

CONFORMED COPY

LOAN NUMBER 7565-PK
CREDIT NUMBER 4463-PK
CREDIT NUMBER 4464-PK

Project Agreement

(Electricity Distribution and Transmission Improvement Project)

among

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

and

HYDERABAD ELECTRIC SUPPLY COMPANY, LTD.

Dated July 14, 2008

PROJECT AGREEMENT

AGREEMENT dated July 14, 2008, entered into among INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (“Bank”), INTERNATIONAL DEVELOPMENT ASSOCIATION (“Association”) and HYDERABAD ELECTRIC SUPPLY COMPANY, LTD. (alternatively “HESCO” or the “Project Implementing Entity”) (“Project Agreement”) in connection with the Loan Agreement (“Loan Agreement”) of same date between the ISLAMIC REPUBLIC OF PAKISTAN (“Borrower”) and the Bank, and the Financing Agreement (“Financing Agreement”) of the same date between ISLAMIC REPUBLIC OF PAKISTAN (“Recipient”) and the Association. The Bank, the Association 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 and in Section 1.01 of the Financing 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 Loan Agreement, the Financing Agreement or the General Conditions (as so respectively defined in the Loan Agreement and the Financing Agreement).

ARTICLE II — PROJECT

- 2.01. The Project Implementing Entity declares its commitment to the objectives of the Project and the Program. To this end, the Project Implementing Entity shall carry out Part A.4 and HESCO’s related activities under Parts C and D of the Project (HESCO’s “Respective Parts of the Project”) in accordance with the provisions of Article V of the Bank’s General Conditions and Article IV of the Association’s General Conditions, and shall provide promptly as needed, the funds, facilities, services and other resources required for its Respective Parts of the Project.
- 2.02. Without limitation upon the provisions of Section 2.01 of this Agreement, and except as the Bank, the Association and the Project Implementing Entity shall otherwise agree, the Project Implementing Entity shall carry out its Respective Parts of 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 HESCO’s Chief Executive Officer.

3.02. The Bank's and the Association's Address is:

International Bank for Reconstruction and Development
International Development Association
1818 H Street, N.W.
Washington, D.C. 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:

Hyderabad Electric Supply Company Ltd.
WAPDA Offices Complex
Hussainabad
Hyderabad
Pakistan

Phone:	Facsimile:
(92)-22-9260023 / 9260161	(92)-22-9260361

AGREED at Islamabad, Islamic Republic of Pakistan, as of the day and year first above written.

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

By

/s/ Yusupha B. Crookes
Authorized Representative

HYDERABAD ELECTRIC SUPPLY
COMPANY LTD.

By

/s/ Guftar Ahmad
Authorized Representative

SCHEDULE

Execution of the Project Implementing Entity's Respective Parts of the Project

Section I. Implementation Arrangements

A. Institutional Arrangements

1. HESCO shall, at all times throughout the implementation of its Respective Parts of the Project:
 - (a) (i) be governed in accordance with its Memorandum and Articles of Association, dated April 23, 1998; and
 - (ii) refrain from assigning, amending, abrogating, or waiving its Memorandum and Articles of Association, and/or any provision thereof, if, in the opinion of the Bank and the Association, such assignment, amendment, abrogation or waiver will materially and adversely affect HESCO's ability to implement the Project;
 - (b) maintain a Board of Directors with appropriate experience and qualifications, comprising representation from the public and private sector, which Board shall exercise the general oversight of HESCO's Respective Parts of the Project;
 - (c) maintain a unit headed by a Project Director, with experience and qualifications and under terms of reference satisfactory to the Bank and the Association, and provided with sufficient resources and competent staff, in adequate numbers, and under terms of reference and with experience and qualifications acceptable to the Bank and the Association, to be responsible for the day-to-day coordination of the implementation of HESCO's Respective Parts of the Project; and
 - (d) keep the Bank and the Association promptly informed of any changes in membership of either the Board of Directors (including its Chair) and/or the management team referred to in sub-paragraph (c) above, and ensure that any such changes will be made in accordance with procedures set forth in HESCO's Memorandum and Articles of Association, and in terms satisfactory to the Bank and the Association.
2. HESCO shall hire, on an annual basis, independent external auditors satisfactory to the Bank and the Association, with terms of reference acceptable to the Bank and the Association, to be responsible for carrying out HESCO's annual audit and the audits of the HESCO's Project accounts and Financial Statements. The

audit reports shall include the independent auditor's opinion on HESCO compliance with the financial covenants and reports set forth in this Agreement.

3. HESCO shall maintain throughout the implementation of its Respective Parts of the Project, an environmental unit, headed by a qualified environmental and social specialist satisfactory to the Bank and the Association, to be provided with sufficient resources and competent staff in adequate numbers, and under terms of reference and with experience and qualifications acceptable to the Bank and the Association, which unit shall be responsible for the carrying out of the environmental monitoring and mitigation, including the regular update of the Environmental and Social Assessment, and the implementation of the Environmental and Social Management Plan and Resettlement Action Plan as the case may be.
4. HESCO shall carry out its Respective Parts of the Project in accordance with the financial arrangements, policies and procedures set forth in the Financial Management Manual, and shall refrain from assigning, amending, abrogating, or waiving the Financial Management Manual, and/or any provision thereof, without the prior concurrence of the Bank and the Association.

B. Energy Efficiency Component

In carrying out Part D of the Project, HESCO shall:

- (a) prepare and furnish to the Borrower, the Bank and the Association for review, comments and concurrence, a draft project description document detailing the proposed activities under Part D of the Project, which detail shall include: (i) an assessment of the technical, economic and financial justification/viability of the activities proposed; (ii) implementation plan; (iii) the environmental and social assessment of such activities, whenever necessary, and the mitigation measures therefor; and (iv) the proposed budget and associated procurement plan (including any arrangements for supplementing/strengthening the procurement capacity);
- (b) finalize, such project description document based on the drafts as discussed with, and agreed by, the Borrower, the Bank and the Association; and
- (c) thereafter, carry out Project activities under Part D of the Project in accordance with the project description documents, as so approved.

C. Anti-Corruption

HESCO shall ensure that its Respective Parts of the Project is carried out in accordance with the provisions of the Anti-Corruption Guidelines and the Procurement Action Plan.

D. Safeguards

1. HESCO shall:

- (a) carry out its Respective Parts of the Project in accordance with the principles set forth in the Environmental and Social Guidelines and HESCO's Environmental and Social Assessment, and the protocols and procedures provided in HESCO's Environmental and Social Management Plan and Resettlement Action Plan;
- (b) on an annual basis, no later than April 30 of each year, update the Environmental and Social Assessment, the Environmental and Social Management Plan and the Resettlement Action Plan, in accordance with the policies, procedures and criteria set forth in the Environmental and Social Guidelines, and furnish each such updates to the Bank and the Association for review and approval;
- (c) ensure that the implementation of its Environmental and Social Management Plan and Resettlement Action Plan and/or any updated thereof, are adequately monitored and supervised throughout Project Implementation; and
- (d) neither amend, nor suspend, abrogate or in anyway waive any provision of its Environmental and Social Guidelines, Environmental and Social Management Plan and Resettlement Action Plan, if, in the opinion of the Bank and the Association, such amendment, suspension, abrogation and waiver might materially and adversely affect the carrying out of HESCO's Respective Parts of the Project, or the achievement of the objectives of either the Environmental Social Guidelines, the Environmental and Social Management Plan or the Resettlement Action Plan.

2. HESCO shall refrain from commencing any civil works that would give rise to Displaced Persons until HESCO has adequately resettled all such Displaced Persons and/or paid them adequate monetary compensations for any land takings, in accordance with the provisions of HESCO's Resettlement Action Plan and on terms satisfactory to the Bank and the Association.

3. HESCO shall hire an independent external environmental expert/firm satisfactory to the Bank and the Association, with terms of reference acceptable to the Bank and the Association, to be responsible for carrying out, at least twice during Project implementation (i.e. prior to its estimated mid-term review, and preceding the preparation of the report provided for in Section II.A.2 below), a third party monitoring, validation and certification of:
 - (a) HESCO's appropriate implementation of its Environmental and Social Management Plan and/or its Resettlement Action Plan, as the case may be; and
 - (b) HESCO's monitoring of the social impact of Project activities under its Respective Parts of the Project.

Section II. Project Monitoring, Reporting and Evaluation

A. Project Reports

1. HESCO shall monitor and evaluate the progress of its Respective Parts of the Project and prepare Project Reports for its Respective Parts of the Project in accordance with the provisions of Section 5.08(b) of the Bank's General Conditions and Section 4.08(b) of the Association's General Conditions and on the basis of the indicators agreed with the Bank and the Association. Each such Project Report shall cover the period of one calendar quarter, and shall be furnished to the Borrower not later one month after the end of the period covered by such report for incorporation and forwarding by the Borrower to the Bank and the Association of the overall Project Report.
2. HESCO shall provide to the Borrower not later than November 30, 2011, for incorporation in the report referred to in Section 5.08(c) of the Bank's General Conditions and Section 4.08(c) of the Association's General Conditions all such information as the Borrower, the Bank or the Association shall reasonably request for the purposes of that Section.

B. Financial Reports and Audits

1. HESCO shall maintain a financial management system and prepare financial statements in accordance with consistently applied accounting standards acceptable to the Bank and the Association, both in a manner adequate to reflect the operations and financial condition of HESCO, including the operations, resources and expenditures related to HESCO's Respective Parts of the Project.
2. HESCO shall have its financial statements referred to above audited by independent auditors acceptable to the Bank and the Association, in accordance with consistently applied auditing standards acceptable to the Bank and the

Association. Each audit of these financial statements shall cover the period of one fiscal year of HESCO. The audited financial statements for each period shall be furnished to the Borrower, the Bank and the Association not later than six months after the end of the period.

3. Without limitation on the provisions of Part A of this Section and the preceding paragraph B.2 above, HESCO shall prepare interim un-audited financial reports, in form and substance satisfactory to the Bank and the Association, covering each calendar quarter of Project implementation. The interim un-audited financial report for each such calendar quarter shall be furnished to the Borrower, the Bank and the Association not later than forty-five (45) days after the end of the respective calendar quarter.

C. Financial Management Covenants

1. HESCO shall:
 - (a) by no later than December 31, 2008, prepare a financial restructuring plan in terms satisfactory to the Bank and the Association, and within fifteen (15) days furnish it to the Bank and the Association for its review and comments, which plan shall set forth the measures to be taken in order to achieve financial and operational sustainability for the company; i.e. cover its operating costs -including taxes-, earn an adequate return on investments, meet its financial obligations and make a reasonable contribution to future investment for the expansion of service coverage;
 - (b) have its Board of Directors approve the financial restructuring plan prepared under subparagraph (a) above, as reviewed/commented by the Bank and the Association, by no later than July 1, 2009; and
 - (c) thereafter, carry out the HESCO's financial restructuring in accordance with the approved financial restructuring plan.
2. HESCO shall prepare by June 30 of each year, commencing on June 30, 2009, and furnish to the Borrower, the Bank and the Association for review, a rolling medium-term financial projection report integrating financial, operational and investment program information (including, *inter alia*, projected income statements, balance sheets and cash flow statements covering a period of no less than five (5) years following each such report).
3. (a) HESCO, the Bank and the Association shall, from time to time, at the request of each party, exchange views with regard to NEPRA's approved

tariff schedules and pricing policies, as well as the plans and strategies for the overall development of the electricity sector.

- (b) HESCO undertakes to file with NEPRA, whenever the applicable tariff schedule no longer meets the standards and parameters set forth in Section 31(2) of the NEPRA Act and Part III of the NEPRA SRO, a petition for a tariff revision and update. Said petition shall request a tariff adjustment that would: (i) allow HESCO to achieve the financial targets set out in the restructuring plan provided for in paragraph (1) of this Section II.C (i.e. cover their operating costs -including taxes-, earn an adequate return on investments, meet their financial obligations and make a reasonable contribution to future investment for the expansion of service coverage); (ii) be reasonably competitive in price as compared to other local electricity service providers; and (iii) pass on to consumers the benefit of declines in the real cost of HESCO's electric power operations, through a reduction in tariffs in real terms.

Section III. Procurement

All goods, works and services required for the HESCO's Respective Parts of the Project and to be financed out of the proceeds of the Loan or the Financing shall be procured in accordance with the provisions of Section III of Schedule 2 to the Loan Agreement.