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LOAN NUMBER 2571-AZE

PROJECT AGREEMENT

(Water Supply and Sanitation Investment Program – Project 1)

between

ASIAN DEVELOPMENT BANK

and

AZERSU JOINT STOCK COMPANY

DATED 17 December 2009

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PAL: AZE 42408

## PROJECT AGREEMENT

PROJECT AGREEMENT dated 17 December 2009 between ASIAN DEVELOPMENT BANK ("ADB") and AZERSU JOINT STOCK COMPANY ("AZERSU").

### WHEREAS

(A) by a Loan Agreement of even date herewith between the Republic of Azerbaijan ("Borrower") and ADB, ADB has agreed to make to the Borrower a loan of seventy-five million dollars (\$75,000,000) on the terms and conditions set forth in the Loan Agreement, but only on the condition that: (i) a portion of the proceeds of the Loan (\$47,000,000 equivalent) be made available to AZERSU and the remainder portion of the proceeds of the Loan (\$28,000,000 equivalent) be made available to the State Amelioration and Water Management Agency of the Nakhchivan Autonomous Republic ("SAWMA"); and (ii) SAWMA agrees to undertake certain obligations towards ADB as set forth in the Project Agreement of even date herewith between ADB and SAWMA; and

(B) AZERSU, in consideration of ADB entering into the Loan Agreement with the Borrower, has agreed to undertake the obligations hereinafter set forth;

NOW THEREFORE the parties hereto agree as follows:

## ARTICLE I

### Definitions

Section 1.01. Wherever used in this Project Agreement, unless the context otherwise requires, the several terms defined in the Loan Agreement and in the Loan Regulations (as so defined) have the respective meanings therein set forth, except that for purposes of this Project Agreement, the term "Project" means the activities in the Project in all areas except in Nakhchivan as described in Schedule 1 to the Loan Agreement.

## ARTICLE II

### Particular Covenants

Section 2.01. (a) AZERSU shall carry out the Project with due diligence and efficiency, and in conformity with sound administrative, financial, engineering, environmental and social safeguards practices.

(b) In the carrying out of the Project and operation of the Project facilities, AZERSU shall perform all obligations set forth in the Schedule to this Project Agreement.

Section 2.02. AZERSU shall make available, promptly as needed, the funds, facilities, services, equipment, land and other resources which are required, in addition to the proceeds of the Loan, for the carrying out of the Project.

Section 2.03. (a) In the carrying out of the Project, AZERSU shall employ competent and qualified consultants and contractors, acceptable to ADB, to an extent and upon terms and conditions satisfactory to ADB.

(b) 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 the Loan Agreement. 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 2.04. AZERSU shall carry out the Project in accordance with plans, design standards, specifications, work schedules and construction methods acceptable to ADB. AZERSU 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 2.05. (a) AZERSU shall take out and maintain with responsible insurers, or make other arrangements satisfactory to ADB for insurance of the Project facilities to such extent and against such risks and in such amounts as shall be consistent with sound practice.

(b) Without limiting the generality of the foregoing, AZERSU undertakes to insure, or cause to be insured, the Goods to be imported for the Project and to be financed out of the proceeds of the Loan against hazards incident to the acquisition, transportation and delivery thereof to the place of use or installation, and for such insurance any indemnity shall be payable in a currency freely usable to replace or repair such Goods.

Section 2.06. AZERSU shall maintain, or cause to be maintained, records and accounts adequate to identify the Goods, Works, consulting services and other items of expenditure financed out of the proceeds of the Loan, to disclose the use thereof in the Project, to record the progress of the Project (including the cost thereof) and to reflect, in accordance with consistently maintained sound accounting principles, its operations and financial condition.

Section 2.07. (a) ADB and AZERSU shall cooperate fully to ensure that the purposes of the Loan will be accomplished.

(b) AZERSU shall promptly inform ADB of any condition which interferes with, or threatens to interfere with, the progress of the Project, the performance of its obligations under this Project Agreement, or the accomplishment of the purposes of the Loan.

(c) ADB and AZERSU shall from time to time, at the request of either party, exchange views through their representatives with regard to any matters relating to the Project, AZERSU and the Loan.

Section 2.08. (a) AZERSU shall furnish to ADB all such reports and information as ADB shall reasonably request concerning: (i) the Loan and the expenditure of the proceeds thereof; (ii) the Goods, Works, consulting services and other items of expenditure financed out of such proceeds; (iii) the Project; (iv) the administration, operations and financial condition of AZERSU; and (v) any other matters relating to the purposes of the Loan.

(b) Without limiting the generality of the foregoing, AZERSU shall furnish to ADB quarterly reports on the execution of the Project and on the operation and management of the Project facilities. Such reports shall be submitted in such form and in such detail and within such a period as ADB shall reasonably request, and shall indicate, among other things, progress made and problems encountered during the quarter under review, steps taken or proposed to be taken to remedy these problems, and proposed program of activities and expected progress during the following quarter.

(c) Promptly after physical completion of the Project, but in any event not later than 3 months thereafter or such later date as ADB may agree for this purpose, AZERSU shall prepare and furnish to ADB a report, in such form and in such detail as ADB shall reasonably request, on the execution and initial operation of the Project, including its cost, the performance by AZERSU of its obligations under this Project Agreement and the accomplishment of the purposes of the Loan.

Section 2.09. (a) AZERSU shall: (i) maintain separate accounts for the Project; (ii) have such accounts and related financial statements (balance sheet, statement of income and expenses, and related 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; and (iii) furnish to ADB, promptly after their preparation but in any event not later than 6 months after the close of the fiscal year to which they relate, 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 covenants of the Loan Agreement as well as on the use of the procedures for imprest account/statement of expenditures), all in the English language. AZERSU shall furnish to ADB such further information concerning such accounts and financial statements and the audit thereof as ADB shall from time to time reasonably request.

(b) AZERSU shall enable ADB, upon ADB's request, to discuss AZERSU's financial statements and its financial affairs from time to time with the auditors appointed by AZERSU pursuant to Section 2.09(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 AZERSU unless AZERSU shall otherwise agree.

Section 2.10. AZERSU 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 2.11. (a) AZERSU shall, promptly as required, take all action within its powers to maintain its corporate existence, to carry on its operations, and to acquire, maintain and renew all rights, properties, powers, privileges and franchises which are necessary in the carrying out of the Project or in the conduct of its business.

(b) AZERSU shall at all times operate and maintain its plants, equipment and other property, and from time to time, promptly as needed, make all necessary repairs and renewals thereof, all in accordance with sound administrative, financial, engineering, environmental, social safeguards, and maintenance and operational practices.

Section 2.12. Except as ADB may otherwise agree, AZERSU shall not sell, lease or otherwise dispose of any of its assets which shall be required for the efficient carrying on of its operations or the disposal of which may prejudice its ability to perform satisfactorily any of its obligations under this Project Agreement.

Section 2.13. Except as ADB may otherwise agree, AZERSU shall apply the proceeds of the Loan to the financing of expenditures on the Project in accordance with the provisions of the Loan Agreement and this Project Agreement, and shall ensure that all Goods, Works and consulting services financed out of such proceeds are used exclusively in the carrying out of the Project.

Section 2.14. AZERSU shall promptly notify ADB of any proposal to amend, suspend or repeal any provision of its Charter and shall afford ADB an adequate opportunity to comment on such proposal prior to taking any action thereon.

### **ARTICLE III**

#### **Effective Date; Termination**

Section 3.01. This Project Agreement shall come into force and effect on the date on which the Loan Agreement shall come into force and effect. ADB shall promptly notify AZERSU of such date.

Section 3.02. All the provisions of this Project Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the Loan Agreement.

### **ARTICLE IV**

#### **Miscellaneous**

Section 4.01. Any notice or request required or permitted to be given or made under this Project Agreement and any agreement between the parties contemplated by this Project 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, facsimile or radiogram to the party to which it is required or permitted to be given or made at its 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 ADB

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

Facsimile Numbers:

(632) 636-2444  
(632) 636-2484.

For AZERSU

AzerSu Joint Stock Company  
67 Moscow Avenue  
AZ.1012  
Baku  
Republic of Azerbaijan

Facsimile Number:

(994-12) 498 38 14.

Section 4.02. (a) Any action required or permitted to be taken, and any documents required or permitted to be executed, under this Project Agreement by or on behalf of AZERSU may be taken or executed by its President or by such other person or persons as he or she shall so designate in writing notified to ADB.

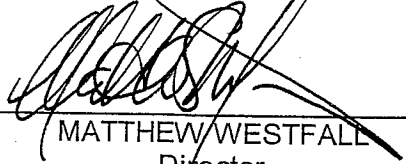
(b) AZERSU shall furnish to ADB sufficient evidence of the authority of each person who will act under paragraph (a) of this Section, together with the authenticated specimen signature of each such person.

Section 4.03. No delay in exercising, or omission to exercise, any right, power or remedy accruing to either party under this Project Agreement upon any default shall impair any such right, power or remedy or be construed to be a waiver thereof or an acquiescence in such default; nor shall the action of such party in respect of any default, or any acquiescence in any default, affect or impair any right, power or remedy of such party in respect of any other or subsequent default.

IN WITNESS WHEREOF the parties hereto, acting through their representatives thereunto duly authorized, have caused this Project 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.

ASIAN DEVELOPMENT BANK

By



MATTHEW WESTFALL

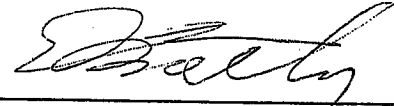
Director

Urban Services Division

Central and West Asia Department

AZERSU JOINT STOCK COMPANY

By



NIZAMEDDIN RZAYEV

President

## SCHEDULE

### Execution of Project and Operation of Project Facilities; Financial Matters

#### A. Project Management

1. AZERSU shall be the Project Executing Agency for the activities under the Project.

2. The PMO established at AZERSU by the Borrower for implementing the Project shall comprise of the PMF Consultants and the counterpart staff. AZERSU shall ensure that:

(a) recruitment of PMF Consultants is completed within 1 month of Loan effectiveness; and

(b) the PMO shall have counterpart staff comprising: (i) a program director; (ii) a financial management/disbursement specialist; (iii) a WSS/monitoring and evaluation specialist; and (iv) a safeguards expert. Selection of the program director shall be satisfactory to ADB. Following project completion, these counterpart staff may be integrated and become part of the staff of the JSC in Goychay.

3. AZERSU shall ensure that the PMO: (a) submit the PFRs; (b) undertake due diligence and prepare detailed designs for subsequent projects, and supervise procurement work and construction; (c) oversee safeguards and gender compliance; (d) coordinate among rayon agencies; (e) monitor and evaluate progress and prepare progress reports; and (f) provide expertise in project management, planning, results measurement and training.

4. AZERSU shall ensure that:

(a) the JSC in Goychay designate an implementation team to work with the PMO during project implementation. Such implementation team shall include at least: (i) a water supply engineer; (ii) a sewerage specialist; (iii) 3 field inspectors; and (iv) 2 electro-mechanical technicians;

(b) the PMO provide "hands-on" training to the JSC during each stage of the project implementation; and

(c) additional training shall be provided to the JSC through a twinning arrangement with an external WSS utility. Such twinning program shall be finalized within 12 months of Loan effectiveness.

5. AZERSU shall ensure that the JSC is adequately staffed (including through providing adequate staff resources to the JSC).

6. AZERSU shall ensure that the time-bound action plans to be agreed with the JSC during implementation of the Project are strictly complied with and monitored through the PSC and PIRC meetings to avoid implementation delay.

**B. Tariff Levels and Payment Recovery**

7. AZERSU shall ensure that revised tariffs are implemented for customers receiving improved WSS services.

8. AZERSU shall ensure that the JSC have adequate enforcement mechanism for effective collection of service fees and penalising defaulters, deterring non-payment and ensuring sustainability of JSC operations.

**C. Environmental and Social Safeguards**

9. No land acquisition and resettlement is expected for the Project. However, if land acquisition or resettlement activity arises, AZERSU shall ensure that it shall be carried out promptly and efficiently in accordance with applicable laws and regulations in Azerbaijan, ADB's *Involuntary Resettlement Policy* (1995) and the LARF.

10. AZERSU shall ensure that:

(a) the Project is carried out in accordance with the project design, and construction and operations will comply with applicable laws and regulations in Azerbaijan and ADB's *Environment Policy* (2002);

(b) the EARF is applied to ensure compliance with ADB's *Environment Policy*;

(c) the EMPs in the IEEs are updated, and made contract- and site-specific during final design;

(d) the environmental mitigation and monitoring measures specified in the EMPs are incorporated in the bidding documents to be released only after the relevant environmental assessment reports have been approved by ADB;

(e) the contracts for civil works require the contractors to implement the EMPs and such contractors are closely supervised to ensure compliance; and

(f) the design supervision consultant will undertake environmental monitoring, and reflect the results in the project progress reports and bi-annual environmental monitoring reports submitted to ADB.

**D. Public Consultation and Participation**

11. AzerSu shall implement a public consultation and participation plan comprising: (i) a community awareness and participation program; (ii) a hygiene and sanitation program; and (iii) a training program for town water users associations.

**E. Accounting and Auditing**

12. AZERSU shall maintain separate records and accounts adequate to identify; (a) the Goods and consulting services financed from the Loan proceeds; (b) financing resources received; (c) expenditures incurred on the components for the Project; and (d) the use of Government contribution. These accounts and related financial statements shall be audited annually in accordance with sound auditing standards by an independent auditor acceptable to ADB. The audit of the imprest account and statement of expenditure shall be carried out as part of the regular annual audit. The auditor's opinion of the examination of the imprest account and statement of expenditure shall be separately set out in the auditor's report. AZERSU shall submit annual audited reports and related financial statements to ADB within 6 months after the end of each fiscal year during implementation of the Project.

**F. Governance and Anticorruption**

13. AZERSU acknowledges 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 practices relating to the activities carried out under the Project, and shall: (a) comply with ADB's Anti-Corruption Policy (1998, as amended to date); and (b) cooperate with any investigation and extend all necessary assistance, including access to all relevant books and records, and for the engagement of independent experts who may be needed for satisfactory completion of such investigation.

14. AZERSU shall ensure that anti-corruption 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 AZERSU, the relevant JSC and all contractors, suppliers, consultants, and other service providers as they relate to the Project. All costs related to such investigations shall be borne under the Investment Program

15. AZERSU shall ensure that: (a) all decisions relating to procurement shall be made by the Tendering Committee which comprises representatives of the Ministry of Economic Development, the Ministry of Finance, the State Procurement Agency (as observer) and other relevant agencies in accordance with the Procurement Guidelines; (b) the supervision consultant shall verify the contractors' invoices in accordance with working drawings and contract specifications; and (c) disclosure of information on selection of consultants and contractors be made through local newspapers.

**G. Project Monitoring and Evaluation**

16. AZERSU shall establish (through its PMO) a PPMS acceptable to ADB within 3 months of the effectiveness of the Loan. The PPMS shall help monitor and evaluate the performance of the Project. It shall incorporate a set of performance monitoring indicators relating to outputs and outcomes in the design and monitoring framework, including service delivery performance, physical implementation, management improvement and capacity development milestones. The PMO shall develop baseline data for each of the selected indicators and conduct annual surveys, and update ADB on the progress against each indicator. For activities procured under the turnkey and design-build-operate modalities under the Project, key performance indicators satisfactory to ADB shall be developed during the preparation of requests for proposals and draft contract documents for such activities.

17. AZERSU shall prepare (through its PMO) annual reports on the progress against the above performance monitoring indicators, to be submitted to ADB within 30 days after the review period. These reports shall incorporate the information provided by relevant JSCs. These reports shall also discuss progress made during the period of review, changes (if any) on implementation schedule, problems or difficulties encountered and remedial actions taken, and work to be undertaken in the following quarter.

**H. Project Review**

18. The Borrower, AZERSU and ADB shall jointly review implementation progress of the Project on a semiannual basis. Such reviews shall examine: (a) performance of the components under the Project; and (b) any changes to the implementation arrangements or remedial measures to be undertaken for achieving the objectives of the Project.

19. The Borrower, AZERSU and ADB shall jointly conduct a more comprehensive review at midterm of the Project. Such review shall: (a) evaluate the Project's scope, design, and implementation arrangements; (b) evaluate the progress of the WSS infrastructure development and capacity development aspects; (c) evaluate the performance of the PMO; (d) identify changes needed in any or all of the above areas; (e) assess implementation performance against agreed targets in the design and monitoring framework; (f) identify critical issues and constraints; and (g) recommend adjustments to the project design and/or implementation arrangements.

20. AZERSU shall submit to ADB a project completion report within 3 months following physical completion of the Project. The report shall provide detailed evaluation of the Project, including, the design, costs, performance of the contractors and consultants, social, environmental and economic impacts, economic rate of return and other details pertaining to the Project as may be requested ADB.