.** Except as otherwise provided in paragraph 2 below, consultants’ services shall be procured under contracts awarded on the basis of Quality and Cost-based Selection.
2. **Other Methods of Procurement of Consultants’ Services.** The following table specifies methods of procurement, other than Quality and Cost-based Selection, which may be used for consultants’ services. The Procurement Plan shall specify the circumstances under which such methods may be used.

Procurement Method
(a) Quality-based Selection
(b) Selection under a Fixed Budget
(c) Least Cost Selection
(d) Selection based on Consultants’ Qualifications
(e) Single-source Selection
(f) Procedures set forth in paragraphs 5.2 through 5.4 of the Consultant Guidelines for the Selection of Individual Consultants

D. Review by the Association of Procurement Decisions

The Procurement Plan shall set forth those contracts which shall be subject to the Association’s Prior Review. All other contracts shall be subject to Post Review by the Association.

Section IV. Withdrawal of the Proceeds of the Financing

A. General

1. The Recipient may withdraw the proceeds of the Financing in accordance with the provisions of Article II of the General Conditions, this Section, and such additional instructions as the Association shall specify by notice to the Recipient (including the “World Bank Disbursement Guidelines for Projects” dated May 2006, as revised from time to time by the Association and as made applicable to this Agreement pursuant to such instructions), to finance Eligible Expenditures as set forth in the table in paragraph 2 below.

2. The following table specifies the categories of Eligible Expenditures that may be financed out of the proceeds of the Financing (“Category”), the allocations of the amounts of the Financing to each Category, and the percentage of expenditures to be financed for Eligible Expenditures in each Category:

Category	Amount of the Financing Allocated (expressed in SDR)	Percentage of Expenditures to be Financed (net of VAT)
(1) Works for Component A.2 of the Project	251,000	75%
(2) Goods		75%
(a) for Components A.1 and B.1 of the Project	7,474,000	
(b) for Components A.2 and B.2 of the Project	3,681,000	
(3) Consultants’ Services, including Audit and Training		75%
(a) for Components A.1, B.1 and C.1 of the Project	3,779,000	
(b) for Components A.2, B.2 and C.2 of the Project	1,861,000	
(4) Incremental Operating Costs		75%
(a) for Components A.1, B.1 and C.1 of the Project	336,000	
(b) for Components A.2, B.2 and C.2 of the Project	165,000	
(5) Unallocated	1,253,000	
TOTAL AMOUNT	<u>18,800,000</u>	

B. Withdrawal Conditions; Withdrawal Period

1. Notwithstanding the provisions of Part A of this Section, no withdrawal shall be made for payments made prior to the date of this Agreement.
2. The Closing Date is February 28, 2013.

SCHEDULE 3**Repayment Schedule**

Date Payment Due	Principal Amount of the Credit repayable (expressed as a percentage)*
On each April 15 and October 15:	
commencing October 15, 2018 to and including April 15, 2028	1.25%
commencing October 15, 2028 to and including April 15, 2043	2.50%

* The percentages represent the percentage of the principal amount of the Credit to be repaid, except as the Association may otherwise specify pursuant to Section 3.03 (b) of the General Conditions.

APPENDIX**Definitions**

1. “Anti-Corruption Guidelines” means the “Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants”, dated October 15, 2006.
2. “Azersu” means “Azersu” Joint Stock Company of Republic of Azerbaijan, established under the Presidential Decree No. 252 on June 11, 2004, which is also the Project Implementing Entity.
3. “Azersu Subsidiary Agreement” means the agreement referred to in Section I.B of Schedule 2 to this Agreement pursuant to which the Recipient shall make the proceeds of the Credit available to the Azersu.
4. “Azersu’s Legislation” means its Charter, which was approved by the Decree No. 50 of the Cabinet of Ministers of the Recipient, dated March 22, 2005, and the Presidential Resolution No. 252 on June 11, 2004.
5. “Category” means a category set forth in the table in Section IV of Schedule 2 to this Agreement.
6. “Consultant Guidelines” means the “Guidelines: Selection and Employment of Consultants by World Bank Borrowers” published by the Bank in May 2004 and revised in October 2006.
7. “EMP” means the Environmental Management Plan, dated January 4, 2008, setting forth measures to mitigate any adverse impact to the environment.
8. “FEA” means the Framework Environmental Assessment, dated January 4, 2008, setting forth the framework of environmental assessment to be carried out in order to mitigate any adverse impact to the environment.
9. “General Conditions” means the “International Development Association General Conditions for Credits and Grants”, dated July 1, 2005 (as amended through October 15, 2006).
10. “Incremental Operating Costs” means operating expenditures incurred by the Azersu and the SAWMA on account of management of the Project implementation for communications, utilities, printing and publications, office rent, maintenance and supplies, office security systems, vehicle operation and maintenance, transportation and field trip expenses, training of the staff for the purpose of Project management, remuneration for staff, including qualified social

charges but excluding salaries of civil servants, and such other expenditures as may be agreed upon by the Association.

11. “Loan Agreement” means the loan agreement for the Project between the Recipient and the Bank, dated the same date as this Agreement, as such loan agreement may be amended from time to time. “Loan Agreement” includes all appendices, schedules and agreements supplemental to the Loan Agreement.
12. “PIU” means the Project Implementation Unit within the IRDD of the Azersu and/or the SAWMA, responsible for the implementation of the Project.
13. “Procurement Guidelines” means the “Guidelines: Procurement under IBRD Loans and IDA Credits” published by the Bank in May 2004 and revised in October, 2006.
14. “Procurement Plan” means the Recipient’s procurement plan for the Project, dated March 13, 2008, and referred to in paragraph 1.16 of the Procurement Guidelines and paragraph 1.24 of the Consultant Guidelines, as the same shall be updated from time to time in accordance with the provisions of said paragraphs.
15. “Project Operational Manual” means the manual satisfactory to the Association, to be revised and adopted pursuant to Section 5.01 (c) of this Agreement, setting forth the operational, maintenance and administrative procedures for the implementation of the Project.
16. “RPF” means the Resettlement Policy Framework, dated February 28, 2008, defining the modalities for land acquisition, resettlement and rehabilitation of displaced persons under Components A and C of the Project.
17. “SAWMA” means the State Amelioration and Water Management Agency of Nakhchivan Autonomous Republic, which is also the Project Implementing Entity.
18. “SAWMA’s Legislation” means the Decree of the Supreme Parliament of Nakhchivan Autonomous Republic on the Establishment of the State Amelioration and Water Management Agency on the basis of State Amelioration and Water Management Committee under the Cabinet of Ministers of Nakhchivan Autonomous Republic, dated October 27, 2004 (Decree No. 160-II FR).
19. “SAWMA Subsidiary Agreement” means the agreement referred to in Section I.C of Schedule 2 to this Agreement pursuant to which the Recipient shall make the proceeds of the Credit available to the SAWMA.

20. “Selected Rayons in Azersu’s Service Areas” means Rayons of Imishli, Kurdamir, Siyazan, Aghsu, Ismayili, Udjar, Zardab, Lenkoran, Masalli, Astara, Jaliabad, Yardimli, Lerik, Davachi, Dashkesan and Gadabey, subject to modifications as the Recipient and the Association may agree upon from time to time.
21. “Selected Rayons in SAWMA’s Service Areas” means Rayons of Sadarak, Kangarli, Shahbuz, Djulfa, Ordubad, subject to modifications as the Recipient and the Association may agree upon from time to time.
22. “Training” means expenses incurred by the Recipient, the Azersu and the SAWMA in connection with carrying out training activities under the Project, including travel costs and per diem for local trainees and trainers, study tours and workshops, rental of facilities and equipment and training materials and related supplies.
23. “VAT” means the value-added tax, levied in accordance with the legislation of the Recipient.