
LOAN NUMBER 1820-NEP(SF)

LOAN AGREEMENT
(Special Operations)
(Melamchi Water Supply Project)

between

KINGDOM OF NEPAL

and

ASIAN DEVELOPMENT BANK

DATED 24 January 2001

LAS:NEP 31624

LOAN AGREEMENT (Special Operations)

LOAN AGREEMENT dated 24 January 2001 between the Kingdom of Nepal (hereinafter called the Borrower) and ASIAN DEVELOPMENT BANK (hereinafter called the Bank).

WHEREAS

(A) the Borrower has applied to the Bank for a loan for the purposes of financing or partly financing Components (a), (d), (f), (h), (i) and (j) of the Project described in Schedule 1 to this Loan Agreement;

(B) the Borrower has also applied to the World Bank (IDA) for a credit, (hereinafter called the IDA Credits) in an amount of eighty million dollars (\$80 million), including fifteen million dollars (\$15 million) (hereinafter called the First IDA Credit) in 2001 and a further credit of sixty five million (\$65 million) (hereinafter called the Second IDA Credit) in 2004 for the purposes of financing Component (e) of the Project for the rehabilitation and improvements of the water distribution networks as described in Schedule 1 to this Loan Agreement pursuant to two agreements (hereinafter called the First and Second IDA Credit Agreement respectively) to be entered into between the Borrower and IDA;

(C) the Borrower has applied to the Japanese Bank for International Cooperation (hereinafter called JBIC) for a loan, (hereinafter called the JBIC Loan) in an amount of fifty two million dollars (\$52 million) in 2001 for the purposes of financing Component (c) 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) to be entered into between the Borrower and JBIC;

(D) the Borrower has further applied to the Norwegian Agency for International Cooperation (hereinafter called NORAD) for a grant (hereinafter called the NORAD Grant) in an amount of twenty eight million dollars (\$28 million) in 2001 for the purposes of partly financing Component (a) of the Project for construction of the tunnel (\$25 million) plus design of the Melamchi Diversion Scheme (MDS), (\$3 million) as described in Schedule 1 to this Loan Agreement, pursuant to an agreement (hereinafter called the NORAD Agreement) to be entered into between the Borrower and NORAD;

(E) the Borrower has further applied to the Swedish International Development Agency (hereinafter called Sida) for mixed credits, (hereinafter called the Sida Credits) in an amount of twenty five million dollars (\$25 million) in 2001 for the purposes of partly financing Component (a) of the Project for part financing of the tunnel, as described in Schedule 1 to this Loan Agreement pursuant to an agreement (hereinafter called the Sida Loan and Grant Agreement) to be entered into between the Borrower and Sida;

(F) the Borrower has further applied to the Nordic Development Fund (hereinafter called NDF) for a loan (hereinafter called the NDF Loan) in an amount of nine million dollars (\$9 million) in 2001 for the purposes of partly financing Component (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) to be entered into between the Borrower and NDF;

(G) the Borrower has also applied to 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 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) to be entered into between the Borrower and the OPEC Fund;

(H) the Borrower has also applied to 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 (g) 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) to be entered into between the respective governments; and

(I) the Bank has agreed to make a loan to the Borrower from the Bank's Special Funds resources upon the terms and conditions set forth herein and in the Project Agreement of even date herewith between the Bank and the Borrower;

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 the Bank, 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 the Bank an application in such form and containing such statements and agreements, as the Bank shall reasonably request. Except as the Bank 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 the Bank. 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 the Bank 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 the Bank 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 the Bank to remedy the situation, or (iv) at any time, the Bank 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, the Bank 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: IDA, Japanese Government, JBIC, NDF, NORAD, OPEC Fund, or Sida, and includes any other financier funding any part of the Project;

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

(c) "Drinking Water Supply Act" means the Act which is to be promulgated and which will establish the enabling environment for the Private Operator as noted in paragraph 16 (c) of Schedule 6 to this Loan Agreement;

(d) "environmental management plan" means the Borrower's plan, acceptable to the Bank, 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 the Bank, pursuant to which the NWSC shall borrow funds from the Borrower to pay for any of the Leased assets not held by NWSC, which the Borrower shall transfer to NWSC, and includes arrangements in respect of the payment of interest and the repayment of the aggregate principal amount of the loan by NWSC to the Borrower which shall be entered into between the Borrower and NWSC at the time of the transfer of the Leased assets;

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

(g) "KVWA" means Kathmandu Valley Water Authority of the Borrower or any successor thereto;

(h) "Leased assets" means (i) the water supply and waste water facilities currently existing in the Kathmandu Valley and operated by the NWSC and (ii) the facilities to be constructed under Components (a), (b), (relating to adit access roads only) (c), (d), (e), (f), and (g) of Schedule 1 to this Loan Agreement which operate from the Melamchi River intake to the consumer;

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

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

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

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

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

- (n) "NRs" means Nepalese Rupees, the currency of the Borrower;
- (n) "NWSRB" means the National Water Supply Regulatory Body of the Borrower or any successor thereto;
- (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 the Bank, or any successor thereto;
- (q) "PMU" means the Project management unit referred to in Schedule 6, paragraph 4 to this Loan Agreement;
- (r) "Private Operator" means the private sector third party to whom the NWSC will award a contract for the lease of the Leased assets;
- (s) "Project Executing Agency" for purposes of, and within the meaning of, the Loan Regulations means MPPW, which is responsible for carrying out the Project;
- (t) "Project facilities" means the facilities constructed or to be constructed and the equipment and materials provided or to be provided under the Project;
- (u) "Project roads" means the roads to be improved or constructed under the Project;
- (v) "RAP" means the resettlement action plan satisfactory to the Bank, submitted by MPPW to the Bank regarding the resettlement and/or compensation of Project-affected persons, including communities;
- (w) "Schedule" means a schedule to this Loan Agreement as same may be amended from time to time in accordance with the terms thereof;
- (x) "Strategy" means the Water Supply and Waste Water Sector Strategy for the Kathmandu Valley, dated November 2000, of the Borrower;
- (y) "Subsidiary Loan Agreement" means the agreement between the Borrower and the NWSC referred to in Schedule 6, paragraph 12, to this Loan Agreement; and
- (z) "SUP" means the social uplift program described in Component (h) of Schedule 1 to this Loan Agreement which shall be implemented in the Melamchi Valley to mitigate against indirect adverse social impacts.

ARTICLE II

The Loan

Section 2.01. The Bank agrees to lend to the Borrower from the Bank'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 the Bank 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 the Bank 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 Bank's per capita GNP operational cutoff in respect of the Bank's Special Funds resources for five consecutive years and (ii) the Borrower has achieved the capacity to borrow from the Bank's ordinary capital resources, the Bank 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, the Bank may, in lieu of so increasing any such maturity amounts, charge interest, at an annual rate to be agreed between the Borrower and the Bank, 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, the Bank shall, after due consideration by its Board of Directors, determine that the Borrower's economic condition has deteriorated significantly, the Bank 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 the Bank.

Section 3.03. Except as Bank 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. The Bank 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 the Bank or where the terms and conditions of the contract are not satisfactory to the Bank.

Section 3.04. Except as the Bank 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 the Bank as shall have been specified by the Bank 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 the Bank 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 March 2007 or such other date as may from time to time be agreed between the Borrower and the Bank.

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 6 to this Loan Agreement.

Section 4.02. The Borrower shall make available promptly as needed, and on terms and conditions acceptable to the Bank, 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 the Bank, to be employed to an extent and upon terms and conditions satisfactory to the Borrower and the Bank.

(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 the Bank. The Borrower shall furnish, or cause to be furnished, to the Bank, promptly after their preparation, such plans, design standards, specifications and work schedules, and any material modifications subsequently made therein, in such detail as the Bank 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 the Bank 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 auditing standards consistently applied, by independent auditors whose qualifications, experience and terms of reference are acceptable to the Bank; (iii) furnish to the Bank, as soon as available but in any event not later than 12 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 an imprest account), all in the English language; and (iv) furnish to the Bank such other information concerning such accounts and financial statements and the audit thereof as the Bank shall from time to time reasonably request.

(c) The Borrower shall enable the Bank, upon the Bank'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 the Bank, 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 the Bank all such reports and information as the Bank 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, (NWSC), 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 the Bank 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 the Bank 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 the Bank, the Borrower shall prepare and furnish to the Bank a report, in such form and in such detail as the Bank 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 the Bank'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 the Bank that no other external debt owed a creditor other than the Bank 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 the Bank 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 bank for the Borrower.

Section 4.11. The Borrower shall take all action which shall be necessary on its part to enable NWSC to perform its obligations under the Subsidiary 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 the Bank 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 the Bank.

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(I) of the Loan Regulations:

(a) the right of the Borrower to withdraw the proceeds of the IDA Credit, Japanese Government Grant, JBIC Loan, NDF Loan, NORAD Grant, OPEC Fund Loan, or Sida Mixed Credits, 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 the Bank 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 Act, the NWSC Act, the Drinking Water Supply Act, or any provision thereof shall have been repealed, suspended or amended in any manner which in the reasonable opinion of the Bank 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 the Bank, for provision of foreign-currency funds required for the Project, or the Borrower shall have, to the satisfaction of the Bank, allocated in its budget said foreign-currency funds and authorized their withdrawal for the Project, or the Borrower shall have made arrangements, satisfactory to the Bank, to commit the provision of such foreign-currency funds for the Project within a period of time satisfactory to the Bank:

(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; and

(d) the Borrower shall have amended its Resettlement Policy Framework dated 9 November 2000, to reflect the Bank'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.

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 the Bank, that 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.

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
Bagh Durbar
Kathmandu, Nepal

Facsimile Number:

977-1-259891

For the Bank

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

Cable Address:

ASIANBANK
MANILA

Telex Numbers:

29066 ADB PH (RCA)
42205 ADB PM (ITT)
63587 ADB PN (ETPI)

Telex Numbers:

29066 ADB PH (RCA)
42205 ADB PM (ITT)
63587 ADB PN (ETPI)

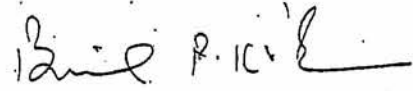
Facsimile Numbers:

(632) 636-2444
(632) 636-2305.

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 the Bank, as of the day and year first above written.

KINGDOM OF NEPAL

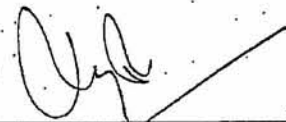
By



BIMAL PRASAD KOIRALA
Authorized Representative

ASIAN DEVELOPMENT BANK

By



RAJAT M. NAG
Deputy Director
Programs Department (West)

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:
 - (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 25 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 about 170 MLD and expandable to about 510 MLD to treat the Melamchi River water;
 - (d) 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;
 - (e) the rehabilitation and improvement of distribution networks at primary, secondary, and tertiary levels;
 - (f) the undertaking of improvements to wastewater system in a phased manner;
 - (g) 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;
 - (h) the development and implementation of (i) a social uplift program, including (a) buffer zone development, (b) rural electrification, (c) health, (d) education, and (e) income generation/community development; (ii) a resettlement action plan; and (iii) an environmental management plan to mitigate direct and indirect Project impacts, including (a) hygiene education, (b) public awareness relations programs, (c) a third party social and environmental monitoring program, and (d) a groundwater monitoring program;
 - (i) institutional reforms including (i) the establishment of a regulatory body for water supply and sanitation for Nepal, (ii) private sector management of urban water supplies in the Kathmandu Valley, (iii) the establishment of

Schedule 1

KVWA for water resource management, and (iv) groundwater licensing in the Kathmandu Valley; and

- (j) the provision of support to carry out various Project administration activities, including PMU operations, design and construction supervision, social and environmental activities, and training.

3. The Project is expected to be completed by 30 September 2006.

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
Amortization Schedule
(Melamchi Water Supply Project)

<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><u>93,253,000</u></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 Bank Financing

3. Except as the Bank 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 twenty million nine hundred and eighty two thousand Special Drawing Rights (SDR20,982,000) 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 Bank 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 6 is for financing interest charge on the Loan during the implementation period of the Project. The Bank 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, the Bank 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 the Bank, 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, the Bank may, by notice to the Borrower, reallocate such excess amount to any other Category.

Imprest Account

8. (a) Except as the Bank shall otherwise agree, the Borrower shall establish immediately after the Effective Date, an imprest account at the Nepal Rastra Bank. The imprest account shall be established, managed, replenished and liquidated in accordance with the Bank's "Loan Disbursement Handbook" dated June 1996, as amended from time to time, and detailed arrangements agreed upon between the Borrower and the Bank. The initial amount to be deposited to the imprest account shall be based on estimated expenditure for the first six months of Project implementation, but shall not exceed the equivalent of \$500,000 for the account.

(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 account, for contracts not exceeding the equivalent of \$50,000 in accordance with the Bank's "Loan Disbursement Handbook" dated June 1996, as amended from time to time, and detailed arrangements agreed upon between the Borrower and the Bank.

Release of Funds

9. MOF shall release funds to MPPW in a timely manner. MWSDB 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 BANK FINANCING	
Number	Item	Amount Allocated SDR		Percentage	Basis for Withdrawal from the Loan Account
		Category	Subcategory		
1	Civil Works	24,922,000			
1A	Melamchi Diversion Scheme		11,377,000	20	[percent of total expenditure] (20% for foreign and 0% for local)
1B	Bulk Distribution System		10,398,000	74	[percent of total expenditure] (67% for foreign and 7% for local)
1C	Wastewater System Improvement		3,147,000	81	Percentage of total expenditure (70% for foreign and 11% for local)
2	Equipment and materials	16,887,000			
2A	Melamchi Diversion Scheme		389,000	100	Percentage of total expenditure (100% for foreign and 0% for local)
2B	Bulk Distribution System		13,529,000	100	percent of foreign expenditure percent of local expenditure*
2C	Wastewater System Improvement		2,969,000	100	
3	Social & Environmental Support	9,667,000		100	Percent of total expenditure (17% for foreign and 83% for local)
4	Consulting Services	15,348,000		100	percent of foreign expenditure percent of local expenditure*
5	Incremental Administration	2,494,000		100	Percentage of total expenditure * (0% for foreign and 100% for local)
6	Interest Charge	10,646,000		100	percent of amounts due
7	Unallocated	13,289,000			
	Total	93,253,000			

*Exclusive of local taxes

SCHEDULE 4

Procurement

1. Except as the Bank may otherwise agree, the procedures referred to in the following paragraphs of this Schedule shall apply in the procurement of goods and services to be financed out of the proceeds of the Loan. In this Schedule, the term "goods" includes equipment and materials; the terms "services" does not include consulting services.

2. Procurement of goods and services shall be subject to the provisions of the "Guidelines for Procurement under Asian Development Bank Loans" dated February 1999 (hereinafter called the Guidelines for Procurement), as amended from time to time, which have been furnished to the Borrower.

3. Procurement of goods and services shall be made without any restriction against, or preference for, any particular supplier or contractor or any particular class of suppliers or contractors, except as otherwise provided herein and in paragraph 5 below.

International Competitive Bidding

4. (a) Each civil works contract estimated to cost the equivalent of more than \$1,000,000 and each supply contract for equipment or materials estimated to cost the equivalent of more than \$500,000 shall be awarded on the basis of international competitive bidding as described in Chapter II of the Guidelines for Procurement. Bidders for civil works contracts shall be prequalified before the bidding.

(b) For contracts to be awarded on the basis of international competitive bidding there shall be submitted to the Bank, as soon as possible, and in any event not later than 90 days before the issuance of either the first prequalification invitation, if any, or the first invitation to bid for the Project, a General Procurement Notice (which the Bank shall arrange to publish separately) in such form and detail and containing such information as the Bank shall reasonably request. The Bank shall be provided the necessary information to update such General Procurement Notice annually as long as any goods and works remain to be procured on the basis of international competitive bidding;

(c) For contracts to be awarded on the basis of international competitive bidding, procurement actions shall be subject to review by the Bank in accordance with the procedures set forth in Chapter IV of the Guidelines for Procurement. Each draft prequalification invitation and each draft invitation to bid, to be submitted to the Bank for approval under such procedures, shall reach the Bank at least 42 days before it is issued and shall contain such information as the Bank shall reasonably request to enable the Bank to arrange for the separate publication of such invitation.

Domestic Preference

5. In comparing bids under the international competitive bidding, a margin of preference shall be provided, at the option of the Borrower and in accordance with the provisions of the Attachment to this Schedule, for (a) goods manufactured in the territory of the Borrower, provided that the bidder offering such goods shall have established to the satisfaction of the Borrower and the Bank that the domestic value added equals at least 20

percent of the ex-factory bid price of such goods, and (b) civil works to be carried out by eligible domestic contractors, as defined by the Bank.

International Shopping

6. (a) Each supply contract for equipment or materials estimated to cost the equivalent of \$500,000 or less (other than minor items) shall be awarded on the basis of international shopping as described in Chapter III of the Guidelines for Procurement.

(b) Notwithstanding paragraph 6(a) herein, when specialized proprietary equipment estimated to cost the equivalent of \$500,000 or less is required, direct purchase from the manufacturers of the original equipment or their agents shall be permitted with prior approval from the Bank. Prior to such procurement, a list of individual items to be procured, an estimate of their costs, an indication of potential sources of supply and any related documents shall be submitted to the Bank for approval. After award, three copies of each contract for such items shall be furnished to the Bank.

Local Competitive Bidding/Direct Purchase

7. Civil works contracts estimated to cost the equivalent of \$1,000,000 or less shall be awarded on the basis of local competitive bidding among contractors in accordance with procedures of the Borrower and which shall be acceptable to the Bank. Selection and engagement of contractors shall be subject to the approval of the Bank. As soon as the bids received have been evaluated, the proposal for award of contract shall be submitted to the Bank for approval. For this purpose, the Bank shall be furnished with three copies of (i) an account of the public opening of bids; (ii) a summary and evaluation of the bids; (iii) the proposal for award; and (iv) a draft contract or a draft letter of acceptance. Promptly after each contract is awarded, the Bank shall be furnished with three copies of the contract as executed.

8. Minor items, costing less than the equivalent of \$100,000 per contract may be purchased directly.

Other Procedures

9. (a) The Borrower shall ensure that all Bank-financed goods and services 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 Bank-financed contracts for the procurement of goods and services 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.

Conditions of Award of Contract

10. The Bank shall not approve any proposal for prequalification of civil works contracts relating to a particular component of Schedule I of the Loan Agreement, until the Borrower has issued a notification to all interested persons under Section 9 of the Land Acquisition Act 2034 of 1977 (the Land Acquisition Act) for permanent land acquisition required for the relevant Project component.

11. The Bank shall not approve any proposal for award of civil works contracts until the Borrower has obtained possession, and either (a) permanently acquired land pursuant to the Land Acquisition Act or (b) temporarily acquired land under the Public Road Act 2031, depending on the purposes of the Project.

12. The Bank shall not approve any proposal for award of civil works contract for the construction of the tunnel under Component (a) of Schedule 1 to this Loan Agreement until the following conditions have been met:

- (i) the First IDA Credit Agreement or such alternative financial assistance under arrangements satisfactory to the Bank shall have been executed and delivered and all conditions precedent to its effectiveness shall have been fulfilled;
- (ii) the Borrower shall have enacted a law to establish, and shall have established, the NWSRB in accordance with the Strategy;
- (iii) the Borrower shall have awarded a private sector lease contract under international competitive procedures to the Private Operator in respect of the Leased assets; and
- (iv) the construction supervision consultants shall have agreed to the design for the said tunnel.

13. The Bank shall not approve any proposal for award of contract for the bulk distribution system to be constructed under Component (d) of Schedule 1 to this Loan Agreement, until the Borrower shall have enacted a law to establish the KVWA, and a law relating to groundwater licensing.

Preference for Domestically Manufactured Goods

1. In the procurement of goods through international competitive bidding, goods manufactured in the territory of the Borrower may be granted a margin of preference in accordance with the following provisions, provided that the bidder shall have established to the satisfaction of the Borrower and the Bank that the domestic value added equals at least 20 percent of the ex-factory bid price of such goods. The 20 percent domestic value added applies to the total ex-factory bid price of the goods and not only to one item in a list.

- (a) For application of domestic preference, all responsive bids shall first be classified into the following three categories:

Category I -- bids offering goods manufactured in the territory of the Borrower which meet the minimum domestic value added requirement;

Category II -- bids offering other goods manufactured in the territory of the Borrower; and

Category III -- bids offering imported goods.

- (b) The lowest evaluated bid of each category shall then be determined by comparing all evaluated bids in each category among themselves, without taking into account customs duties and other import taxes levied in connection with the importation, and sales and similar taxes levied in connection with the sale or delivery, pursuant to the bids, of the goods.
- (c) Such lowest evaluated bids shall next be compared with each other and if, as a result of this comparison, a bid from Category I or Category II is found to be the lowest, it shall be selected for the award of contract.
- (d) If, however, as a result of the comparison under subparagraph (c) above, the lowest bid is found to be from Category III, it shall be further compared with the lowest evaluated bid from Category I. For the purpose of this further comparison only, an upward adjustment shall be made to the lowest evaluated bid price of Category III by adding either:
- (i) the amount of customs duties and other import taxes which a nonexempt importer would have to pay for the importation of the goods offered in such Category III bid; or
- (ii) 15 percent of the CIF bid price of such goods if the customs duties and import taxes referred to above exceed 15 percent of the CIF bid price.

If, after such further comparison, the Category I bid is determined to be the lowest, it shall be selected for the award of contract; if not, the lowest evaluated bid from Category III shall be selected for the award.

2. (a) Bidders applying for the preference shall provide evidence necessary to establish the eligibility of a bid for the preference, including the minimum domestic value added.

(b) The bidding documents shall clearly indicate the preference to be granted, the information required to establish the eligibility of a bid for the preference claimed, and the procedures to be followed in the comparison of bids, all as set forth above.

Domestic Preference for Turnkey Contracts and
Supply-and-Installation Contracts

3. In single-responsibility turnkey (including design-build) contracts and supply-and-installation contracts for large and complex packages, procured through international competitive bidding and in which discrete items of goods are grouped into one contract package and where the CIF cost of goods to be used for or in the permanent works under such contracts is estimated, prior to bidding, to equal or exceed 60 percent of the total cost of such works, a margin of preference shall be applied to the domestically manufactured goods in accordance with the following provisions.

- (a) The margin of preference shall not be applied to the whole package but only to the domestically manufactured goods within the package.
- (b) Goods offered from outside the territory of the Borrower shall be quoted CIF and goods offered domestically shall be offered ex-factory or ex-works (free of sales and similar taxes).
- (c) All other cost components, such as design as well as works installation and supervision, shall be quoted separately.
- (d) In the comparison of bids (which should not be classified into Categories I, II or III as with the domestic preference for goods), only the CIF price in each bid of the goods offered from outside the territory of the Borrower shall be increased by the applicable duty and other taxes payable by a nonexempt importer or by 15 percent, whichever is less.
- (e) If duties vary from item to item within a package, the appropriate tariff for each item shall apply.
- (f) No margin of preference shall be applied to any associated services or works included in the package.
- (g) Bidders will not be permitted or required to modify the mix of domestic and foreign goods after bid opening.

4. (a) Bidders applying for the preference shall provide evidence necessary to establish the eligibility of a bid for the preference.

(b) The bidding documents shall clearly indicate the preference to be granted, the information required to establish the eligibility of a bid for the preference claimed, and the procedures to be followed in the comparison of bids, all as set forth above.

Preference for Domestic Contractors

5. In the selection of civil-works contractors, single-responsibility turnkey (including design-build) contractors or supply-and-installation contractors where the CIF cost of goods to be used for or in the permanent works under such contracts is less than 60 percent of the total cost of such works, eligible domestic contractors, as defined below, through international competitive bidding may be granted a margin of preference in accordance with the following provisions.

- (a) For application of domestic preference, all responsive bids shall first be classified into the following two categories:

Category I -- bids offered by domestic contractors and joint ventures eligible for the preference in accordance with the applicable criteria as set forth in paragraph 6 below; and

Category II -- bids offered by other contractors.

- (b) The lowest evaluated bid of each category shall then be determined by comparing all evaluated bids in each category among themselves.
- (c) Such lowest evaluated bids shall next be compared with each other and if, as a result of this comparison, a bid from Category I is found to be the lowest, it shall be selected for the award of contract.
- (d) If, however, as a result of the comparison under subparagraph (c) above, the lowest bid is found to be from Category II, it shall be further compared with the lowest evaluated bid from Category I. For the purpose of this further comparison only, an upward adjustment shall be made to the lowest evaluated bid price of Category II by adding an amount equal to seven-and-one-half percent of the bid price. If, after such comparison, the Category I bid is determined to be the lowest, it shall be selected for the award of contract; if not, the lowest evaluated bid from Category II shall be selected.

6. (a) To be eligible for the preference set forth in paragraph 5 above, domestic contractors must meet the following criteria:

- (i) firms are registered in the territory of the Borrower;
- (ii) firms have majority ownership by nationals of the Borrower; and
- (iii) firms will not subcontract more than 50 percent of the total value of their work to foreign contractors.

(b) A joint venture between a domestic contractor and its foreign partner shall be eligible for the preference only if it meets the following criteria:

- (i) the domestic partner(s) is individually eligible for the preference according to the criteria stated above;
- (ii) the domestic partner(s) would not qualify for the contract works on technical or financial grounds without the foreign participation; and
- (iii) the domestic partner(s) will, under the arrangements proposed, carry out at least 50 percent of the contract works measured in terms of value.

(c) Contractors applying for the preference shall be required to provide, as part of the data for qualification, necessary information, including details of ownership, for determining whether, according to the applicable criteria, a particular firm or group of firms qualifies for the preference.

7. The bidding documents shall clearly indicate the preference to be granted, the information required to establish the eligibility of firms for the preference claimed, and the procedures to be followed in the comparison of bids, all as set forth above. Bidders applying for the preference shall provide such additional information in support of such eligibility as may be requested by the Borrower and the Bank.

SCHEDULE 5

Consultants

1. The selection, engagement and services of the Bank-financed consultants shall be subject to the provisions of the "Guidelines on the Use of Consultants" by Asian Development Bank and its Borrowers", dated October 1998, as amended from time to time, which have been furnished to MPPW and MWSDB.
2. The services of consultants shall be utilized in carrying out the Project, including:
 - (a) water supply engineering, Project design and construction supervision of civil works;
 - (b) training of the Borrower's personnel involved in the Project;
 - (c) implementing, managing, and monitoring Project activities;
 - (d) developing and conducting public awareness and health and hygiene education programs; and
 - (e) carrying out the SUP.
3. Where consulting services under the Project shall be undertaken by individual international and/or domestic consultants and/or prequalified domestic NGOs, the terms of reference of the consultants shall be determined by agreement between the Bank and MWSDB.
4. The consultants shall be selected and engaged by the Borrower in accordance with the following procedures.
 - (a) A list of the candidates together with their qualifications and a draft contract shall be furnished to the Bank for approval before the selection of consultants.
 - (b) Promptly after the contract is signed, the Bank shall be furnished with the evaluation of the candidates and a brief justification for the selection, together with three copies of the signed contract.
 - (c) If any substantial amendment of the contract is proposed after its execution, the proposed changes shall be submitted to the Bank for prior approval.
5. (a) The prequalification procedures for domestic NGOs shall be in accordance with procedures of the Borrower and shall be acceptable to the Bank.
 - (b) The shortlist of prequalified domestic NGOs shall be updated from time to time based on the performance of the domestic NGOs.
6. Construction supervision consulting services under Component (d) of Schedule 1 to this Loan Agreement for the bulk distribution system shall be utilized. The terms of reference of the consultants shall be determined by agreement between the Bank and MWSDB. The consultants shall be selected and engaged by MWSDB in accordance with the following procedures.

(a) For the above-mentioned consulting services, a contract shall be negotiated by MWSDB with the consultants who have been engaged in the preparation of the design of the bulk distribution system. Before a contract is signed with such consultants, three copies of the draft contract as negotiated shall be furnished to the Bank for approval. Promptly after the contract is signed, the Bank shall be furnished with three copies of the signed contract. If any substantial amendment of the contract is proposed after its execution, the proposed changes shall be submitted to the Bank for prior approval.

(b) Except as the Bank may otherwise agree, the negotiation of a contract with the above-mentioned consultants shall be concluded within 90 days of the Effective Date. If a contract cannot be successfully negotiated, other consultants shall be engaged in accordance with such other procedures, consistent with the "Guidelines on the Use of Consultants by Asian Development Bank and Its Borrowers", as shall be determined by the Bank in consultation with the Borrower.

7. Where a consulting firm is utilized for carrying out the Project, the consultants shall be selected and engaged by MWSDB in accordance with the following procedures.

(a) Invitation for proposals. The invitation to submit proposals and all related documents shall be approved by the Bank before they are issued. For this purpose, three copies of the draft invitation to submit proposals, a list of consultants to be invited, the proposed criteria for evaluation of proposals and other related documents shall be submitted to the Bank. A period of at least 60 days shall be allowed for submission of proposals. A copy of the final invitation as issued, together with all related documents, shall be furnished to the Bank for information promptly after issuance.

(b) Draft Contract. A draft contract with consultants shall be furnished to the Bank for approval before the commencement of evaluation of proposals.

(c) Proposal for selection. After the proposals received have been evaluated and before negotiations are started with the consultants selected for negotiations, approval of the Bank shall be obtained to the selection made. For this purpose, the Bank shall, promptly after the evaluation of proposals, be furnished with three copies of (i) an evaluation of the proposals (together with one set of each proposal not previously furnished to the Bank); and (ii) justification for the selection.

(d) Execution of Contract. After the conclusion of negotiations but before the signing of the contract, the Bank shall be furnished with the contract as negotiated for approval. Promptly after the contract is signed, the Bank shall be furnished with three copies of the signed contract. If any substantial amendment of the contract is proposed after its execution, the proposed changes shall be submitted to the Bank for prior approval.

Advance Action

8. Prior to the date of this Loan Agreement, the Bank approved certain advance action for the recruitment of consultants for the Project management. The Borrower shall obtain such consulting services in accordance with the provisions 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.

Property Rights

9. The Borrower shall ensure that all Bank-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.

SCHEDULE 6

Implementation Arrangements; Regulatory Bodies; Private Operator; Reporting; and Other Matters

Implementation Arrangements

1. The MPPW shall be the Executing Agency for the Project. The MWSDDB shall be the implementing agency and its members shall include 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. The Borrower shall ensure non interference with MWSDDB's autonomy of decision making.
2. 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 to deal with major issues affecting the Project.
3. Consultants forming two Panels of Experts shall be appointed by MWSDDB 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 consensus building/dispute resolution experts. The Panels of Experts shall report to the Project Director who shall make the final decision in the event of any conflict between any of the consultants. 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.
4. The Project Management Unit (PMU) shall be established within the responsibility of the MWSDDB, and shall be responsible for the day-to-day management of the Project. 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 Bank. The PMU shall be staffed by appropriate and adequate administrative staff. The PMU shall be composed of six divisions: (a) an information division responsible for public relations, management information systems, planning and scheduling; (b) an engineering division for specifications, drawings, construction supervision, quality and safety monitoring; (c) a social and environment division to cover resettlement, compensation, social mobilization, environmental management and benefit monitoring; (d) a procurement division addressing legal aspects, claims, consultants, suppliers and contractors; (e) an administration division responsible for personnel, transport, records, communication and payroll; and (f) a finance division for budget, loan administration, accounts, auditing and disbursements. 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 Project implementation, and shall seek the Bank's concurrence for any change of those appointments.
5. The Borrower shall ensure that all consultants for the various Project components shall report to the PMU. The PMU shall be responsible for preparing disbursement projections and budgetary allocations for the counterpart funds.

Kathmandu Valley Water Authority

6. The Borrower shall establish an independent and autonomous Kathmandu Valley Water Authority (KVWA) as a planning, implementing, monitoring and management agency. The KVWA Board shall primarily be constituted with local government representatives and some line ministry representatives. It shall be responsible for comprehensive water resources management, including allocation, use and protection of water resources, and the introduction of river basin management approach in Kathmandu Valley. It shall maintain a small professional staff and shall be empowered to let contracts to consultants and contractors for related works. The Borrower shall ensure that when the Private Operator's lease contract is renegotiated after the first five year period, KVWA shall be a counterparty to the contract.

National Water Supply Regulatory Body

7. Prior to the award of the lease contract to the Private Operator, the Borrower shall establish NWSRB as an independent body having at least one female member and financed from consumer tariffs (a) to protect the consumer interests; (b) to monitor the performance of the Private Operator 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 NWSRB 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 NWSRB to publish an annual report of its activities and findings on the performance of the Private Operator within three months of the end of the each Fiscal Year.

Coordination of Cofinanciers

8. MWSDB shall organize and chair coordination meetings of the Bank and cofinanciers which shall be held at least every two 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 the PMU for the Bank and the cofinanciers, three times a year. Twice a year, the Bank, the cofinanciers, and the Borrower shall jointly review the Project.

Counterpart Funds

9. Without limiting the generality of Section 4.02 of the Loan Agreement, the Borrower shall ensure that counterpart funds in the amount of \$118 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.

Private Operator

10. Upon construction of the Project facilities, the Borrower shall ensure that a Private Operator shall be appointed by NWSC to operate and maintain the Leased assets under a contract with terms and conditions satisfactory to the Bank, and which shall include:

- (a) a requirement to publish a report of annual operations for public review;
- (b) provisions requiring specific monitoring against service delivery indicators including:
 - (i) reduction of physical and commercial water losses;
 - (ii) equitable distribution of water on a daily basis;
 - (iii) maintenance of computerized consumer accounts and management information systems;
 - (iv) increase in number of connections;
 - (v) maximization of revenue collection;
 - (vi) increase in public awareness of water use including hygiene;
 - (vii) improvement of sanitation services;
 - (viii) training of personnel involved in water management;
 - (ix) customer service performance indicators (including hours of supply and water quality); and
 - (x) mapping of the physical system;
- (c) a provision that the Private Operator cannot sell bulk water to a third party who on-sells the water at a price higher than the Private Operator's average tariff imposed for piped water;
- (d) a provision that the Private Operator shall be responsible for the operation and maintenance of all Leased assets and the adit access roads; and
- (e) a requirement for annual accounts and financial statements of Private Operator to be prepared, audited by an accounting firm which meets international accounting standards, and submitted to the Bank within six months of the end of each Fiscal Year.

11. The Borrower shall require the Private Operator 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.

12. The Borrower shall, concurrently with the signing of the private sector lease contract for the Leased assets, transfer the Leased assets to NWSC and enter into a Subsidiary Loan Agreement with NWSC upon terms and conditions satisfactory to the Bank. Except as the Bank shall otherwise agree, the terms for repayment of the loan for purchasing the Leased assets, which shall be based on the current market value of the transferred assets, shall be on a 50 percent grant / 50 percent loan basis and shall include interest at the rate of eight percent (8%) per annum and a repayment period of 20 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

13. Without limiting the generality of Section 4.07 of the Loan Agreement, the MSWDB shall prepare and submit to the Bank, 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;
 - (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 Unit;

(b) the annual monitoring reports on environmental and social issues affecting the Project, within one month of the end of each Fiscal Year; 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

14. The Borrower shall:

(a) within twelve months of the Effective Date, or at a date otherwise agreed by the Bank, have obtained a grant of about \$18 million from the Japanese Government, or equivalent funds from other sources;

(b) within six months of the Effective Date, or at a date otherwise agreed by the Bank, ensure that the recent amendments to the NWSC Act are promulgated;

(c) within six months of the Effective Date, or at a date otherwise agreed by the Bank, ensure that the Drinking Water Supply Act and/or other relevant legislation has been promulgated or amended to establish an enabling environment for the Private Operator to operate the Leased assets, bill and collect water charges, withdraw services from defaulters, and be insulated from external interference;

(d) by 30 June 2004, or a date otherwise agreed by the Bank, have obtained the Second IDA Credit, or equivalent funds from other sources;

- (e) ensure by 31 December 2001, that:
- (i) the Borrower approves the Policy on Groundwater Abstraction, Monitoring and Licensing in 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; and

(f) ensure by 31 Dec 2002, 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.

Environmental Issues

15. 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, environmental management plan and applicable safety and environmental standards of the relevant agency of the Borrower. During the construction of the Project, MWSDB 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 shall collate in an annual report to the Bank, 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 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.

16. The Borrower shall formulate and commence implementation of land use planning and controls in the Kathmandu Valley that relate to the Project, by 31 December 2003.

17. The environmental management plan as described in Component (h) in Schedule 1 to this Loan Agreement 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.

18. 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 Environment, Resettlement and Social Development Division of the PMU shall monitor compliance, and (b) a Social and Environmental Monitoring domestic NGO shall conduct an independent assessment of the extent of compliance, using sound environmental practices and the results shall be reported to the Bank.

19. The Borrower shall require that (a) environmental measures 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 Component (c) of Schedule 1 to this Loan Agreement shall liaise with the Private Operator 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.

Tariffs

20. The Borrower in complying with the Strategy shall ensure that (a) tariffs for private sector operation of the Leased assets meet (i) cash operating costs up to 30 June 2006; and (ii) all the operating and maintenance costs, interest on debt and debt service capital repayments and (b) the Private Operator of the Leased assets receives funds for all capital works up to 2010 on a 50 percent loan:50 percent grant ratio, and thereafter full cost recovery principles will be applied.

21. The Borrower in compliance with the Strategy shall require tariff structures to be designed so as to (a) provide the above cost recovery, (b) apply effective demand management, and (c) ensure affordable and adequate access of the poor to piped water supply services.

22. The Borrower shall ensure that (a) 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 Component (a) of Schedule I to this Loan Agreement.

23. 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 the Bank's *Involuntary Resettlement Policy and Handbook on Resettlement* and the Resettlement Standards of the relevant agency of the Borrower.

24. When 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 inhabitants, and which will be used to fund activities to be determined by the inhabitants and which shall include the funding for the continuation and maintenance of the SUP activities.

Social Issues

24. 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.

25. The SUP shall include development activities covering: (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 (i) take a participatory approach through community mobilizers; and (ii) utilize the institutional structure of the Borrower's ongoing Local Governance Program.

26. The Borrower shall ensure that (a) direct participation of beneficiaries under the Project occurs through (i) the SUP implementation, (ii) representation of adversely affected people on the relevant Compensation Determination Committee, which will be established under the RAP, 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 groups shall be established in each affected ward and village development committee. Prior to 31 December 2001, (a) a consultative committee shall be established representing the inhabitants of the Melamchi Valley and shall include representatives of MWSDB, the Chairpersons of the affected village development committees, and the affected district development committees and (b) a memorandum of understanding shall be signed between this consultative committee and the Borrower.

27. The MWSDB 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 taken over and operated by the Private Operator within six months of the award of the contract.

28. A Low Income Customer Service and Education Unit shall be established within the PMU to monitor targeted hygiene education programs, the tariff based on basic needs consumption, and environmental sanitation improvements. By 30 June 2001, 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.

30. By Effective Date, a pro-active public relations program shall be undertaken by the MWSDB 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 the SUP.

29. Prior to any civil works being undertaken for Components (c), (e) and (f) of Schedule 1 to this Loan Agreement, the RAP shall be expanded to incorporate the necessary provisions applicable to each of those Components, and each change to the resettlement plan shall be subject to the concurrence of the Bank.

Benefit Monitoring and Evaluation

30. MWSDB 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 and MPPW, which shall be ultimately responsible for maintaining the M&E systems. Indicative performance indicators shall be agreed between the Borrower and the Bank. The benefit monitoring and evaluation shall also take due account of the approaches and guidance provided under the Bank's *Benefit Monitoring and Evaluation: A Handbook for Bank Staff, Staff of the Executing Agencies and Consultants*.