

CONFORMED COPY

LOAN NUMBER 4828 HR

Project Agreement

(District Heating Project)

between

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

and

HEP TOPLINARSTVO D.O.O

Dated September 11, 2006

LOAN NUMBER 4828 HR

PROJECT AGREEMENT

Agreement dated September 11, 2006, entered into between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT ("Bank") and HEP TOPLINARSTVO D.O.O. ("Project Implementing Entity") ("Project Agreement") in connection with the Loan Agreement of same date between Hrvatska Elektroprivreda d.d. ("Borrower") and the Bank ("Loan Agreement"). The Bank and the Project Implementing Entity hereby agree as follows:

ARTICLE I - GENERAL CONDITIONS; DEFINITIONS

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

ARTICLE II - PROJECT

- 2.01. The Project Implementing Entity declares its commitment to the objectives of the Project. To this end, the Project Implementing Entity shall:
 - (a) carry out the Project in accordance with the provisions of Article V of the General Conditions; and
 - (b) provide promptly as needed, the funds, facilities, services and other resources required for the Project.
- 2.02. Without limitation upon the provisions of Section 2.01 of this Agreement, and except as the Bank and the Project Implementing Entity shall otherwise agree, the Project Implementing Entity shall carry out the Project in accordance with the provisions of the Schedule to this Agreement.

ARTICLE III - REPRESENTATIVE; ADDRESSES

- 3.01. The Project Implementing Entity's Representative is the Director.

3.02. The Bank's Address is:

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

Cable:	Telex:	Facsimile:
INTBAFRAD Washington, D.C.	248423(MCI) or 64145(MCI)	1-202-477-6391

3.03. The Project Implementing Entity's Address is:

HEP Toplinarstvo d.o.o.
Misevecka 15a
Zagreb 10000
Republic of Croatia

Facsimile:

(385-1) 61 31 978

AGREED at Zagreb, Republic of Croatia, as of the day and year first above written.

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By: /s/ Anand K. Seth
Authorized Representative

HEP TOPLINARSTVO D.O.O.

By: /s/ Robert Krklec
Authorized Representative

SCHEDULE

Execution of the Project

Section I. Institutional and Other Arrangements

1. The Project Implementing Entity, jointly with the Borrower, shall maintain at all times during Project implementation, the Project Implementation Unit, with terms of reference and resources satisfactory to the Bank, and competent staff in adequate numbers.
2. The Project Implementing Entity shall implement the Project in accordance with the provisions of the Environmental Management Plan and of the Land Acquisition Framework, if applicable, both satisfactory to the Bank, and shall not amend, suspend or abrogate any of their provisions without the prior agreement of the Bank.

Section II. Project Monitoring, Reporting, Evaluation

A. Project Reports

1. The Project Implementing Entity shall monitor and evaluate the progress of the Project and prepare Project Reports, commencing from December 31, 2006, in accordance with the provisions of Section 5.08 (b) of the General Conditions and on the basis of indicators agreed with the Bank. Each such Project Report shall cover the period of one (1) calendar semester, and shall be furnished to the Borrower not later one (1) month after the end of the period covered by such report for incorporation and forwarding by the Borrower to the Bank of the overall Project Report.
2. The Project Implementing Entity shall provide to the Borrower not later than April 30, 2010, for incorporation in the report referred to in Section 5.08 (c) of the General Conditions all such information as the Borrower or the Bank shall reasonably request for the purposes of that Section.

B. Financial Management, Financial Reports; Audits

1. The Project Implementing Entity shall maintain a financial management system and prepare financial statements in accordance with consistently applied accounting standards acceptable to the Bank, both in a manner adequate to reflect the operations and financial condition of the Project Implementing Entity, including the operations, resources and expenditures related to the Project.
2. The Project Implementing Entity shall have its financial statements referred to above audited by independent auditors acceptable to the Bank, in accordance with consistently applied auditing standards acceptable to the Bank. Each audit of these financial statements shall cover the period of one (1) fiscal year of the Project

Implementing Entity. The audited financial statements for each period shall be furnished to the Borrower and the Bank not later than six (6) months after the end of the period.

Section III. Procurement

All goods and works to be financed out of the proceeds of the Loan shall be procured in accordance with the provisions of Schedule 2 to the Loan Agreement.

Section IV. Other Undertakings

1. (a) Except as the Bank shall otherwise agree, the Project Implementing Entity shall not incur any debt, unless the net revenues of the Project Implementing Entity for the fiscal year immediately preceding the date of such incurrence or for a later twelve-month period ended prior to the date of such incurrence, whichever is the greater, shall be at least 1.2 times the estimated maximum debt service requirements of the Project Implementing Entity for any succeeding fiscal year on all debt of the Project Implementing Entity, including the debt to be incurred.

(b) For the purposes of this Section:

(i) The term "debt" means any indebtedness of the Project Implementing Entity maturing by its terms more than one (1) 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 adjusted to take account of the Project Implementing Entity's^[w1] rates^[w3] in effect at the time of the incurrence of debt even though they were not in effect during the twelve-month period to which such revenues relate 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 payments, if any) of, and interest and other charges on debt.
- (vi) Whenever for the purposes of this Section it shall be necessary to value, in terms of the currency of the Guarantor, 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.

2. The Project Implementing Entity shall:

(a) within thirty (30) days after the new tariff methodology is approved by the Guarantor, through HERA, pursuant to Section 2.03 of the Guarantee Agreement, submit a proposal to HERA for adjusting the tariffs for district heating based on the approved methodology;

(b) by March 31 of each year during Project implementation, the Project Implementing Entity, jointly with the Borrower, review with the Bank its financial performance for the preceding year and the financial forecasts for the next two (2) years; and

(c) take appropriate actions, required for the Project Implementing Entity to meet its financial obligations under the Project Agreement, including proposing to HERA to adjust the levels and structure of tariffs for district heating which would allow the Project Implementing Entity, under conditions of efficient operation at reasonable levels of capacity utilization, to cover: its operating costs including depreciation; debt service payments, including debt service payments on the Loan; reduction of payment arrears, and provision of internally generated funds for financing of investments under the Project.

3. Not later than December 31, 2006, the Project Implementing Entity shall develop a Demand Side Management Program, satisfactory to the Bank; and shall initiate its implementation from January 15, 2007.

