
LOAN NUMBER 1820-NEP(SF)

AMENDED AND RESTATED LOAN AGREEMENT
(Special Operations)

(Melamchi Water Supply Project)

between

NEPAL

and

ASIAN DEVELOPMENT BANK

DATED 6 April 2008

LAS:NEP 31624

**AMENDED AND RESTATED LOAN AGREEMENT
(Special Operations)**

AMENDED AND RESTATED LOAN AGREEMENT dated 6 April 2008 between Nepal (hereinafter called the Borrower) and ASIAN DEVELOPMENT BANK (hereinafter called ADB).

WHEREAS

(A) By a loan agreement (Original Loan Agreement) made between ADB and the Borrower dated 24 January 2001, ADB agreed to provide a loan to the Borrower for the purposes of financing or partly financing components of the Project described in Schedule 1 to this Loan Agreement other than component (c) of Part A and component (d) of Part B of the Project;

(B) the Borrower has applied to and has received agreement from the Japan Bank for International Cooperation (hereinafter called JBIC) for a loan, (hereinafter called the JBIC Loan) in an amount of five billion four hundred ninety four million Japanese yen (¥5,494 million) in 2001 for the purposes of financing component (c) of Part A of the Project for the water treatment plant, as described in Schedule 1 to this Loan Agreement, pursuant to an agreement (hereinafter called the JBIC Loan Agreement) entered into between the Borrower and JBIC;

(C) the Borrower has further applied to and has received agreement from the Nordic Development Fund (hereinafter called NDF) for a loan (hereinafter called the NDF Loan) in an amount of seven million two hundred thousand Special Drawing Rights (SDR 7.2 million) in 2001 for the purposes of partly financing component (a) of Part A of the Project for the construction supervision of the Melamchi Diversion Scheme, as described in Schedule 1 to this Loan Agreement, pursuant to an agreement (hereinafter called the NDF Loan Agreement) entered into between the Borrower and NDF;

(D) the Borrower has also applied to and has received agreement from OPEC Fund for International Development (hereinafter called OPEC Fund) for a loan (hereinafter called the OPEC Fund Loan) in an amount of thirteen million seven hundred thousand dollars (\$13.7 million) in 2001 for the purposes of financing component (b) of Part A of the Project for the access roads, as described in Schedule 1 to this Loan Agreement, pursuant to an agreement (hereinafter called the OPEC Fund Loan Agreement) entered into between the Borrower and the OPEC Fund;

(E) the Borrower has also applied to and has received agreement from the Japanese Government for a grant (hereinafter called the Japanese Government Grant) in an amount of eighteen million dollars (\$18 million) in 2001 for the purposes of financing component (d) of Part B of the Project for the shallow groundwater development, as described in Schedule 1 to this Loan Agreement, pursuant to an agreement (hereinafter called the Japanese Government Grant Agreement) entered into between the respective governments;

(F) Due to the delay in implementation of the Project, certain events have occurred which require the Original Loan Agreement to be amended and restated as set out herein;

(G) ADB confirms that the conditions for loan effectiveness set out in paragraphs (a), (b), (c) and (d) of Section 6.01 and paragraph (a) of Section 6.02 have been satisfied;

(H) ADB has agreed to continue to provide a loan to the Borrower from the ADB's Special Funds resources upon the terms and conditions of the Original Loan Agreement as such agreement is amended and restated herein and in the Project Agreement (hereinafter called the Project Agreement) of even date herewith between ADB and the Water Utility Operator (as hereinafter defined); and

(I) the Parties agree that the original Loan Agreement is hereby amended and restated 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 Special Operations Loan Regulations of ADB, dated 7 December 1982, 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 Special Operations Loan Regulations as so modified being hereinafter called the Loan Regulations):

(a) Section 2.01(17) is deleted and the following is substituted therefor:

17. The term "dollar" or "dollars" or the sign "\$" means dollar or dollars in the currency of the United States of America.

(b) Section 2.01(27) is deleted and the following is substituted therefor:

27. The term "interest charge" means a charge made on the Loan pursuant to Section 3.02, and includes a portion to cover administrative expenses and a portion that does not.

(c) The term "service charge" wherever it appears in the Loan Regulations shall be substituted by the term "interest charge".

(d) Section 4.05 is deleted and Sections 4.06, 4.07 and 4.08 are renumbered as Sections 4.05, 4.06 and 4.07, respectively.

(e) Section 5.02 is deleted and Sections 5.03, 5.04, 5.05, 5.06 and 5.07 are renumbered as Sections 5.02, 5.03, 5.04, 5.05 and 5.06, respectively.

(f) The renumbered Section 5.02 is deleted and the following is substituted therefor:

Application for Withdrawal. When the Borrower shall desire to withdraw any amount from the Loan Account, the Borrower shall deliver to ADB an application in such form and containing such statements and agreements, as ADB shall reasonably request. Except as ADB and the Borrower shall otherwise agree, applications for withdrawal, with the necessary documentation as hereinafter in this Article provided, shall be made promptly in relation to expenditures for the Project.

(g) Section 8.03 is deleted and the following is substituted therefor:

Cancellation by ADB. If (i) the right of the Borrower to make withdrawals from the Loan Account shall have been suspended with respect to any amount of the Loan for a continuous period of thirty (30) days, or (ii) at any time ADB determines, after consultation with the Borrower, that any amount of the Loan will not be required for the purposes of the Project, or (iii) at any time ADB determines, with respect to any contract to be financed out of the proceeds of the Loan, that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Loan during the procurement/consultant selection or the execution of such contract, without the Borrower having taken timely and appropriate action satisfactory to ADB to remedy the situation, or (iv) at any time, ADB determines that the procurement of any contract to be financed out of the proceeds of the Loan is inconsistent with the procedures set forth or referred to in the Loan Agreement, or (v) by the date specified in the Loan Agreement as the closing date for withdrawals an amount of the Loan shall remain unwithdrawn from the Loan Account, ADB may by notice to the Borrower and the Guarantor, if any, terminate the right of the Borrower to make withdrawals with respect to such amount or contract. Upon the giving of such notice, the amount of the Loan or the relevant portion thereof shall be cancelled.

(h) Section 8.04 is deleted and Sections 8.05, 8.06 and 8.07 are renumbered as Sections 8.04, 8.05 and 8.06, respectively.

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) "Cofinancier" means any one of the following: Japanese Government, JBIC, NDF, or OPEC Fund, and includes any other financier funding any part of the Project;

(b) "Consulting Guidelines" means ADB's "Guidelines on the Use of Consultants by ADB and its Borrowers" dated February 2007, as amended from time to time;

(c) "construction supervision consultants" means the consultants appointed to supervise the construction to be carried out under Components (a), (b) and (c) of Part A, and (a), (b), (c) and (d) of Part B of Schedule 1 to this Loan Agreement;

(d) "environmental management plan" means the Borrower's plan, acceptable to ADB, to manage the environmental impact of the Project;

(e) "Financing Arrangements" means the arrangements, terms and conditions, which at all times are to be acceptable to ADB, pursuant to which the KVWSMB shall borrow funds from the Borrower to finance the implementation of components of Subproject 2 as set out in Schedule 5, and includes arrangements in respect of the payment of interest and the repayment of the aggregate principal amount of the loan by the KVWSMB to the Borrower;

(f) "Fiscal Year" means the fiscal year of the Borrower ending on 15 July of the year referred to;

(g) "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;

(h) "KVWSMB" means Kathmandu Valley Water Supply Management Board of the Borrower or any successor thereto acceptable to ADB;

(i) "License and Lease Agreement" means the license issued to the WUO and the Lease agreement between KVWSMB and the WUO, both dated 12 February 2008 and any amendments from time to time to either of them, as may be agreed by ADB;

(j) "MLD" means a millions liters per day;

(k) "MOF" means the Ministry of Finance of the Borrower or any successor thereto;

(l) "MPPW" means the Ministry of Physical Planning and Works of the Borrower or any successor thereto;

(m) "MOWR" means the Ministry of Water Resources of the Borrower or any successor thereto;

(n) "MWSDB" means the Melamchi Water Supply Development Board, established under the Development Board Act 1957 or any successor thereto;

(o) "NRs" means Nepalese Rupees, the currency of the Borrower;

(p) “NWSC” means the Nepal Water Supply Corporation, governed by the NWSC Act or such other agency of the Borrower as shall be agreed by ADB;

(q) “NWSC Assets” means the water supply and waste water facilities currently existing in the Kathmandu Valley and operated by the NWSC immediately prior to the Transfer Date;

(r) “PMU” means the Project management unit referred to in Schedule 5, paragraph 7 to this Loan Agreement;

(s) “Procurement Guidelines” means ADB’s “Procurement Guidelines” dated February 2007, as amended from time to time;

(t) “Procurement Plan” means the procurement plan for the Project dated 4 April 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;

(u) “Project Executing Agency” for purposes of, and within the meaning of, the Loan Regulations means MPPW or any successor thereto acceptable to ADB, which is responsible for carrying out the Project;

(v) “Project facilities” means the facilities constructed or to be constructed and the equipment and materials provided or to be provided under the Project;

(w) “Project roads” means the roads to be improved or constructed under the Project;

(x) “RAP” means the resettlement action plan satisfactory to ADB, submitted by MPPW to ADB regarding the resettlement and/or compensation of Project-affected persons, including communities;

(y) “Schedule” means a schedule to this Loan Agreement as same may be amended from time to time in accordance with the terms thereof;

(z) “Strategy” means the Water Supply and Waste Water Sector Strategy for the Kathmandu Valley, dated November 2000, of the Borrower;

(aa) “Subsidiary Loan Agreement” means the agreement between the Borrower and the KVWSMB referred to in Schedule 5, paragraph 19, to this Loan Agreement;

(bb) “Subproject 1” means the Melamchi River water diversion subproject as more fully described in Part A of Schedule 1 to this Agreement;

(cc) “Subproject 2” means the Kathmandu Valley water supply and sanitation subproject as more fully described in Part B of Schedule 1 to this Agreement;

(dd) "SUP" means the social uplift program described in Component (d) of Part A of Schedule 1 to this Loan Agreement which shall be implemented in the Melamchi Valley to support socio-economic development;

(ee) "Transfer date" means 13 February 2008, being the date on which the transfer of assets agreement between NWSC and KVWSMB dated 3 February 2008 became unconditionally effective;

(ff) "Water Supply Management Board Act" means the Borrower's law establishing the enabling environment for the Water Utility Operator and the delegation of management of its operations to a private contractor;

(gg) "Water Utility Operator" or "WUO" means the company to whom the KVWSMB has licensed the management and operation of the provision of water services and leased its assets, namely the Kathmandu Upatyaka Khanepani Limited or any successor thereto acceptable to ADB;

(hh) "Works" means construction or civil works to be financed out of the proceeds of the Loan, 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; and

(ii) "WSTFC" means the Water Supply Tariff Fixation Commission of the Borrower or any successor thereto acceptable to ADB.

ARTICLE II

The Loan

Section 2.01. ADB agrees to lend to the Borrower from ADB's Special Funds resources an amount in various currencies equivalent to ninety three million, two hundred and fifty three thousand Special Drawing Rights (SDR 93,253,000).

Section 2.02. (a) The Borrower shall pay to ADB an interest charge at the rate of one percent (1%) per annum during the grace period, and one and one-half percent (1.5%) per annum thereafter, on the amount of the Loan withdrawn from the Loan Account and outstanding from time to time.

(b) The term "grace period" as used in paragraph (a) of this Section means the period prior to payment of the first principal amount of the Loan on the payment date in accordance with the amortization schedule set forth in Schedule 2 to this Loan Agreement.

Section 2.03. The interest charge and any other charge on the Loan shall be payable semiannually on 15 June and 15 December in each year.

Section 2.04. (a) Subject to the provisions of paragraphs (b) and (c) below, the Borrower shall repay the principal amount of the Loan withdrawn from the

Loan Account in accordance with the amortization schedule set forth in Schedule 2 to this Loan Agreement.

(b) If ADB shall determine, after due consideration by its Board of Directors, that (i) the Borrower's gross national product per capita (per capita GNP) has exceeded the ADB's per capita GNP operational cutoff in respect of ADB's Special Funds resources for five consecutive years and (ii) the Borrower has achieved the capacity to borrow from ADB's ordinary capital resources, ADB may, by notice to the Borrower, modify the terms of repayment of the Loan by increasing by 100 percent the amount of each maturity due thereafter until the principal amount of the Loan shall have been fully repaid. However, at the request of the Borrower, ADB may, in lieu of so increasing any such maturity amounts, charge interest, at an annual rate to be agreed between the Borrower and ADB, on the principal amount of the Loan withdrawn and outstanding from time to time in such a manner and to such extent as to yield the same grant element as would be obtained under the above-stated increase of maturity amounts.

(c) If, at any time after a modification of the lending terms pursuant to the provisions of paragraph (b) above, ADB shall, after due consideration by its Board of Directors, determine that the Borrower's economic condition has deteriorated significantly, ADB may, at the request of the Borrower, restore the original lending terms with respect to the remaining amount of the Loan withdrawn and outstanding.

ARTICLE III

Use of Proceeds of the Loan

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

Section 3.02. The goods and services and other items of expenditure to be financed out of the proceeds of the Loan and the allocation of amounts of the Loan among different categories of such goods and services and other items of expenditure 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 3.03. Except as ADB may otherwise agree, all goods and services to be financed out of the proceeds of the Loan shall be procured in accordance with the provisions of Schedule 4 and Schedule 5 to this Loan Agreement. ADB may refuse to finance a contract where goods or 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 3.04. Except as ADB may otherwise agree, the Borrower shall cause all goods and services financed out of the proceeds of the Loan to be used exclusively in the carrying out of the Project.

Section 3.05. Withdrawals from the Loan Account in respect of goods and services shall be made only on account of expenditures relating to

- (a) goods which are produced in and supplied from and services which are supplied from such member countries of ADB as shall have been specified by ADB from time to time as eligible sources for procurement, and
- (b) goods and services which meet such other eligibility requirements as shall have been specified by ADB from time to time.

Section 3.06. The closing date for withdrawals from the Loan Account for the purposes of Section 8.03 of the Loan Regulations shall be 31 December 2013 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 water management 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 obligations set forth in Schedule 5 to this Loan Agreement.

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

Section 4.03. (a) In the carrying out of the Project, the Borrower shall cause competent and qualified consultants and contractors, acceptable to the Borrower and 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 the Borrower and 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 departments 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 make 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, the Borrower 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 4.06. (a) The Borrower shall maintain, or cause to be maintained, records and accounts adequate to identify the goods and 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, the operations and financial condition of the agencies of the Borrower responsible for the carrying out of the Project and operation of the Project facilities, or any part thereof.

(b) The Borrower shall (i) maintain, or cause to be maintained, separate accounts for the Project; (ii) have such accounts and related financial statements audited annually, in accordance with appropriate international auditing standards consistently applied, by independent auditors licensed by the Institute of Chartered Accountants of Nepal and satisfactory to ADB; (iii) furnish to ADB, as soon as available but in any event not later than 9 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 covenants of this Loan Agreement as well as on the use of the procedures for imprest accounts), 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.

(c) 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 Borrower's auditors, 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 4.07. (a) The Borrower shall furnish, or cause to be furnished, to ADB all such reports and information as ADB shall reasonably request concerning (i) the Loan, and the expenditure of the proceeds and maintenance of the service thereof; (ii) the goods and services and other items of expenditure financed out of the proceeds of the Loan; (iii) the Project; (iv) the administration, operations and financial condition of MWSDB, KVWSMB, WUO, and any other agencies of the Borrower responsible for the carrying out of the Project and operation of the Project facilities, or any part thereof; (v) financial and economic conditions in the territory of the Borrower and the international balance-of-payments position of the Borrower; and (vi) any other matters relating to the purposes of the Loan.

(b) Without limiting the generality of the foregoing, the Borrower shall furnish, or cause to be furnished, to ADB trimesterly reports on the carrying out 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 trimester under review, steps taken or proposed to be taken to remedy these problems, and proposed program of activities and expected progress during the following trimester.

(c) Promptly after physical completion of the Project, but in any event not later than three (3) months thereafter or such later date as may be agreed for this purpose between the Borrower and ADB, the Borrower 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 the Borrower of its obligations under this Loan Agreement and the accomplishment of the purposes of the Loan.

Section 4.08. The Borrower shall enable ADB's representatives to inspect the Project, the goods financed out of the proceeds of the Loan, and any relevant records and documents.

Section 4.09. The Borrower shall ensure that the Project facilities are operated, maintained and repaired in accordance with sound administrative, financial, engineering, environmental, water management, and maintenance and operational practices.

Section 4.10. (a) It is the mutual intention of the Borrower and ADB that no other external debt owed a creditor other than ADB shall have any priority over the Loan by way of a lien on the assets of the Borrower. To that end, the Borrower undertakes (i) that, except as ADB may otherwise agree, if any lien shall be created on any assets of the Borrower as security for any external debt, such lien will ipso facto equally and ratably secure the payment of the principal of, and interest charge and any other charge on, the Loan; and (ii) that the Borrower, in creating or permitting the creation of any such lien, will make express provision to that effect.

(b) The provisions of paragraph (a) of this Section shall not apply to (i) any lien created on property, at the time of purchase thereof, solely as security for payment of the purchase price of such property; or (ii) any lien arising in the ordinary course of banking transactions and securing a debt maturing not more than one year after its date.

(c) The term "assets of the Borrower" as used in paragraph (a) of this Section includes assets of any political subdivision or any agency of the Borrower and assets of any agency of any such political subdivision, including the Nepal Rastra Bank and any other institution performing the functions of a central for the Borrower.

Section 4.11. The Borrower shall take all action which shall be necessary on its part to enable the KVWSMB to perform its obligations under the Subsidiary Loan Agreement, and shall not take or permit any action which would interfere with the performance of such obligations.

Section 4.12. (a) The Borrower shall exercise its rights under the Subsidiary Loan Agreement in such a manner as to protect the interests of the Borrower and ADB and to accomplish the purposes of the Loan.

(b) No rights or obligations under the Subsidiary Loan Agreement shall be assigned, amended, or waived without the prior concurrence of ADB.

ARTICLE V

Suspension; Cancellation; Acceleration of Maturity

Section 5.01. The following are specified as additional events for suspension of the right of the Borrower to make withdrawals from the Loan Account for the purposes of Section 8.02(l) of the Loan Regulations:

(a) the right of the Borrower to withdraw the proceeds of the Japanese Government Grant, JBIC Loan, NDF Loan, OPEC Fund Loan, or any other loan or grant made available to the Borrower in lieu thereof, shall have been suspended, cancelled or terminated, in whole or in part, pursuant to the terms of the agreement providing therefor, or any loan made available to the Borrower in lieu thereof shall have become due and payable prior to the agreed maturity date; provided that, this provision shall not apply if the Borrower establishes to the satisfaction of ADB that (i) such suspension, cancellation, termination or prematuring is not caused by the failure of the Borrower to perform any of its obligations under such agreement/s; and (ii) adequate funds for the Project are available to the Borrower from other sources on terms and conditions consistent with the obligations of the Borrower under this Loan Agreement;

(b) the MWSDB Formation Order (1998), the NWSC Act (2007), the Water Supply Management Board Act (2006), or any provision thereof shall have been repealed, suspended or amended in any manner which in the reasonable opinion of the ADB will or may adversely affect the carrying out of the Project or the operation of the Project facilities.

Section 5.02. The following are specified as additional events for acceleration of maturity for the purposes of Section 8.06(d) of the Loan Regulations: any of the events specified in Section 5.01 of the Loan Agreement shall have occurred.

ARTICLE VI

Effectiveness

Section 6.01. The following are specified as additional conditions to the effectiveness of this Loan Agreement for the purposes of Section 9.01(f) of the Loan Regulations:

(a) the JBIC Loan Agreement, the NORAD Agreement, the Sida Loan and Grant Agreement, the OPEC Fund Loan Agreement, and the NDF Loan shall each have been duly executed and delivered, and all conditions precedent to their effectiveness (other than a condition requiring effectiveness of this Loan Agreement) have been fulfilled or the

Borrower shall have obtained financial assistance from an external source, under arrangements satisfactory to ADB, for provision of foreign-currency funds required for the Project, or the Borrower shall have, to the satisfaction of ADB, allocated in its budget said foreign-currency funds and authorized their withdrawal for the Project, or the Borrower shall have made arrangements, satisfactory to ADB, to commit the provision of such foreign-currency funds for the Project within a period of time satisfactory to ADB;

(b) the Borrower shall have provided appropriate counterpart staff to the PMU;

(c) a high level inter-ministerial coordination committee, with membership including the Ministers of MOF, MPPW, and MOWR and the Vice Chairman of the National Planning Commission, shall have been established to deal with major issues affecting the Project;

(d) the Borrower shall have amended its Resettlement Policy Framework dated 9 November 2000, to reflect ADB's requirement that the definition of severely Project affected families includes those families who lose 25 percent or more of their total affected land holding within the Project affected areas;

(e) this Amended and Restated Loan Agreement, in form and substance satisfactory to ADB, shall have been duly executed and delivered on behalf of ADB and the Borrower and is legally binding on the Borrower in accordance with its terms, subject only to this condition of effectiveness;

(f) the Project Agreement, in form and substance satisfactory to ADB, shall have been duly executed and delivered on behalf of ADB and WUO and is legally binding on WUO in accordance with its terms, subject only to the effectiveness of this Loan Agreement; and

(g) the Subsidiary Loan Agreement, in form and substance satisfactory to ADB, shall have been duly executed and delivered on behalf of the Borrower and KVWSMB and shall have become legally binding upon each of them in accordance with its terms, subject only to the effectiveness of this Loan Agreement.

Section 6.02. The following is specified as an additional matter for the purposes of Section 9.02(d) of the Loan Regulations, to be included in the opinion or opinions to be furnished to ADB, that:

(a) the JBIC Loan Agreement, NORAD Agreement, Sida Credit Agreement, OPEC Fund Loan Agreement, and NDF Agreement have been duly authorized by or ratified by, and executed and delivered, and are legally binding upon the Borrower in accordance with their terms, subject only to the effectiveness of this Loan Agreement; and

(b) each of the Amended and Restated Loan Agreement and the Project Agreement have been duly authorized by or ratified by, and executed and delivered, and are legally binding upon the Borrower and WUO, respectively, in accordance with their terms, subject only to the effectiveness of this Loan Agreement.

Section 6.03. A date ninety (90) days after the date of this Loan Agreement is specified for the effectiveness of the Loan Agreement for the purposes of Section 9.04 of the Loan Regulations.

ARTICLE VII

Miscellaneous

Section 7.01. The Secretary, Ministry of Finance of the Borrower is designated as representative of the Borrower for the purposes of Section 11.02 of the Loan Regulations.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the Loan Regulations:

For the Borrower

Ministry of Finance
Singh Durbar
Kathmandu, Nepal

Facsimile Number:

977 1 425 9891.

For ADB

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

Facsimile Numbers:

(632) 636-2444
(632) 636-2293.

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.

NEPAL

By 
VIDYADHAR MALLIK
Secretary
Ministry of Finance

ASIAN DEVELOPMENT BANK

By 
PAUL HEYTENS
Country Director
Nepal Resident Mission

SCHEDULE 1

Description of the Project

1. The main objective of the Project is to alleviate the chronic water shortage in Kathmandu Valley on a sustainable, long-term basis, to improve the health and wellbeing of its inhabitants, and to develop a comprehensive institutional framework for water resource management within the Valley.

2. The Project comprises the following Components:

Part A (Melamchi River Water Diversion Subproject): Subproject 1

- (a) the construction of the Melamchi Diversion Scheme to carry about 170 MLD of raw water from the Melamchi River into Kathmandu Valley through a 26 km tunnel;
- (b) the construction of about 43 km of access roads and upgrading of about 29 km of road to assist the construction of the Project facilities and their maintenance;
- (c) the construction of a water treatment plant with an initial capacity of at least 85 MLD and expandable to about 510 MLD to treat the Melamchi River water; and
- (d) the development and implementation of a social uplift program, including (a) buffer zone development, (b) rural electrification, (c) health, (d) education, and (e) income generation/community development.

Part B (Kathmandu Valley Water Supply and Sanitation Subproject): Subproject 2

- (a) the construction of a bulk distribution system comprising service reservoirs strategically located in the Kathmandu Valley and bulk water supply pipelines leading to the reservoirs from the water treatment plant;
- (b) the rehabilitation and improvement of distribution networks at primary, secondary, and tertiary levels, and house connections and the rehabilitation and improvement of existing water supply system including intakes, transmission mains, water treatment plants and service reservoirs;
- (c) the undertaking of improvements to wastewater system in a phased manner; and
- (d) the development of a shallow groundwater wellfield at Manohara within the Kathmandu Valley to extract, treat, and distribute about 15 MLD and about 25 MLD of water in the dry and wet season, respectively.

Part C: Project Support

- (a) In respect of the Project, the development and implementation of (i) a resettlement action plan; and (ii) an environmental management plan (EMP) to mitigate direct and indirect Project impacts, including (a) hygiene education, (b) public awareness relations programs, (c) (if required by ADB) a social and environmental monitoring program undertaken by a panel of domestic experts, and (d) a groundwater monitoring program; and
 - (b) the provision of support to carry out various Project administration activities, including PMU operations, design and construction supervision, social and environmental activities, and training. Provision of incremental administration and operation costs.
3. The Project is expected to be completed by 30 June 2013.

SCHEDULE 2
Amortization Schedule
(Melamchi Water Supply Project)

<u>Date Payment Due</u>			<u>Payment of Principal</u> (expressed in Special Drawing Rights)*
15	June	2009	1,942,770
15	December	2009	1,942,770
15	June	2010	1,942,770
15	December	2010	1,942,770
15	June	2011	1,942,770
15	December	2011	1,942,770
15	June	2012	1,942,770
15	December	2012	1,942,770
15	June	2013	1,942,770
15	December	2013	1,942,770
15	June	2014	1,942,770
15	December	2014	1,942,770
15	June	2015	1,942,770
15	December	2015	1,942,770
15	June	2016	1,942,770
15	December	2016	1,942,770
15	June	2017	1,942,770
15	December	2017	1,942,770
15	June	2018	1,942,770
15	December	2018	1,942,770
15	June	2019	1,942,770
15	December	2019	1,942,770
15	June	2020	1,942,770
15	December	2020	1,942,770
15	June	2021	1,942,770
15	December	2021	1,942,770
15	June	2022	1,942,770
15	December	2022	1,942,770
15	June	2023	1,942,770
15	December	2023	1,942,770
15	June	2024	1,942,770
15	December	2024	1,942,770
15	June	2025	1,942,770

* The figures in this column represent SDR equivalents determined as of the respective dates of withdrawal. The arrangements for payment of each maturity are subject to the provisions of Sections 3.04 and 4.03 of the Loan Regulations.

Schedule 2

<u>Date Payment Due</u>			<u>Payment of Principal</u> (expressed in Special Drawing Rights)*
15	December	2025	1,942,770
15	June	2026	1,942,770
15	December	2026	1,942,770
15	June	2027	1,942,770
15	December	2027	1,942,770
15	June	2028	1,942,770
15	December	2028	1,942,770
15	June	2029	1,942,770
15	December	2029	1,942,770
15	June	2030	1,942,770
15	December	2030	1,942,770
15	June	2031	1,942,770
15	December	2031	1,942,770
15	June	2032	1,942,770
15	December	2032	1,942,810
Total			<u>93,253,000</u>

* The figures in this column represent SDR equivalents determined as of the respective dates of withdrawal. The arrangements for payment of each maturity are subject to the provisions of Sections 3.04 and 4.03 of the Loan Regulations.

SCHEDULE 3**Allocation and Withdrawal of Loan Proceeds**General

1. The table attached to this Schedule sets forth the Categories of goods, 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.)

Taxes

2. No withdrawals from the Loan Account shall be made in respect of any local taxes.

Percentages of ADB Financing

3. 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.

4. Notwithstanding paragraph 5 of this Schedule, any contract awarded to a local supplier after effective international competitive bidding or international shopping pursuant to the relevant provisions of Schedule 4 to this Loan Agreement shall be financed out of the proceeds of the Loan on the following basis:

- (a) where the goods procured from a local supplier are manufactured locally, 100 percent of the ex-factory price of the goods supplied (exclusive of any taxes); and
- (b) where the goods procured from a local supplier have been entirely imported, 100 percent of the foreign-currency component of the contract price.

Local Expenditure

5. (a) Loan proceeds up to the amount equivalent to thirty million five hundred and thirty eight thousand Special Drawing Rights (SDR30,538,000) may be withdrawn from the Loan Account in foreign currency for the purposes of financing local expenditure.

(b) Except as provided in this paragraph or as the ADB may otherwise agree, no withdrawals from the Loan Account shall be made in respect of any local expenditure on the Project.

Interest Charge

6. The amount allocated to Category 5 is for financing interest charge on the Loan during the implementation period of the Project. ADB shall be entitled to withdraw from the Loan Account and pay to itself, on behalf of the Borrower, the amounts required to meet payments, when due, of such interest charge.

Reallocation

7. Notwithstanding the allocation of Loan proceeds and the withdrawal percentages set forth in the Table and subject to paragraph 5 of this Schedule,

(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, by notice to 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.

Imprest Accounts

8. (a) Except as ADB shall otherwise agree, the Borrower shall establish immediately after the Effective Date, an imprest account in its name at the Nepal Rastra Bank for each of the two implementing agencies, i.e. MWSDB and WUO respectively. The imprest accounts shall be established, managed, replenished and liquidated in accordance with ADB's "Loan Disbursement Handbook" dated January 2007, as amended from time to time, and detailed arrangements agreed upon between the Borrower and the ADB. The initial amount to be deposited to each imprest account shall be based on estimated expenditure for the first six months of each Subproject implementation or 10% of the Loan amount allocated for the respective Subproject.

(b) The statement of expenditures (SOE) procedure may be used for reimbursement of eligible expenditures for the Project and to liquidate advances provided into the imprest accounts, for any individual payment not exceeding the equivalent of \$100,000 in accordance with the ADB's "Loan Disbursement Handbook" dated January 2007, as amended from time to time, and detailed arrangements agreed upon between the Borrower and ADB.

Release of Funds

9. The Borrower acting through the MOF shall release funds to MPPW in a timely manner. MWSDB and WUO shall coordinate the timely release of funds under the Project.

Advance Action

10. Prior to the date of this Loan Agreement, the Bank approved certain advance action for the prequalification of contractors for the construction of Project roads. The Borrower shall obtain such services in accordance with the provisions of Schedule 3 of this Loan Agreement and the approval of advance action shall not in any way derogate from the obligations set forth in this Loan Agreement.

TABLE

ALLOCATION AND WITHDRAWAL OF LOAN PROCEEDS (Melamchi Water Supply Project)					
CATEGORY				PERCENTAGE OF ADB FINANCING	
Number	Item	Amount Allocated SDR		Percentage ¹⁾	Basis for Withdrawal from the Loan Account
		Category	Subcategory		
1	Civil Works	58,442,000			
1A	Melamchi Diversion Scheme (tunnel and access road) – Subproject 1		44,089,000	80	[percent of total expenditure]
1B	Bulk Distribution System, Distribution Network Improvement and Wastewater System Improvement – Subproject 2		14,353,000	72	[percent of total expenditure]
2	Social & Environmental Support	5,116,000			
2A	Social & Environmental Support – Subproject 1		4,225,000	80	[percent of total expenditure]
2B	Social & Environmental Support – Subproject 2		891,000	80	[percent of total expenditure]
3	Consulting Services and Training	10,517,000			
3A	Consulting Services and Training – Subproject 1		7,883,000 ²⁾	100	[percent of total expenditure]
3B	Consulting Services – Subproject 2		2,634,000	100	[percent of total expenditure]
4	Incremental Administration	2,863,000			
4A	Incremental administration – Subproject 1		2,227,000	100	[percent of total expenditure]
4B	Incremental Administration – Subproject 2		636,000	100	[percent of total expenditure]
5	Interest Charge	10,116,000		100	percent of amounts due
6	Unallocated	6,199,000			
	Total	93,253,000			

1) Percent of total expenditure is exclusive of local taxes.

2) The amount includes the amount of SDR 165,000 of the contract for the detailed engineering design for demonstration project which should have been under Subproject 2 if it had not been completed.

SCHEDULE 4

Procurement and Consulting Services

A. General

1. All Goods and 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
Shopping
Direct Contracting
Community Participation

The methods of procurement are 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. Domestic Preference. The Borrower may grant a margin of preference in the evaluation of bids under international competitive bidding in accordance with paragraphs 2.55(a) and 2.56 of the Procurement Guidelines for domestically manufactured Goods and paragraphs 2.55(b) and 2.56 of the Procurement Guidelines for domestic Works.
5. National Competitive Bidding. No procurement activity shall be undertaken under National Competitive Bidding until ADB and the Borrower have agreed in writing on any necessary modifications or clarifications to the Borrower's standard procurement procedures to ensure consistency with the Procurement Guidelines. Such modifications or clarifications shall be set out in the Procurement Plan and hereby incorporated by reference.

C. Conditions for Award of Contract

6. ADB shall not approve any proposal for prequalification of civil works contracts relating to any Project component under Schedule I to the Loan Agreement requiring land acquisition, until the Borrower has issued a notification to all interested persons under Section 9 of the Land Acquisition Act 2034 (1997) (the Land Acquisition Act) for permanent land acquisition required for the relevant Project component.

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7. ADB shall not approve any proposal for award of civil works contracts until the Borrower has obtained lawful possession, and either (a) permanently acquired land pursuant to the Land Acquisition Act or (b) temporarily acquired land for construction of works under relevant acts for relevant components, depending on the purposes of the Project.

8. ADB shall not approve any proposal for award of civil works contract for the construction of the tunnel under paragraph (a) of Part A of Schedule 1 to this Loan Agreement until the following conditions have been met:

- (i) the Borrower shall have enacted a law to establish, and shall have established, the WSTFC in accordance with the Strategy; and
- (ii) the construction supervision consultants shall have agreed to the design for the said tunnel.

9. ADB shall not approve any proposal for award of contract for the bulk distribution system to be constructed under paragraph (a) of Part B of Schedule 1 to this Loan Agreement, until the Borrower shall have enacted a law to establish the KVWSMB.

D. Recruitment of Consulting Services

10. Quality- and Cost-Based Selection. Except as ADB may otherwise agree, and except as set forth in the paragraph below, the Borrower shall apply quality- and cost-based selection for recruiting consulting services.

11. The Borrower shall apply the following methods for recruiting the specified consulting services, in accordance with, among other things, the procedures set forth in the Procurement Plan:

Consultants' Qualifications Selection for the consulting services where the contract price is less than \$200,0000.

12. The Borrower's standard procedures for recruiting consultants may be used for recruiting individual consultants for Project Management Unit and are subject to modifications set out in the Procurement Plan which are hereby incorporated by reference.

E. Industrial or Intellectual Property Rights

13. (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.

14. 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.

F. ADB's Review of Procurement Decisions

15. 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

Implementation Arrangements; Regulatory Bodies; Reporting; and Other Matters

Implementation Arrangements

1. The MPPW shall be the Executing Agency for the Project.
2. The MWSDB shall initially be the implementing agency of the Project. On the Transfer Date, the WUO shall take over as implementing agency from MWSDB for all components of the Project relating to Subproject 2 as set forth in Schedule 1 this Agreement. The Borrower shall ensure non interference with MWSDB and WUO's respective autonomy of decision making.
3. The MWSDB members shall comprise the Secretary of MPPW as chairman, representatives at the joint secretary level from the MOF and MOWR, the Mayor of the Kathmandu Metropolitan City, and the Executive Director as member Secretary, who shall also be the Project Director in respect of Subproject 1.
4. The Borrower shall ensure that by 31 May 2008, it shall have taken all necessary actions, including amending MWSDB Formation Order (such amendments having being first been approved by ADB) and to such other orders and processes, as required to ensure that; (a) MWSDB's revised management and organizational structure is finalized and endorsed, and (b) standard operating procedures, including the delegation of authorities, are detailed and put in place, all of which shall be satisfactory to ADB. In particular, the amendment to the said MWSDB Formation Order shall include the establishment by MWSDB of an executive committee (Executive Committee) comprising the Executive Director, a geotechnical expert and a contract management expert. The Executive Committee shall have delegated to it all procurement activities of the MWSDB and the Executive Committee shall be supported by management consultants who will provide secretarial support. The Executive Committee will remain in place until the completion of the Project.
5. The Borrower shall ensure that the high level coordination committee including the Ministers of MOF, MOWR, and MPPW, and the Vice Chairman of the National Planning Commission shall be retained and continue to deal with major issues affecting the Project.
6. Consultants forming two Panels of Experts shall be appointed by MWSDB to supplement consulting services provided under the construction supervision contracts and the operations of the PMU. The first Panel of Experts shall include experts in hydraulics, geotechnical engineering, and tunnel contracting. The second Panel of Experts shall include sociology, environmental management, and water supply management experts. The Panels of Experts shall report to the Project Director of Subproject 1 who shall make the final decision in the event of any conflict between any of the consultants. In addition, the second Panel of Experts shall also report to the Board of Directors of the WUO. The Panels of Experts shall visit the Project site twice a year to examine and provide advice on specific technical issues, problems and concerns, and shall identify and resolve any new potential issues.

Subproject 1

7. The Melamchi Valley project management unit (PMU) shall be established within the MWSDB, and shall be responsible for the day-to-day management of the Subproject 1. The PMU shall be headed by the Project Director who shall be a senior officer at joint secretary level with adequate technical and administration experience and qualifications acceptable to the ADB. The PMU shall be staffed by appropriate and adequate administrative staff. By no later than 31 May 2008, the PMU will be restructured based on functional divisions; each unit will consist of qualified technical staff. Units handling the main infrastructure civil works and social programs for the Melamchi Valley (such as engineering and safeguard units) will be located in the Melamchi Valley and headed by a qualified deputy executive director, while the main PMU office (which will handle administration, procurement, financial, communication, and planning) will be located in Kathmandu and managed by another qualified deputy executive director. The PMU shall be supported by a team of international and domestic consultants. The Borrower shall exert its best endeavors to ensure that, subject to satisfactory performance, the initially appointed Project Director and PMU division heads will be maintained in the positions for a minimum of three years during the Subproject implementation, and shall seek the ADB's concurrence for any change of those appointments or change in the structure of the PMU or its responsibilities.

8. The Borrower shall ensure that all consultants for the various Subproject components shall report to the PMU. The PMU shall be responsible for preparing disbursement projections and budgetary allocations for Borrower counterpart funds for Subproject 1. The PMU shall prepare annual accounts and financial statements, in accordance with international standards, audited by an accounting firm duly licensed by the Institute of Chartered Accountants for Nepal, and submitted to ADB within nine months of the end of each Fiscal Year.

Subproject 2

9. The Borrower shall establish and maintain an independent and autonomous Kathmandu Valley Water Supply Management Board (KVWSMB). KVWSMB shall primarily be constituted with local government representatives, some line ministry representatives, and civil society representatives. KVWSMB shall be the asset owner of the NWSC Assets as from the Transfer Date and shall be responsible for planning, investment, developing and overseeing service policies and allocation and regulation of groundwater use in Kathmandu Valley.

10. The Borrower shall ensure (whether by amendment of the KVWSMB Formation Order or otherwise) that, as from the Transfer Date, all procurement and contract management authority of the KVWSMB is delegated to a three member executive committee under the KVWSMB in order to provide for a professional and efficient decision making process. The Borrower shall also ensure that KVWSMB discharge its duties and obligations under Lease and License Agreement in an expeditious and lawful manner

11. In respect of Subproject 2, the implementation responsibilities will be transferred from MWSDB to KUKL as from the Transfer Date. The WUO will operate the water supply and wastewater services system within the Kathmandu Valley in accordance

with the terms of the License and Lease Agreement. The Borrower shall ensure that WUO shall:

- (a) publish at the end of each Fiscal Year a report of annual operations for public review;
- (b) establish provisions for requiring specific monitoring against service delivery indicators including:
 - (i) equitable distribution of water on a daily basis;
 - (ii) improvement of sanitation services; and
 - (iii) customer service performance indicators (including hours of supply and water quality).
- (c) prepare and publish annual accounts and financial statements, in accordance with international standards, audited by an accounting firm duly licensed by the Institute of Chartered Accountants for Nepal, and submitted to ADB within nine months of the end of each Fiscal Year;
- (d) establish a project management unit (KPMU) within the WUO, which will be headed by the general manager of the WUO, and shall be responsible for the preparation of all procurement of consultancy services, equipment purchases, and civil works under Subproject 2 and ensuring all necessary approvals from KVWSMB; and
- (e) appoint, as soon as reasonably practicable, a full time project coordinator within KPMU, who will be responsible for overall administration and coordination between KVWMSB and ADB in the implementation of Subproject 2.

12. The Borrower shall require the WUO to use appropriate and cost effective technology such as developing efficient sewerage systems in dense urban areas and onsite systems and small bore community sewers coupled with natural treatment technologies in peri-urban and other low-density areas.

Regulation and Tariffs

13. The Borrower shall:

- (a) within six months of the Effective Date, or at a date otherwise agreed by ADB, ensure that the recent amendments to the NWSC Act are promulgated;
- (b) within six months of the Effective Date, or at a date otherwise agreed by ADB, ensure that the Water Supply Management Board Act and/or other relevant legislation has been promulgated or amended, to establish and maintain an enabling environment for the WUO to effectively carry out its obligations under the Project and the terms of the License and Lease Agreement;
- (c) ensure by 30 September 2008, that:

- (i) KVWSMB shall commence and thereafter continue regular monitoring of groundwater in the Kathmandu Valley;
- (ii) the Borrower approves and the MPPW publicly notifies the approval of the Kathmandu Valley Urban Development Sector Strategy; and
- (iii) the Borrower approves and MPPW publicly notifies the approval of the Policy on a Kathmandu Valley Levy for Melamchi Valley;

(d) ensure by 31 Dec 2011, that legislation shall be enacted to require the payment of a levy by the water consumers of Kathmandu Valley to the inhabitants of Melamchi, Yangri, and Larke Valleys for the payment of water taken from those valleys; and

(e) ensure that (unless such transfer has already taken place) all Project facilities in respect of Subproject 1 are transferred to KVWSMB upon completion of such Project facilities.

14. The Borrower shall ensure that WSTFC is maintained as an independent body financed from consumer tariffs (a) to protect the consumer interests; (b) to monitor the performance of the WUO against the agreed set of performance indicators; and (c) to approve the tariff adjustments in accordance with the terms of the Strategy. It shall also annually undertake consumer surveys and publicize the results widely, within three months of completing the surveys. The WSTFC shall be initially established to monitor the Kathmandu Valley water supply but it shall expand its operations to regulate other water supply and sanitation systems in the country. The Borrower shall require WSTFC to publish an annual report of its activities and findings within three months of the end of the each Fiscal Year.

15. The Borrower will ensure that:

(a) the average tariff per cubic meter of water sales be increased to meet the cost recovery levels in FY2008/09 and FY2009/10 as agreed with ADB, and that agreed cost recovery principles shall be applied in the fixing of tariffs for the WOU so that by June 2013 when water is expected to flow through Melamchi tunnel the average tariff charged by the WUO is not less than the level required to cover (i) WUO's operating costs, (ii) payments to WSTFC and KVWSMB, (iii) debt service, and (iv) a margin sufficient to finance minimum level of at least 20% of investments in the distribution network from its own resources. After 1 July 2013, full cost recovery principles will be applied in setting tariffs for the WUO.

(b) KVWSMB receives all funds (both Loan proceeds and counterpart funds) for all capital works for Subproject 2, on a timely basis and that KVWSMB applies all such funds received on capital works so as to ensure that WUO is able implement and complete such works on a timely and efficient basis.

(c) the Government will ensure that WSTFC makes timely approval and publication of water tariff increases on the basis of the indicative water tariffs set out in Lease and License Agreement.

16. As soon as water flows from the Melamchi Valley to the Kathmandu Valley, a levy shall be paid on all abstraction volumes as measured at the water treatment plant by the water consumers of Kathmandu Valley to the inhabitants of the Melamchi Valley (the inhabitants) via a mechanism which is to be agreed between the Borrower and the Hyolmo Sindhu Melamchi Valley SUP Implementation Committee (HSMC), and which will be used to fund activities to be determined by the inhabitants (including the funding for the continuation and maintenance of the SUP activities).

Coordination of Cofinanciers

17. MWSDB and WUO shall organize and chair coordination meetings of the ADB and cofinanciers which shall be held at least every six months or more often as necessary, for the purposes of ensuring coordination and resolving any problems arising during the Project. The first meeting shall be convened within one month of the Effective Date. Project progress reports shall be produced by each of MWSDB and WUO for ADB and the cofinanciers, four times a year. Twice a year, ADB, the cofinanciers, and the Borrower shall jointly review the Project.

Counterpart Funds

18. Without limiting the generality of Section 4.02 of the Loan Agreement, the Borrower shall ensure that counterpart funds in the amount of at least \$90.6 million equivalent are provided for the Project through (a) adequate budgetary allocations; and (b) other costs including vehicle operation costs, office accommodation and furnishings, travel, water, power and telephone rental (local), and remuneration of counterpart staff, are provided in a timely manner.

Transfer of Assets and Subsidiary Loan Agreement

19. The Borrower shall, ensure (i) the transfer of the NWSC Assets by NWSC to KVWSMB and (ii) KVWSMB to execute the License and Lease Agreement, in a form satisfactory to ADB. Any amendments to the License and Lease Agreement shall be subject to ADB's prior concurrence. The Borrower shall enter into the Subsidiary Loan Agreement with KVWSMB, upon terms and conditions satisfactory to ADB. Except as ADB shall otherwise agree, the terms for repayment of the loans for constructing the assets shall be on a 50 percent grant / 50 percent loan basis and shall include interest at the rate of nine percent (9%) per annum and a repayment period of 30 years including a grace period of seven years. The Borrower shall assume the foreign exchange risk on all sums due and owing under the Subsidiary Loan Agreement.

Reporting

20. Without limiting the generality of Section 4.07 of the Loan Agreement, the MSWDB and WUO shall prepare and submit to the ADB, within one month of the end of the reporting period:

- (a) reports for each trimester concerning:
 - (i) a consolidation and analysis of monthly reports from the construction supervision consultants;

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- (ii) the overall Project schedule, critical path activities, Project accounts, commitments and disbursements, land acquisition, resettlement and/or compensation activities under the Project;
 - (iii) the public relations activities undertaken and proposed by the PMU's Public Relations Units;
- (b) the six-monthly monitoring reports on environmental and social issues affecting the Project, within one month of the end of each relevant period; and
- (c) annual reports on the monitoring of surface and groundwater in Kathmandu Valley within one month of the end of each Fiscal Year.

Other Project Issues

21. The Borrower shall within twelve months of the Effective Date, or at a date otherwise agreed by ADB, have obtained a grant of about \$18 million from the Japanese Government, or equivalent funds from other sources;

22. The Borrower shall ensure and shall cause KVWSMB to ensure that the WUO shall operate and conduct its business on a commercial and independent basis, and that its board of directors is free from outside interference in all policy and operational matters including the appointment, promotion and disengagement of staff and the development of its business and services.

Anti Corruption Measures

23. (a) The Borrower shall comply with, and shall cause MPPW and all implementing agencies to comply with ADB's *Anticorruption Policy* (1998, as amended to date) and the Policy relating to *Enhancing ADB's Role in Combating Money Laundering and the Financing of Terrorism* (2003). The Borrower (i) acknowledges ADB's right to investigate, directly or through its agents, any alleged corrupt, fraudulent, collusive or coercive practices relating to the Project; (ii) agrees to cooperate fully with, and to cause MPPW and all implementing agencies to cooperate fully with any such investigation and to extend all necessary assistance, including providing access to all relevant books and records, as may be necessary for the satisfactory completion of any such investigation; and (iii) agrees to refrain, and cause MPPW and all implementing agencies to refrain, from engaging in money laundering activities or financing of terrorism and shall allow, and cause MPPW and all implementing agencies to allow, ADB to investigate any violation or potential violation of these undertakings.

(b) Without limiting the generality of the preceding paragraph, the Borrower shall (i) ensure that MPPW and all implementing agencies conduct periodic inspections on the contractors' activities related to fund withdrawals and settlements and (ii) ensure and cause MPPW and all implementing agencies to ensure that all contracts financed by ADB in connection with the Project include provisions specifying the right of ADB to audit and examine the records and accounts of all contractors, suppliers, consultants and other service providers as they relate to the Project.

Environmental Issues

24. The Borrower shall ensure that by 31 March 2008 the existing environmental management plan (EMP) and resettlement action plan (RAP) shall, in each case, be updated and be divided in to two separate plans, one dealing with Subproject 1 activities and the other dealing with Subproject 2 activities, and that such division shall be made on a consistent basis and be retained for the duration of the Project. References in this Loan Agreement to the EMP or RAP shall be to the relevant EMP or RAP for each of Subproject 1 and Subproject 2, as the case may be.

25. The Borrower shall ensure that all necessary measures in design, construction, operation, maintenance and monitoring are taken to mitigate possible adverse environmental impacts associated with the Project in accordance with the Environmental Impact Assessment, EMP and applicable safety and environmental standards of the relevant agency of the Borrower. During the construction of the Project, MWSDB, KVWSMB and WUO shall assure that the implementation of the mitigating measures are properly documented in the working drawings, specifications, construction logbooks and the minutes of construction meetings. MWSDB, KVWSMB and WUO shall collate in an annual report to the ADB, the implementation of the environmental and safety concerns during construction and operation of the Project. In the event that the Project is cited for violation of any environmental and safety laws, regulations and standards, the MWSDB and WUO shall ensure that the annual report shall include a certification from the relevant agency of the Borrower that the violation has been corrected or a plan to correct the defect has been submitted to, and/or approved by, the relevant agency/ies of the Borrower.

26. The EMP shall include provisions to mitigate against construction phase impacts. In construction contracts affecting the Melamchi Valley the Borrower shall include appropriate clauses requiring measures to mitigate possible environmental impacts associated with (a) cutting down of trees by the construction work force, (b) wildlife hunting by the construction workforce, (c) damage to the water quality of local waterways, (d) increased erosion, (e) damage to rivers and fish due to poor spoil and topsoil management, (f) deterioration of air quality along haul roads and at construction plant sites, and (g) failure to rehabilitate land temporarily occupied by the contractor's facilities. For contracts affecting the Project roads, including adits, the Borrower shall ensure that the contract provisions shall include measures associated with slope stability and soil erosion. The Borrower shall ensure that the Project is implemented and all project facilities are constructed, maintained and operated in strict conformity to (a) all applicable national environmental laws, regulations and procedures, (b) ADB's Environmental Policy (2002), and (c) the environmental mitigation and monitoring measures detailed in the approved environmental impact assessment (EIA), the SEIA, the relevant SIEEs and the relevant EMP for each of the Subprojects.

27. The Borrower undertakes to implement the following actions in accordance with and pursuant to an action plan with milestones, agreed by ADB:

(a) simplification of the environmental and social safeguards management system, including transferring to (i) MWSMB and WUO (as the case may be) overall responsibility for safeguards design, implementation and reporting, and strengthening and increase capacity of MWSMB's and WUO's safeguards division (ii) EMP monitoring consultant responsibility for environmental effects monitoring, social impacts monitoring, and

EMP monitoring, and (iii) construction contractors the responsibility for design and implementation of the EMP for their specific contracts; and

(b) improvement in SUP implementation in the Melamchi Valley, including facilitating the award of SUP implementation contracts and working with local stakeholders to establish temporal, geographical and technical parameters of the SUP.

28. The Borrower shall ensure that (a) construction supervision consultants shall be responsible for ensuring contractors follow contract specifications, particularly with regard to environmental mitigation and the safeguards units of the PMU and KPMU shall monitor compliance, and (b)(if required by ADB), a Social and Environmental Monitoring domestic panel of experts acceptable to the ADB shall conduct an independent assessment of the extent of compliance, using sound environmental practices and the results shall be reported to the ADB.

29. The Borrower shall require that (a) environmental measures described in the SUP include (i) a catchment management and tourism promotion program, (ii) an environmental awareness program for residents residing in the buffer zone, and (iii) an afforestation program with establishment of forest user groups, and a cultural preservation program for one village; (b) the designer of the water treatment plant under paragraph (c) of Part A of Schedule 1 to this Loan Agreement shall liaise with the WUO to include environmentally acceptable methods of sludge disposal from the water treatment process; and (c) the replacement trees of similar varieties as those felled shall be planted on land adjacent to that land where trees are felled for the Project, wherever feasible.

30. The Borrower shall ensure that water abstracted shall be used after treatment, for water supply purposes and shall not be used for flushing the Bagmati River except when it is used for periodic cleaning of the tunnel constructed under paragraph (a) of Part A of Schedule I to this Loan Agreement.

Social Issues

31. The Borrower shall ensure that all necessary measures are taken to mitigate possible adverse social impacts and maximize the social benefits associated with the Project, including implementing the SUP, the hygiene education program, the RAP, and Resettlement Policy Framework for the Project in accordance with ADB's *Involuntary Resettlement Policy (1995)* and the resettlement standards of the relevant agency of the Borrower.

32. Where community facilities and common property resources (including irrigation channels, community forests, community halls) are affected under the Project, the Borrower shall ensure that compensation shall be made to the relevant community which shall be equivalent to at least the replacement value. Loss of income directly due to the Project, including loss of crops and commercial business, shall also be compensated, and for those persons severely affected by the Project, rehabilitation and, if necessary, relocation assistance shall be provided by the Borrower, in line with the resettlement plan requirements.

33. The Borrower shall ensure that, prior to the disbursement of any funds in relation to the SUP, guidelines are agreed with the HSMC and ADB, with respect to the use of SUP funds, which shall include detailed criteria for subproject selection to ensure

consistency and compliance with ADB safeguard requirements and that any proposed changes in SUP guidelines thereafter are subject to ADB's prior concurrence. Further, the Borrower shall ensure that the MPPW will, each year, provide an annual budget which identifies SUP sub-projects to be undertaken, for the following year of implementation, to ADB for review and concurrence. The annual budget should not exceed one-sixth of the current SUP budget.

34. The Borrower shall ensure that the Project Executing Agency will continue discussions with HSMC and the relevant community in respect of the last stretch of less than 2 kilometers of the main access road of the project, including the Ambathan adit access road, to ensure, by no later than 15 March 2008, the commencement of project work in relation to the said access road and continued and uninterrupted access to Project personnel and contractors. The Executing Agency shall provide ADB forthwith, a copy of the memorandum of agreement agreed between the Borrower and the HSMC (or the interim committee as currently represented).

35. The SUP may, subject to the guidelines referred to in paragraph 33 above, include development activities such as: (a) buffer zone development, (b) rural electrification, (c) health, (d) education, and (e) income generation/community development. Women's special needs for reproductive health, adult literacy, skills development and income generation, legal awareness raising, and anti-trafficking in women and girls shall also be addressed. The SUP shall take a participatory approach through community mobilizers.

36. The Borrower shall ensure that (a) direct participation of beneficiaries under the Project occurs through (i) the SUP implementation, (ii) consultation with adversely affected people by ensuring their participation as invitees in the relevant Compensation Determination Committee formed under the Land Acquisition Act 1977, and (iii) representation of Kathmandu Valley beneficiaries on the relevant water users association; (b) consensus building shall be undertaken at all levels on issues such as water services, environmental and social mitigation and compensation, and employment; and (c) for adversely affected communities in the Melamchi Valley, local consultative group shall be established. Prior to 31 December 2001, a consultative committee shall be established representing the inhabitants of the Melamchi Valley and shall be composed of representatives of the affected village district committees.

37. The WUO shall develop a pilot program for hygiene education and promotion program that shall be expanded to a full-scale program when success of the pilot program has been proven. The Borrower shall ensure that this program shall be operated.

38. By 30 June 2003, the Borrower shall develop and commence implementation of a gender strategy to ensure that women's participation and gender concerns under the Project are fully addressed.

39. By Effective Date, a pro-active public relations program shall be undertaken by the MWSDB and, following the Transfer date, also by WUO with respect Subproject 2, to identify any potential conflict areas at an early stage of the Project, assist in problem solving between the Project and the local communities, and manage public expectation on compensation and, where relevant, the SUP.

40. Prior to any civil works being undertaken in respect of activities under paragraphs (a), (b) and (c) Part B of Schedule 1 to this Loan Agreement, the RAP shall be expanded to incorporate the necessary provisions applicable to each of those activities, and each change to the RAP shall be subject to the concurrence of the ADB.

41. The Borrower shall comply with ADB's *Public Communications Policy* (2005) in respect of any documentation required for public disclosure under the Project.

Benefit Monitoring and Evaluation

42. MWSDB and WUO shall finalize Project performance indicators and establish baseline conditions in consultation with the Panel of Experts for the purposes of Project monitoring and evaluation (M&E). M&E indicators and procedures shall be tested for data availability and other constraints, revised if necessary, and institutionalized in the MWSDB, WUO and MPPW, which shall be ultimately responsible for maintaining the M&E systems. Indicative performance indicators shall be agreed between the Borrower and the ADB. The project performance benefit monitoring and evaluation system shall be subject to the agreement of ADB.