

CONFORMED COPY

LOAN NUMBER 4352 HR

Project Agreement

(Municipal Environmental Infrastructure Project)

among

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

and

EKO KASTELANSKI ZALJEV

and

SPLIT WATER AND SEWERAGE COMPANY

Dated September 25, 1998

LOAN NUMBER 4352-0 HR

PROJECT AGREEMENT

AGREEMENT, dated September 25, 1998, between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank), EKO KASTELANSKI ZALJEV (the EKO) and SPLIT WATER AND SEWERAGE COMPANY (the SWSC).

WHEREAS (A) by the Loan Agreement of even date herewith between the Croatian Bank for Reconstruction and Development (the Borrower) and the Bank, the Bank has agreed to make available to the Borrower an amount in various currencies equivalent to sixty-five million Deutsche Marks (DEM 65,000,000), on the terms and conditions set forth in the Loan Agreement, but only on condition that the EKO and SWSC agree to undertake such obligations toward the Bank as are set forth in this Agreement;

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

WHEREAS the EKO and the SWSC, in consideration of the Bank's entering into the Loan Agreement with the Borrower, have 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 therein) have the respective meanings therein set forth.

ARTICLE II

Execution of the Project

Section 2.01. (a) The EKO and the SWSC declare their 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 with due diligence and efficiency and in conformity with appropriate administrative, financial, engineering, environmental and technical practices, as well as in conformity with the provisions of the Environmental Mitigation Plan, 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 the EKO and the SWSC shall otherwise agree, the EKO and the SWSC 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 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. The EKO and the SWSC 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.

Section 2.04. The EKO and the SWSC shall duly perform all their obligations under the Subsidiary Agreement. Except as the Bank shall otherwise agree, the EKO and the SWSC shall not take or concur in any action which would have the effect of amending, abrogating, assigning or waiving the Subsidiary Agreement or any provision thereof.

Section 2.05. (a) The EKO and the SWSC shall, at the request of the Bank, exchange views with the Bank with regard to the progress of the Project, the performance of their obligations under this Agreement and under the Subsidiary Agreement, and other matters relating to the purposes of the Loan.

(b) The EKO and the SWSC 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 Subloan, or the performance by the EKO and the SWSC of their obligations under this Agreement and under the Subsidiary Agreement.

ARTICLE III

Management and Operations of the EKO and the SWSC

Section 3.01. The EKO and the SWSC shall carry on their operations and conduct their affairs in accordance with sound administrative, financial, and environmental practices under the supervision of qualified and experienced management assisted by competent staff in adequate numbers.

Section 3.02. The SWSC 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 environmental practices.

Section 3.03. The EKO and the SWSC 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.

Section 3.04. Not later than December 31, 1999, the SWSC shall: (i) prepare and furnish to the Borrower and the Bank the Performance Enhancement Program, based on terms of reference satisfactory to the Borrower and the Bank; and (ii) implement said program taking into account the recommendations of the Borrower and the Bank according to a time schedule to be specified in said program.

ARTICLE IV

Financial Covenants

Section 4.01. (a) The EKO and the SWSC shall each establish and 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, adequate to reflect their operations and financial condition, and to register separately the operations, resources and expenditures for and in connection with the carrying out of the Project.

(b) The EKO and the SWSC shall:

(i) have their records, accounts and financial statements (balance sheets, statements of income and expenses and related statements) for each fiscal year audited, in accordance with 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 the financial statements referred to in paragraph (a) above for such year as so audited, and (B) an opinion on such statements and a 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 such records, accounts and financial statements, and the audit thereof, and concerning said auditors, as the Bank may 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 expenditure, the EKO and the SWSC shall:

(i) maintain, or cause to be maintained, in accordance with paragraph (a) of this Section, records and separate 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 expenditure 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. The SWSC shall ensure that:

(a) the SWSC projected operating revenues are sufficient to meet its projected expenses for that fiscal year;

(b) by or before March 31 of each of the SWSC's fiscal years during Project implementation, the SWSC and Beneficiary Municipalities shall review, on the basis of forecasts prepared by the SWSC and satisfactory to the Bank, whether the SWSC would be able to meet the requirements set forth in paragraph (a) above in respect of such year and the next following fiscal year, and shall furnish to the Borrower and the Bank a copy of such review upon its completion;

(c) if any such review shows that the SWSC would not meet the requirements set forth in paragraph (a) for the SWSC's fiscal years covered by such review, the SWSC shall promptly take, and ensure that the Beneficiary Municipalities take, all necessary measures (including, without limitation, adjustments of the structure or level of its rates) in order to meet such requirements; and

(d) for the purposes of this paragraph (a):

(i) the term "projected operating revenues" means the sum of collected revenues from all sources related to operations, consumer deposits, operating subsidies received by the SWSC, and consumer contributions in aid of construction;

(ii) the term "projected operating expenses" means all expenses related to operations, including administration, adequate maintenance and taxes and payments in lieu of taxes (excluding provision for depreciation and other non-cash operating charges), interest payable on all debt related to the SWSC's operations, and the larger of the depreciation allocation or loan amortization, all cash dividends and other cash distributions of surplus, and other cash outflows other than capital expenditures;

(iii) 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;

(iv) the term "capital expenditures" means all expenditures incurred on account of fixed assets, including interest charged to construction, related to operations; and

(v) whenever for the purposes of this paragraph 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) The SWSC shall not incur any new debt unless a reasonable forecast of the SWSC's revenues and expenditures shows that the estimated net revenues of the SWSC 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 the SWSC in such year on all debt of the SWSC, including the debt to be incurred.

(b) For the purposes of this paragraph:

(i) The term "debt" means any indebtedness of the Borrower 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:

and net (A) the sum of revenues from all sources related to operations non-operating income; and
administration, (B) the sum of all expenses related to operations including 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:

operations; and (A) revenues from all sources other than those related to
incurred in (B) expenses, including taxes and payments in lieu of taxes, 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) The term "reasonable forecast" means a forecast prepared by the SWSC not earlier than twelve (12) months prior to the incurrence of the debt in question, which the Bank, the Borrower and SWSC accept as reasonable and as to which the Bank has notified the Borrower 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 the SWSC.

(vii) Whenever for the purposes of this paragraph 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.

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 the EKO and the SWSC thereunder shall terminate on the date on which the Loan Agreement shall terminate in accordance with its terms, and the Bank shall promptly notify the EKO and the SWSC 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, N.W.
Washington, D.C. 20433
United States of America

Cable address:

INTBAFRAD
Washington, D.C.

Telex:

248423 (MCI) or
64145 (MCI)

For the EKO:

EKO KASTELANSKI ZALJEV
Drazanac 70
21000 Split
Republic of Croatia

For the SWSC:

SPLIT WATER AND SEWERAGE COMPANY
JKP Vodovod I Kanalizacija
Biokovska 3
21000 Split
Republic of Croatia

Section 6.02. (a) Any action required or permitted to be taken, and any document required or permitted to be executed, under this Agreement on behalf of the EKO, or by the EKO on behalf of the Borrower under the Loan Agreement, may be taken or executed by the Executive Director or such other person or persons as the Executive Director shall designate in writing, and the Executive Director shall furnish to the Bank sufficient evidence of the authority and the authenticated specimen signature of each such person. (b) Any action required or permitted to be taken, and any document required or permitted to be executed, under this Agreement on behalf of the SWSC, may be taken or executed by the Director or such other person or persons as the Director shall designate in writing, and the Director 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/ Arntraud Hartmann

Acting Regional Vice President
Europe and Central Asia

EKO KASTELANSKI ZALJEV

By /s/ Nikola Grabic

Authorized Representative

SPLIT WATER AND SEWERAGE COMPANY

By /s/ Andriano Petkovic

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, and September 1997 (the Guidelines) and the following provisions of this Section.

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) Grouping of contracts

To the extent practicable, contracts for pipeline installation and construction of pumping stations shall be grouped in bid packages estimated to cost \$5,000,000 equivalent or more each.

(b) 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.

(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. National Competitive Bidding

Works estimated to cost less than \$2,000,000 equivalent per contract, up to an aggregate amount not to exceed \$3,000,000 equivalent, may be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines.

2. International Shopping

Goods estimated to cost less than \$300,000 equivalent per contract, up to an aggregate amount not to exceed \$300,000 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.

3. National Shopping

Goods and works estimated to cost less than \$50,000 equivalent per contract, up to an aggregate amount not to exceed \$300,000 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

With respect to each contract procured under the International Competitive Bidding procedures and the first two contracts procured under the National Competitive Bidding procedures, the procedures set forth in paragraphs 3.5 and 3.6 of 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

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. Quality-based Selection

Services under Parts C.1 and C.2 of the Project and other services which are estimated to cost more than \$100,000 equivalent per contract, shall be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 through 3.4 of the Consultant Guidelines.

2. Single Source Selection

Services under Parts C.1 and C.2 of the Project and other services which are 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.

3. Individual Consultants

Services under Parts C.1 and C.2 of the Project which are estimated to cost less than \$50,000 equivalent per contract 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 all contracts for employment of consulting firms, estimated to cost the equivalent of \$100,000 or more, the procedures set forth in paragraphs 1, 2 (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 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 said approval shall have been given.

3. Post Review

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

SCHEDULE 2

Implementation Program

Part A: Joint Obligations of the EKO and the SWSC

1. The EKO and the SWSC shall:

(a) maintain policies and procedures adequate to enable them 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 objectives thereof;

(b) not later than March 31 and September 30 of each fiscal year during the Project, prepare, under terms of reference satisfactory to the Bank, and furnish to the Bank, based on the results of the monitoring and evaluation activities performed pursuant to paragraph 1 (a) of this Schedule, a report (Semi-annual Report) of such scope and detail as the Bank shall reasonably request, describing the progress achieved in the carrying out of the Project during the preceding six (6) months, and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the following six (6) months;

(c) review with the Bank, by April 30 and October 31 of each fiscal year during the Project, or such later date as the Bank shall request, the Semi-annual Reports, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Bank's views on the matter.

(d) prepare, under terms of reference satisfactory to the Bank, and furnish to the Borrower and the Bank, on or about September 30, 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 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 objectives thereof during the period following such date; and

(e) review with the Borrower and the Bank, by October 31, 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 completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Bank's views on the matter.

2. For the purposes of Section 9.07 of the General Conditions and without limitation thereto, the EKO and the SWSC shall: (a) 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 among the Bank and the EKO and the SWSC, a plan for the future operation of the Project; and (b) afford the Bank a reasonable opportunity to exchange views with the EKO and the SWSC on said plan.

Part B: Obligations of the EKO

1. The EKO shall be responsible for the implementation of Parts A, B, C.2 and C.4 of the Project, including engagement of consultants, procurement, preparation of withdrawal applications for payment by the Bank, or from the Special Account, monitoring and reporting in respect to physical progress and financial management related to Parts A, B, C.2 and C.4, and preparation of consolidated Project reports on physical progress and financial management.

2. Not later than December 31, 1998, the EKO shall prepare and furnish to the Borrower and the Bank an updated Environmental Mitigation Plan, incorporating therein the findings and results of detailed engineering work in regard to the two proposed tunnels.

Part C: Obligations of the SWSC

1. The SWSC shall be responsible for the implementation of Parts C.1 and C.3 of the Project, including engagement of consultants, procurement, monitoring and reporting, in respect of the physical progress, financial management, and implementation of the Performance Enhancement Program and the SWSC Corporate Development Plan, and the timely and complete submission of information in relation to Parts C.1 and C.3 to the EKO to enable the EKO to prepare the consolidated Project progress reports.

2. Not later than December 31, 1998, the SWSC shall employ consultants, with qualifications and under terms of reference satisfactory to the Bank, to assist the SWSC in preparing a Performance Enhancement Program, to be submitted to the Borrower and the Bank, by December 31, 1999.

3. Not later than December 31, 1999, the SWSC shall prepare and furnish to the Borrower and the Bank, under terms of reference satisfactory to the Bank, the SWSC Corporate Development Plan, and implement said plan taking into account the recommendations of the Borrower and Bank, according to a time schedule to be specified in said plan.

