
LOAN NUMBER 2437-AZE

LOAN AGREEMENT
(Ordinary Operations)

(Power Transmission Enhancement Project)

between

AZERENERGY OPEN JOINT-STOCK COMPANY

and

ASIAN DEVELOPMENT BANK

DATED 06 December 2008

LAL:AZE 42085

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**LOAN AGREEMENT
(Ordinary Operations)**

LOAN AGREEMENT dated 06 December 2008 between AZERENERGY OPEN JOINT-STOCK COMPANY (hereinafter called the Borrower) and ASIAN DEVELOPMENT BANK (hereinafter called ADB).

WHEREAS

(A) the Borrower is an open joint-stock company incorporated and operating under the laws of the Republic of Azerbaijan;

(B) the Borrower has applied to ADB for a loan for the purposes of financing parts 2 (i) to (iii) of the Project described in Schedule 1 to this Loan Agreement;

(C) the Borrower shall finance from its own resources parts 2 (iv) and (v) of the Project described in Schedule 1 to this Loan Agreement;

(D) the Loan is to be guaranteed by the Republic of Azerbaijan (hereinafter called the Guarantor) under the terms of the Guarantee Agreement of even date herewith; and

(E) ADB on the basis *inter alia* of the foregoing, has agreed to make a loan to the Borrower from ADB's ordinary capital resources upon the terms and conditions hereinafter set forth;

NOW THEREFORE the parties hereto agree as follows:

ARTICLE I

Loan Regulations; Definitions

Section 1.01. All the provisions of the Ordinary Operations Loan Regulations Applicable to LIBOR-Based Loans Made from ADB's Ordinary Capital Resources, dated 1 July 2001, are hereby made applicable to this Loan Agreement with the same force and effect as if they were fully set forth herein, subject, however, to the following modifications thereof (said Ordinary Operations Loan Regulations as so modified being hereinafter called the Loan Regulations):

(a) Section 3.03 is deleted and the following is substituted therefor:

Commitment Charge; Credit. (a) The Borrower shall pay a commitment charge on the unwithdrawn amount of the Loan at the rate and on the terms specified in the Loan Agreement.

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(b) ADB shall provide to the Borrower a credit at the rate specified in the Loan Agreement, which credit shall remain fixed for the term of the Loan. ADB shall apply the amount of the credit against the interest payable by the Borrower.

(b) Section 3.06 is deleted and the following is substituted therefor:

(a) Following any announcement by ADB that the Fixed Spread applicable to new Loans shall be reduced, ADB shall provide a Rebate to any Borrower with an outstanding Loan on which a higher Fixed Spread is applicable. The amount of the Rebate shall be determined by multiplying (i) the difference between the Fixed Spread applicable to the outstanding Loan and the Fixed Spread that will be applied to new Loans (expressed as a percentage per annum), by (ii) the principal amount of the outstanding Loan on which the Borrower shall pay interest for all interest periods commencing on and after the effective date of the lower Fixed Spread that will be applied to new Loans.

(b) Following any announcement by ADB that its Funding Cost Margin calculations with respect to any Loan Currency (or Approved Currency) in any Semester resulted in ADB achieving savings, ADB shall provide a Rebate to the Borrower. The amount of the Rebate shall be determined by multiplying (i) the Funding Cost Margin (expressed as a percentage per annum) by (ii) the principal amount of the Loan on which the Borrower shall pay interest for the Interest Period commencing immediately after the Semester for which the Funding Cost Margin was calculated. ADB shall apply the amount of the Rebate against the interest payable by the Borrower for the Interest Period commencing immediately after the Semester for which the Funding Cost Margin was calculated.

(c) Section 3.07 is deleted and the following is substituted therefor:

(a) Following any announcement by ADB that the Fixed Spread applicable to new Loans shall be increased, any Borrower with an outstanding Loan on which a lower Fixed Spread is applicable shall pay ADB a Surcharge. The amount of the Surcharge shall be determined by multiplying (i) the difference between the Fixed Spread that will be applied to new Loans and the Fixed Spread applicable to the outstanding Loan (expressed as a percentage per annum), by (ii) the principal amount of the outstanding Loan on which the Borrower shall pay interest for all interest periods commencing on and after

the effective date of the higher Fixed Spread that will be applied to new Loans.

(b) Following any announcement by ADB that its Funding Cost Margin calculations with respect to any Loan Currency (or Approved Currency) in any Semester resulted in ADB incurring additional costs, the Borrower shall pay ADB a Surcharge. The amount of the Surcharge shall be determined by multiplying (i) the Funding Cost Margin (expressed as a percentage per annum) by (ii) the principal amount of the Loan on which the Borrower shall pay interest for the Interest Period commencing immediately after the Semester for which the Funding Cost Margin was calculated. ADB shall add the amount of the Surcharge to the interest payable by the Borrower for the Interest Period commencing immediately after the Semester for which the Funding Cost Margin was calculated.

Section 1.02. Wherever used in this Loan Agreement, unless the context otherwise requires, the several terms defined in the Loan Regulations have the respective meanings therein set forth, and the following additional terms have the following meanings:

(a) “Consulting Guidelines” means ADB’s Guidelines on the Use of Consultants by Asian Development Bank and Its Borrowers (2007, as amended from time to time);

(b) “EMMP” means the environmental management and monitoring plan included in the IEE;

(c) “Goods” means equipment and materials to be financed out of the proceeds of the Loan; and including related services such as transportation, insurance, installation, commissioning, training, and initial maintenance, but excluding consulting services;

(d) “IEE” means the initial environmental examination prepared for the Project, and approved by the Borrower on 24 June 2008;

(e) “kV” means kilo-volt;

(f) “MED” means the Ministry of Economic Development of the Guarantor;

(g) “MENR” means the Ministry of Ecology and Natural Resources of the Guarantor;

(h) “MIE” means the Ministry of Industry and Energy of the Guarantor;

(i) “MOF” means the Ministry of Finance of the Guarantor;

(j) “MVA” means mega volt-ampere;

- (k) "PCB" means polychlorinated biphenyl;
- (l) "PMU" means the Project management unit as described in paragraphs 1 and 2 of Schedule 5 to this Loan Agreement;
- (m) "Procurement Guidelines" means ADB's Procurement Guidelines (2007, as amended from time to time);
- (n) "Procurement Plan" means the procurement plan for the Project dated 18 July 2008 and agreed between the Borrower and ADB, as updated from time to time in accordance with Procurement Guidelines, Consulting Guidelines, and other arrangements agreed with ADB;
- (o) "Project Executing Agency" for the purposes of, and within the meaning of, the Loan Regulations means the Borrower; and
- (p) "Works" means construction or civil works to be financed out of the proceeds of the Loan, and including services such as drilling or mapping, and project related services that are provided as part of a single responsibility or turnkey contract, but excluding consulting services.

ARTICLE II

The Loan

Section 2.01. (a) ADB agrees to lend to the Borrower from ADB's ordinary capital resources an amount of one hundred sixty million Dollars (\$160,000,000), as such amount may be converted from time to time through a Currency Conversion in accordance with the provisions of Section 2.06 of this Loan Agreement.

(b) The Loan has a principal repayment period of 20 years, and a grace period as defined in paragraph (c) of this Section.

(c) The term "grace period" as used in paragraph (b) of this Section means the period prior to the first Principal Payment Date in accordance with the amortization schedule set forth in Schedule 2 to this Loan Agreement.

Section 2.02. The Borrower shall pay to ADB interest on the principal amount of the Loan withdrawn and outstanding from time to time at a rate for each Interest Period equal to the sum of LIBOR and 0.60% as provided by Section 3.02 of the Loan Regulations, less a credit of 0.40% as provided by Section 3.03 of the Loan Regulations.

Section 2.03. The Borrower shall pay a commitment charge of 0.15% per annum. Such charge shall accrue on the full amount of the Loan (less amounts withdrawn from time to time), commencing sixty (60) days after the date of this Loan Agreement.

Section 2.04. Interest and other charges on the Loan shall be payable semiannually on 15 March and 15 September in each year.

Section 2.05. The Borrower shall repay the principal amount of the Loan withdrawn from the Loan Account in accordance with the provisions of Schedule 2 to this Loan Agreement.

Section 2.06. (a) The Borrower may at any time request any of the following Conversions of the terms of the Loan in order to facilitate prudent debt management:

- (i) a change of the Loan Currency of all or any portion of the principal amount of the Loan, whether withdrawn and outstanding or unwithdrawn, to an Approved Currency;
- (ii) a change of the interest rate basis applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding from a Floating Rate to a Fixed Rate, or vice versa; and
- (iii) the setting of limits on the Floating Rate applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding by the establishment of an Interest Rate Cap or Interest Rate Collar on said Floating Rate.

(b) Any conversion requested pursuant to paragraph (a) of this Section that is accepted by ADB shall be considered a "Conversion", as defined in Section 2.01(6) of the Loan Regulations, and shall be effected in accordance with the provisions of Article V of the Loan Regulations and the Conversion Guidelines.

ARTICLE III

Use of Proceeds of the Loan

Section 3.01. The Borrower shall cause the proceeds of the Loan to be applied to the financing of expenditures on the Project in accordance with the provisions of this Loan Agreement.

Section 3.02. No consulting services are envisaged to be financed out of the proceeds of the Loan; provided, however, that in the course of Project implementation, if financing of any consulting services is requested by the Borrower and agreed by ADB, then the description of such consulting services and the proposed method of selection shall be deemed to be incorporated herein by updating the Procurement Plan.

Section 3.03. Subject to Section 3.02 of this Loan Agreement, the Goods, Works and consulting services to be financed out of the proceeds of the Loan and the allocation of amounts of the Loan among different categories of such Goods, Works and consulting services shall be in accordance with the provisions of Schedule 3 to this Loan

Agreement, as such Schedule may be amended from time to time by agreement between the Borrower and ADB.

Section 3.04. Subject to Section 3.02 of this Loan Agreement, and except as ADB may otherwise agree, all Goods, Works and consulting services to be financed out of the proceeds of the Loan shall be procured in accordance with the provisions of Schedule 4 to this Loan Agreement.

Section 3.05. ADB may refuse to finance a contract where Goods, Works or consulting services have not been procured under procedures substantially in accordance with those agreed between the Borrower and ADB or where the terms and conditions of the contract are not satisfactory to ADB.

Section 3.06. Except as ADB may otherwise agree, the Borrower shall cause all Goods, Works and consulting services financed out of the proceeds of the Loan to be used exclusively in the carrying out of the Project.

Section 3.07. The closing date for withdrawals from the Loan Account for the purposes of Section 9.02 of the Loan Regulations shall be 30 June 2012 or such other date as may from time to time be agreed between the Borrower and ADB.

ARTICLE IV

Particular Covenants

Section 4.01. (a) The Borrower shall cause the Project to be carried out with due diligence and efficiency and in conformity with sound administrative, financial, engineering, environmental, and power sector development practices.

(b) In the carrying out of the Project and operation of the Project facilities, the Borrower shall perform, or cause to be performed, all its obligations set forth in Schedule 5 to this Loan Agreement.

Section 4.02. The Borrower shall make available, promptly as needed, the funds, facilities, services, land and other resources which are required, in addition to the proceeds of the Loan, for the carrying out of the Project and for the operation and maintenance of the Project facilities.

Section 4.03. (a) In the carrying out of the Project, the Borrower shall cause competent and qualified consultants and contractors, acceptable to ADB, to be employed to an extent and upon terms and conditions satisfactory to the Borrower and ADB.

(b) The Borrower shall cause the Project to be carried out in accordance with plans, design standards, specifications, work schedules and construction methods acceptable to ADB. The Borrower shall furnish, or cause to be furnished, to ADB, promptly after their preparation, such plans, design standards, specifications and work schedules, and any material modifications subsequently made therein, in such detail as ADB shall reasonably request.

Section 4.04. The Borrower shall ensure that the activities of its divisions and agencies with respect to the carrying out of the Project and operation of the Project facilities are conducted and coordinated in accordance with sound administrative policies and procedures.

Section 4.05. (a) The Borrower shall (i) maintain separate accounts for the Project; (ii) have such accounts and related financial statements audited annually, in accordance with appropriate auditing standards consistently applied, by independent auditors whose qualifications, experience and terms of reference are acceptable to ADB; (iii) furnish to ADB, as soon as available but in any event not later than 6 months after the end of each related fiscal year, certified copies of such audited accounts and financial statements and the report of the auditors relating thereto (including the auditors' opinion on the use of the Loan proceeds and compliance with the financial covenants of this Loan Agreement, as well as on the use of the procedures for imprest account and statement of expenditures), all in the English language; and (iv) furnish to ADB such other information concerning such accounts and financial statements and the audit thereof as ADB shall from time to time reasonably request.

(b) The Borrower shall enable ADB, upon ADB's request, to discuss the Borrower's financial statements for the Project and its financial affairs related to the Project from time to time with the auditors appointed by the Borrower pursuant to Section 4.05(a) hereabove, and shall authorize and require any representative of such auditors to participate in any such discussions requested by ADB, provided that any such discussion shall be conducted only in the presence of an authorized officer of the Borrower unless the Borrower shall otherwise agree.

Section 4.06. The Borrower shall enable ADB's representatives to inspect the Project, the Goods and Works financed out of the proceeds of the Loan, and any relevant records and documents.

Section 4.07. The Borrower shall ensure that the Project facilities are operated, maintained and repaired in accordance with sound administrative, financial, engineering, environmental, maintenance and operational practices.

ARTICLE V

Effectiveness

Section 5.01. A date thirty (30) days after the date of this Loan Agreement is specified for the effectiveness of this Loan Agreement for the purposes of Section 10.04 of the Loan Regulations.

ARTICLE VI

Miscellaneous

Section 6.01. The Vice President of the Borrower is designated as representative of the Borrower for the purposes of Section 12.02 of the Loan Regulations.

Section 6.02. The following addresses are specified for the purposes of Section 12.01 of the Loan Regulations:

For the Borrower

Azerenergy Open Joint-Stock Company
10, Ac. Abdulkerim Alizade str.
Baku, AZ 1001
Azerbaijan

Facsimile Number:

994 12 498 5523

For ADB

Asian Development Bank
P.O. Box 789
0980 Manila, Philippines

Facsimile Numbers:

(632) 636-2444
(632) 636-2428.

IN WITNESS WHEREOF the parties hereto, acting through their representatives thereunto duly authorized, have caused this Loan Agreement to be signed in their respective names and to be delivered at the principal office of ADB, as of the day and year first above written.

AZERENERGY OPEN JOINT-STOCK
COMPANY

By 

ETIBAR SINABADDIN PIRVERDIYEV
President

ASIAN DEVELOPMENT BANK

By 

FARAJ HUSEYNBEOV
Team Head
Azerbaijan Resident Mission

SCHEDULE 1

Description of the Project

Objective

1. The objective of the Project is to improve the power transmission system by expanding and strengthening the backbone 220 kV power transmission and distribution network, removing transmission bottlenecks, and reducing transmission losses.

Scope

2. The Project consists of the following parts:

- (i) Construction of 220 kV double-circuit transmission line from Mingechevir hydropower plant to Absheron substation with a total length of about 280 kilometers;
- (ii) Construction of a new 220/110 kV substation at Agdash and installation of two units of transformers each with capacity of 125 MVA, its related equipment, and the associated 110 kV transmission lines in the vicinity of the substation;
- (iii) Installation of one unit of transformer with capacity of 400 MVA and its related equipment;
- (iv) Provision of Project management support in relation to procurement, supervision of construction, monitoring of Project implementation, and other capacity building measures; and
- (v) Strengthening institutional capacity of the Borrower through provision of on-the-job training to its staff on transmission and substation operation and maintenance, environmental management, and social safeguard implementation.

3. The Project is expected to be completed by 31 December 2011.

SCHEDULE 2**Amortization Schedule****(Power Transmission Enhancement Project)**

1. The following table sets forth the Principal Payment Dates of the Loan and the percentage of the total principal amount of the Loan payable on each Principal Payment Date (Installment Share). If the proceeds of the Loan shall have been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined by ADB by multiplying: (a) the total principal amount of the Loan withdrawn and outstanding as of the first Principal Payment Date; by (b) the Installment Share for each Principal Payment Date, such repayment amount to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.

<u>Payment Due</u>	<u>Installment Share</u> (Expressed as a %)
15 Mar 2014	2.500000
15 Sep 2014	2.500000
15 Mar 2015	2.500000
15 Sep 2015	2.500000
15 Mar 2016	2.500000
15 Sep 2016	2.500000
15 Mar 2017	2.500000
15 Sep 2017	2.500000
15 Mar 2018	2.500000
15 Sep 2018	2.500000
15 Mar 2019	2.500000
15 Sep 2019	2.500000
15 Mar 2020	2.500000
15 Sep 2020	2.500000
15 Mar 2021	2.500000
15 Sep 2021	2.500000
15 Mar 2022	2.500000
15 Sep 2022	2.500000
15 Mar 2023	2.500000
15 Sep 2023	2.500000
15 Mar 2024	2.500000
15 Sep 2024	2.500000
15 Mar 2025	2.500000
15 Sep 2025	2.500000
15 Mar 2026	2.500000
15 Sep 2026	2.500000
15 Mar 2027	2.500000
15 Sep 2027	2.500000
15 Mar 2028	2.500000
15 Sep 2028	2.500000

Schedule 2

15 Mar 2029	2.500000
15 Sep 2029	2.500000
15 Mar 2030	2.500000
15 Sep 2030	2.500000
15 Mar 2031	2.500000
15 Sep 2031	2.500000
15 Mar 2032	2.500000
15 Sep 2032	2.500000
15 Mar 2033	2.500000
15 Sep 2033	<u>2.500000</u>
TOTAL	100.000000

2. If the proceeds of the Loan shall not have been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined as follows:

(a) To the extent that any proceeds of the Loan shall have been withdrawn as of the first Principal Payment Date, the Borrower shall repay the amount withdrawn and outstanding as of such date in accordance with paragraph 1 of this Schedule.

(b) Any withdrawal made after the first Principal Payment Date shall be repaid on each Principal Payment Date falling after the date of such withdrawal in amounts determined by ADB by multiplying the amount of each such withdrawal by a fraction, the numerator of which shall be the original Installment Share specified in the table in paragraph 1 of this Schedule for said Principal Payment Date (the Original Installment Share) and the denominator of which shall be the sum of all remaining Original Installment Shares for Principal Payment Dates falling on or after such date, such repayment amounts to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.

3. Withdrawals made within two calendar months prior to any Principal Payment Date shall, for the purposes solely of calculating the principal amounts payable on any Principal Payment Date, be treated as withdrawn and outstanding on the second Principal Payment Date following the date of withdrawal and shall be repayable on each Principal Payment Date commencing with the second Principal Payment Date following the date of withdrawal.

4. Notwithstanding the provisions of paragraphs 1 and 2 of this Schedule, upon a Currency Conversion of all or any portion of the withdrawn principal amount of the Loan to an Approved Currency, the amount so converted in said Approved Currency that shall be repayable on any Principal Payment Date occurring during the Conversion Period, shall be determined by ADB by multiplying such amount in its currency of denomination immediately prior to said Conversion by either: (i) the exchange rate that reflects the amounts of principal in said Approved Currency payable by ADB under the Currency Hedge Transaction relating to said Conversion; or (ii) if ADB so determines in accordance with the Conversion Guidelines, the exchange rate component of the Screen Rate.

5. If the principal amount of the Loan withdrawn and outstanding from time to time shall be denominated in more than one Loan Currency, the provisions of this Schedule shall apply separately to the amount denominated in each Loan Currency, so as to produce a separate amortization schedule for each such amount.

SCHEDULE 3

Allocation and Withdrawal of Loan Proceeds

General

1. The table attached to this Schedule sets forth the Categories of Goods, Works, consulting services and other items to be financed out of the proceeds of the Loan and the allocation of amounts of the Loan to each such Category (hereinafter called the Table). (Reference to "Category" or "Categories" in this Schedule is to a Category or Categories of the Table, and reference to "Subcategory" or "Subcategories" in this Schedule is to a Subcategory or Subcategories of a Category).

Percentages of ADB Financing

2. Except as ADB may otherwise agree, the items of the Categories and Subcategories listed in the Table shall be financed out of the proceeds of the Loan on the basis of the percentages set forth in the Table.

Reallocation

3. Notwithstanding the allocation of Loan proceeds and the withdrawal percentages set forth in the Table,

(a) if the amount of the Loan allocated to any Category appears to be insufficient to finance all agreed expenditures in that Category, ADB may, in consultation with the Borrower, (i) reallocate to such Category, to the extent required to meet the estimated shortfall, amounts of the Loan which have been allocated to another Category but, in the opinion of ADB, are not needed to meet other expenditures, and (ii) if such reallocation cannot fully meet the estimated shortfall, reduce the withdrawal percentage applicable to such expenditures in order that further withdrawals under such Category may continue until all expenditures thereunder shall have been made; and

(b) if the amount of the Loan then allocated to any Category appears to exceed all agreed expenditures in that Category, ADB may, by notice to the Borrower, reallocate such excess amount to any other Category.

Disbursement Procedures

4. Except as ADB may otherwise agree, the Loan proceeds for financing Goods, Works and consulting services shall be disbursed in accordance with ADB's "Loan Disbursement Handbook" dated January 2007 (ADB's Loan Disbursement Handbook), as amended from time to time.

Imprest Account; Statement of Expenditures

5. (a) Except as ADB may otherwise agree, the Borrower shall establish immediately after the Effective Date, an imprest account at the National Bank or a commercial bank in Azerbaijan acceptable to ADB. The imprest account shall be established, managed, replenished and liquidated in accordance with ADB's Loan Disbursement

Handbook, and detailed arrangements agreed upon between the Borrower and ADB. The currency of the imprest account shall be Dollars. The initial amount to be deposited into the imprest account shall not exceed the lower of (i) the estimated expenditure for the first six months of Project implementation, or (ii) the equivalent of ten (10) percent of the Loan amount.

(b) The statement of expenditures (SOE) procedure may be used for reimbursement of eligible expenditures for and to liquidate advances provided into the imprest account, in accordance with ADB's Loan Disbursement Handbook and detailed arrangements agreed upon between the Borrower and ADB. Any individual payment to be reimbursed or liquidated under the SOE procedure shall not exceed the equivalent of \$100,000.

Retroactive Financing

6. Withdrawals from the Loan Account may be made for reimbursement of reasonable expenditures incurred under the Project before the Effective Date, but not earlier than 12 months before the date of this Loan Agreement in connection with civil works, subject to a maximum amount equivalent to 20 percent of the Loan amount.

TABLE

ALLOCATION AND WITHDRAWAL OF LOAN PROCEEDS (Power Transmission Enhancement Project)				
CATEGORY				ADB FINANCING BASIS
Number	Item	Total Amount Allocated for ADB Financing \$		Percentage of ADB Financing from the Loan Account
		Category	Subcategory	
1	Equipment and Material	128,400,000		
1A	220 kV substation "Agdash"		18,300,000	100 percent of total expenditure claimed*
1B	220 kV transmission line		101,800,000	100 percent of total expenditure claimed*
1C	Substation "Absheron" upgrading		8,300,000	100 percent of total expenditure claimed*
2	Works	28,800,000		
2A	220 kV substation "Agdash"		3,100,000	100 percent of total expenditure claimed*
2B	220 kV transmission line		15,800,000	100 percent of total expenditure claimed*
2C	Substation "Absheron" upgrading		1,400,000	100 percent of total expenditure claimed*
2D	Dismantling Work and Local transportation		8,500,000	100 percent of total expenditure claimed*
3	Unallocated	2,800,000		
	Total	160,000,000		

*Exclusive of taxes and duties imposed within the territory of the Borrower.

SCHEDULE 4

Procurement of Goods and Works, and Consulting Services

A. General

1. All Goods, Works and consulting services to be financed out of the proceeds of the Loan shall be subject to and governed by the Procurement Guidelines, and the Consulting Guidelines, respectively.

2. All terms used and not otherwise defined in this Loan Agreement have the meanings provided in the Procurement Guidelines and/or the Consulting Guidelines, as applicable.

B. Procurement for Goods and Works

3. Except as ADB may otherwise agree, Goods and Works shall only be procured on the basis of the methods of procurement set forth below:

International Competitive Bidding
National Competitive Bidding

The methods of procurement are is subject to, among other things, the detailed arrangements and threshold values set forth in the Procurement Plan. The Borrower may only modify the methods of procurement or threshold values with the prior agreement of ADB, and modifications must be set out in updates to the Procurement Plan.

4. National Competitive Bidding. The Borrower and ADB shall ensure that national competitive bidding for the procurement of Goods and Works shall conform to the provisions of the Public Procurement Law of December 27, 2001 with the clarifications and modifications described in the Procurement Plan. Any subsequent change to the agreed clarifications and modifications shall become effective only after written approval of such change by the Borrower and ADB.

C. Selection of Consulting Services

5. In the event ADB finances any consulting services under the Project, then except as otherwise agreed by ADB and set forth in the Procurement Plan, the Borrower shall apply quality- and cost-based selection for selecting and engaging such consulting services.

D. Industrial or Intellectual Property Rights

6. (a) The Borrower shall ensure that all Goods and Works procured (including without limitation all computer hardware, software and systems, whether separately procured or incorporated within other goods and services procured) do not violate or infringe any industrial property or intellectual property right or claim of any third party.

(b) The Borrower shall ensure that all contracts for the procurement of Goods and Works contain appropriate representations, warranties and, if appropriate, indemnities from the contractor or supplier with respect to the matters referred to in subparagraph (a) of this paragraph.

7. The Borrower shall ensure that all ADB-financed contracts with consultants contain appropriate representations, warranties and, if appropriate, indemnities from the consultants to ensure that the consulting services provided do not violate or infringe any industrial property or intellectual property right or claim of any third party.

E. ADB's Review of Procurement Decisions

8. All contracts procured under international competitive bidding procedures and contracts for consulting services shall be subject to prior review by ADB, unless otherwise agreed between the Borrower and ADB and set forth in the Procurement Plan.

SCHEDULE 5

Execution of Project and Operation of Project Facilities; Financial Matters

Implementation Arrangements

1. The Borrower shall establish a PMU to be headed by a Project manager and staffed by specialists in technical, financial, procurement, social, and environmental matters. The PMU shall report to the Chief Engineer or the Deputy President of the Borrower.
2. The PMU shall be responsible for day-to-day Project implementation, including procurement, contract supervision and management, social and environmental management, and financial management, including Project accounting, financial reporting, loan disbursements, and arrangements for external audits.
3. The Borrower shall carry out the Project in accordance with the construction and installation drawings drawn up in line with the specifications in the engineering, procurement and commissioning contracts, and shall adhere to the relevant international practices and standards in the implementation of the Project.

Financial Management

4. The Borrower shall ensure that (i) ADB is kept informed about the Guarantor's announcements on the implementation of tariff policy reform, and (ii) it implements the tariff policy in accordance with its terms and defined timetable, so to achieve full cost recovery of its operations by 31 December 2010.
5. In addition to the provisions of Section 4.05 of this Loan Agreement, the Borrower shall, within six (6) months of the end of each financial year, submit to ADB its consolidated financial statements (in respect of the company and its subsidiaries) drawn up in accordance with International Financial Reporting Standards, and audited by an international auditing firm acceptable to ADB.
6. (a) Within three (3) months of the end of each financial year, the Borrower shall compute its debt service coverage ratio and gearing ratio for each such financial year and submit these to ADB; and from the year 2012 onwards, maintain its debt service coverage ratio of not less than 1.5, and the gearing ratio of not more than 70%.

(b) For the purposes of this Section, the term "debt service coverage ratio" shall mean cash flow available for debt service, i.e., cash flow from operating activities / (total principal repayments for the year + total interest payments for the year); and the term "gearing ratio" shall mean long term debts / (total equity + long term debts).

Environment

7. The Borrower shall ensure that (i) the Project is designed, constructed, and operated in accordance with applicable laws and regulations of the Guarantor, ADB's *Environment Policy* (2002) and the IEE; (ii) any adverse environmental impacts are

minimized by undertaking the mitigating measures detailed in the EMMP; (iii) implementation of the EMMP and any violation of environmental standards are reported semiannually to ADB; (iv) the EMMP is incorporated in bidding documents and bills of quantities of the civil work contracts; (v) the EMMP is updated after detailed design and due diligence, with prior approval of ADB; and (vi) all environmental permits, licenses and clearances are obtained in a timely manner prior to commencement of civil works in the relevant section of the Project.

8. The Borrower shall ensure that (i) the handling of transformers and PCBs is undertaken in compliance with the terms of the Stockholm Convention, of which the Guarantor is a signatory, and with United Nations procedures for safe handling of PCBs; (ii) the new transformers are filled with non-toxic substitute for PCB; and (iii) it closely coordinates with the MENR, and engages the services of a specialized company established by the MENR for handling of hazardous materials.

Resettlement

9. The Borrower shall ensure that (i) the Project does not require any land acquisition or involuntary resettlement; (ii) the new transmission lines and towers follow the existing alignment and locations, respectively; (iii) before commencement of civil works, a detailed due diligence report is completed on potential social impacts and submitted to ADB for approval; (iv) in the event any land acquisition or resettlement becomes necessary, or any potential impact on indigenous peoples is identified, a suitable resettlement plan is drawn up in consultation with the affected people, and approval of ADB, in accordance with the applicable laws of the Guarantor, ADB's *Involuntary Resettlement Policy* (1995) and *Policy on Indigenous Peoples* (1998), and is implemented in accordance with its terms; (v) the existing houses under the transmission lines remain intact during Project implementation; (vi) the construction is scheduled in the farm areas only during the non-agricultural season (June to September); and (vii) these provisions are incorporated suitably in the bidding documents and made part of the civil works contracts.

Government

10. The Guarantor shall ensure that (i) it remains committed to the implementation of the State Program on the Development of the Fuel and Energy Sector in Azerbaijan (2005–2015); (ii) it fully implements its medium term tariff policy which incorporates transition to full cost recovery for utility service providers by 2010; (iii) the distribution companies are required to make timely payments for 100% of the power received from the Borrower; (iv) it provides financial support, as and when needed, to the Borrower to enable it to fulfill its obligations under this Loan Agreement; (v) it causes Borrower to make available all counterpart funding and facilities for timely implementation of the Project; and (vi) its cabinet of ministers coordinates the work between MED, MENR, MIE, MOF, and other government ministries/agencies for expeditious resolution of the issues and timely implementation of the Project.

Anticorruption

11. The Borrower and the Guarantor (i) shall comply with ADB's *Anticorruption Policy* (1998, as amended to date); (ii) acknowledge that ADB, consistent with its commitment to good governance, accountability and transparency, reserves the right to investigate directly, or through its agents, any alleged corrupt, fraudulent, collusive or

coercive practice related to the Project; and (iii) shall cooperate with any such investigation and extend all necessary assistance including access to all relevant books and records, and for engagement of independent experts who may be needed for satisfactory completion of such investigation.

12. The Borrower shall ensure that (i) the anticorruption provisions acceptable to ADB are included in all bidding documents and contracts, including provisions specifying the right of ADB to audit and examine the records and accounts of the executing agencies and all contractors, suppliers, consultants, and other service providers as they relate to the Project; (ii) all contracts, in addition to the Project accounts and financial statements, are audited by an independent external auditor; (iii) decisions on all procurement-related matters are taken by the Tendering Committee, which will comprise representatives of the MED, MIE, MOF, and the State Procurement Agency; (iv) contractors' payment claims are verified by the supervision consultant in accordance with contract specifications; (v) the information on selection of consultants and contractors is disclosed through local newspapers in a timely manner; and (vi) status of procurements and awards of contracts is disclosed on Borrower's website in accordance with ADB's *Procurement Guidelines*.

Change in Ownership and Operation

13. In the event that the Borrower proposes to make (i) any change in ownership of the Project, (ii) any sale, transfer, or assignment of interest or control in the Project, or (iii) a lease or contract out or otherwise materially modify its functions and authority over implementation and operation of the Project, the Borrower shall, at least six (6) months prior to the implementation of such a proposal, consult with ADB and obtain its consent.

14. In the event that the Guarantor proposes to make any change in the ownership of the Borrower, the Guarantor shall consult with ADB to ensure that it does not affect the implementation of the Project or the terms of this Loan Agreement.

Reporting

15. The Borrower shall prepare and submit to ADB quarterly progress reports, which will include (i) a narrative description of progress made during the reporting period, (ii) changes, if any, in the implementation schedule, (iii) problems or difficulties encountered, and (iv) activities and actions to be undertaken in the next reporting period.

Performance Monitoring and Evaluation

16. The Borrower shall (i) by the end of the year 2008, engage Project implementation consultants for monitoring and evaluation of the Project; (ii) collect additional data from relevant agencies, including local governments and statistics bureaus for compiling the performance indicators; and (iii) measure the performance indicators at the inception, Project completion, and three (3) years after Project completion.

Project Review

17. ADB and the Borrower shall meet regularly as necessary, and at least every six (6) months, to review the progress under the Project. In addition, the Guarantor, Borrower, and ADB shall jointly undertake a midterm review in year 2009, which will focus on

(i) Project impacts; (ii) implementation progress; (iii) sector reform and performance; (iv) performance of consultants and contractors; (v) status of compliance with the covenants stipulated in this Loan Agreement; and (vi) the need for any changes in the scope or schedule of the Project to ensure full achievement of its objectives.