

# Project Administration Manual

Project Number: 49451-002  
Guarantee: GU 3492  
September 2018

Republic of Azerbaijan: Partial Credit Guarantee  
Shah Deniz Gas Field Expansion Project

## **ABBREVIATIONS**

ADB	–	Asian Development Bank
ASDL	–	Azerbaijan (Shah Deniz) Limited
bcm	–	billion cubic meter
BPXSD	–	BP Exploration (Shah Deniz)
ESIA	–	Environmental and Social Impact Assessment
FLMP	–	Fishing Livelihood Management Plan
JOA	–	Joint Operating Agreement
PAM	–	Project Administration Manual
PSA	–	Production Sharing Agreement
SGC	–	Southern Gas Corridor Closed Joint-Stock Company
SGCU	–	SGC Upstream LLC
SPS	–	Safeguard Policy Statement (2009)

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### **Project Administration Manual Purpose and Process**

The project administration manual (PAM) describes the essential administrative and management requirements to implement the project on time, within budget, and in accordance with the policies and procedures of the government and Asian Development Bank (ADB). The PAM should include references to all available templates and instructions either through linkages to relevant URLs or directly incorporated in the PAM.

The Government of the Republic of Azerbaijan (ROA) and the Southern Gas Corridor Closed Joint-Stock Company (SGC) are taking part in the implementation of projects supported by ADB financing. ADB staff is responsible for supporting implementation, including compliance by SGC of their obligations and responsibilities for project implementation, in accordance with ADB's policies and procedures.

During the counter-guarantee and indemnity agreement (CGIA) negotiations in October-November 2016, the SGC and ADB agreed to the PAM (and its redacted public disclosure version) to ensure consistency with the counter-guarantee and indemnity agreement. Such agreement is reflected in the minutes of the counter-guarantee and indemnity negotiations dated 29 October 2016. In the event of any discrepancy or contradiction between the PAM and the counter-guarantee and indemnity agreement, the provisions of the counter-guarantee and indemnity agreement shall prevail.

After ADB Board approval of the project's report and recommendations of the President (RRP), changes in implementation arrangements are subject to agreement and approval pursuant to relevant ROA and ADB administrative procedures (including the Project Administration Instructions) and upon such approval, they are subsequently incorporated in the PAM. The PAM has been updated to reflect the final agreed provisions of the syndicated commercial loan facility agreement (Facility Agreement), the sovereign guarantee provided by ROA in favor of the commercial lenders (Sovereign Guarantee Agreement), the ADB partial credit guarantee (PCG), the ASDL Direct Agreement and the CGIA, in each case dated 22 December 2017.

## I. PROJECT DESCRIPTION

1. The proposed project will provide support in the form of a Partial Credit Guarantee (PCG) provided by Asian Development Bank (ADB) backed by a sovereign counter-guarantee and indemnity, to be issued by the Republic of Azerbaijan (ROA) to ADB covering up to \$524.5 million in principal repayments plus regular interest accrued thereon of a syndicated commercial loan facility (Facility) to support the Southern Gas Corridor Closed Joint-Stock Company (SGC or the “Borrower”) investments in the Shah Deniz Stage II (Shah Deniz-II).

2. The project will increase the annual gas production capacity of the Shah Deniz Field from 9.8 billion cubic meters (bcm) in 2015 to 26 bcm by 2022. The additional gas will be exported to Europe, via Georgia and Turkey. It represents a first step in creating the southern gas corridor as an alternative for potential future gas deliveries to Europe from other sources in the Caspian region and the Middle East. Thus, the project supports regional cooperation and integration, one of ADB's core operational areas in Strategy 2020, and will improve Europe's energy security by diversifying the sourcing of its gas supply.

3. **Impact and outcome.** The impact of the project is aligned with sustained revenues from oil and gas exports, which will facilitate diversification of the country's economy. The outcome will be increased production and exports of gas from Shah Deniz gas field. Beyond the targeted impact, when complete, the project will help diversify Europe's energy sources and contribute to the development of a multi-seller, multi-buyer market.

4. **Outputs and beneficiaries.** The project's outputs are: (i) Shah Deniz-II natural gas production and processing facility under construction, (ii) greater efficiency in gas sector, and (iii) jobs created during construction and operations. ADB's PCG will help SGC secure financing and the project making progress with: (i) construction of two new bridge-linked oil platforms, (ii) drilling of 26 new subsea wells, (iii) construction of a new 500-kilometer subsea pipeline network, (iv) consolidation of government's interests in Shah Deniz within a single entity, and (v) creation of over 19,000 temporary and 1,800 permanent local jobs during construction and operation of Shah Deniz-II, respectively. At least 15% of the permanent local jobs are expected to be for women.

## II. IMPLEMENTATION PLANS

### A. Project Readiness Activities

**Table 1a: Processing Schedule (original)**[illegible]

ADB = Asian Development Bank, CGIA = counter-guarantee and indemnity agreement, MOF = Ministry of Finance, MOJ = Ministry of Justice, PCG= partial credit guarantee, SGC = Southern Gas Corridor Closed Joint-Stock Company.

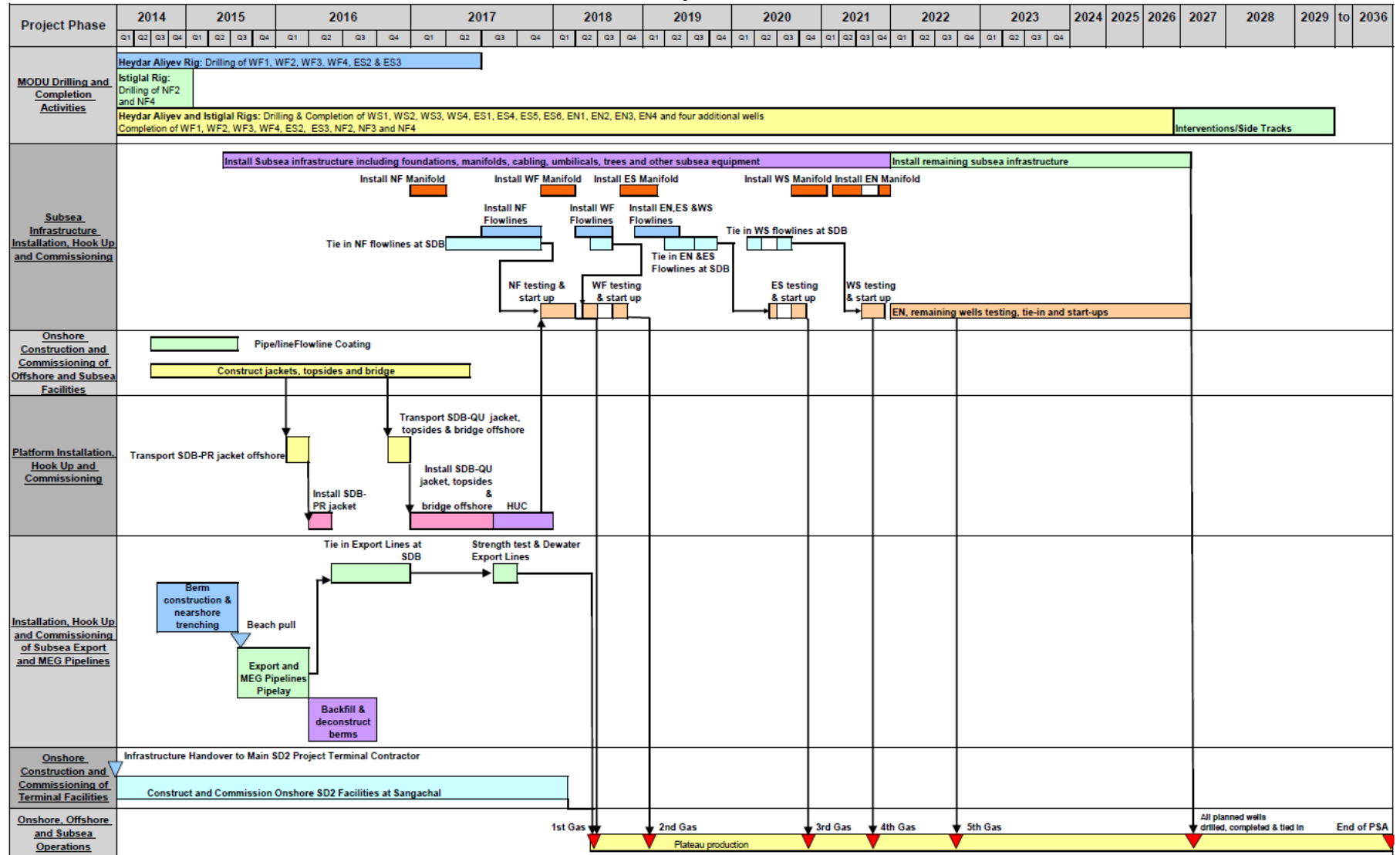
**Table 1b: Processing Schedule (as updated in August 2018)**

Indicative actions	2016			2017			2018												Agency Responsible
	10	11	12	1	- -	12	1	2	3	4	5	6	7	8	9	10	11	12	
PCG and CGIA negotiations	X																		ADB, MOF, SGC, Commercial Banks, Facility Agent
ADB Board consideration			X																ADB
PCG and CGIA signing						X													ADB, MOF, SGC, Commercial Banks, Facility Agent
Sovereign Guarantee signing						X													MOF, MOJ, Commercial Banks
Commercial Loan Agreement Signing						X													Commercial Banks, Facility Agent, SGC
PCG and CGIA effectiveness										X									Commercial Banks, Facility Agent, SGC, ADB, MOF
Sovereign Guarantee effectiveness										X									Commercial Banks, Facility Agent, MOF
Commercial Loan Agreement effectiveness										X									Commercial Banks, Facility Agent, SGC

ADB = Asian Development Bank, CGIA = counter-guarantee and indemnity agreement, Commercial Banks = the lenders under the Facility, Facility Agent = Bank of New York Mellon, London Branch, MOF = Ministry of Finance, MOJ = Ministry of Justice, PCG= partial credit guarantee, SGC = Southern Gas Corridor Closed Joint-Stock Company.

## B. Overall Project Implementation Plan

**Table 2: Shah Deniz 2 Implementation Schedule**



Source: BP, Environmental and Social Impact Assessment for the Shah Deniz 2 Project

### III. PROJECT MANAGEMENT ARRANGEMENTS

#### A. Project Implementation Organizations: Roles and Responsibilities

**Table 3: Management Roles and Responsibilities**

<b>Organizations</b>	<b>Management Roles and Responsibilities</b>
<ul style="list-style-type: none"> <li>Ministry of Finance (MOF) on behalf of the Republic of Azerbaijan (ROA)</li> </ul>	<ul style="list-style-type: none"> <li>Overall coordination of inter-government agencies</li> <li>Representative of Sovereign Guarantor to the sovereign guarantee given in favor of the Facility Agent, on behalf of the commercial lenders of the Facility and responsible for compliance with covenants, representations and warranties under the Sovereign Guarantee Agreement</li> <li>Representative of Sovereign Guarantor to the sovereign counter guarantee and indemnity given in favor of ADB and responsible for compliance with covenants, representations and warranties under the CGIA</li> </ul>
<ul style="list-style-type: none"> <li>Southern Gas Corridor Closed Joint-Stock Company (SGC)</li> </ul>	<p>Borrower and Executing Agency</p> <ul style="list-style-type: none"> <li>Project execution</li> <li>Ensuring loan proceeds are used in accordance with the Approved Purpose under the Facility Agreement</li> <li>Project progress reporting to ADB</li> <li>Meet conditions precedent to withdrawal which are applicable to it, comply with loan covenants, representations and warranties under the Facility Agreement.</li> </ul>
<ul style="list-style-type: none"> <li>[CONFIDENTIAL INFORMATION DELETED]</li> </ul>	
<ul style="list-style-type: none"> <li>[CONFIDENTIAL INFORMATION DELETED]</li> </ul>	
<ul style="list-style-type: none"> <li>The Bank of New York Mellon, London Branch</li> </ul>	<p>Facility Agent</p> <ul style="list-style-type: none"> <li>Administration of the Facility including conditions precedent to utilization, passing on information provided by SGC to the lenders and ADB, and other administrative requirements under the Facility Agreement, Sovereign Guarantee Agreement, PCG and CGIA</li> </ul>
<ul style="list-style-type: none"> <li>Deutsche Bank AG, London Branch</li> </ul>	<p>Lender and the original lender</p> <ul style="list-style-type: none"> <li>Provide the Commercial Loan to the Borrower as original lender</li> <li>Comply with covenants, representations and warranties under the PCG</li> </ul>
<ul style="list-style-type: none"> <li>Asian Development Bank (ADB)</li> </ul>	<p>Partial Credit Guarantor</p> <ul style="list-style-type: none"> <li>Provide partial credit guarantee in favor of the Facility Agent (acting on behalf of the commercial lenders) to cover the non-honoring of a sovereign obligation under the Sovereign Guarantee provided to support the commercial loan to SGC.</li> <li>Monitor and review overall implementation of the project in consultation with Executing Agency including: the project implementation schedule, actions required in terms of poverty</li> </ul>



reduction, environmental impacts, and resettlement plans (RPs), as applicable; timeliness of budgetary allocations and counterpart funding; project expenditures; statement of expenditure when applicable; compliance with particular loan, PCG and CGIA covenants; and the likelihood of attaining the project's immediate development objectives.

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## B. Key Persons Involved in Implementation

SGC (Executing Agency)	Officer's Name	Afgan Isayev
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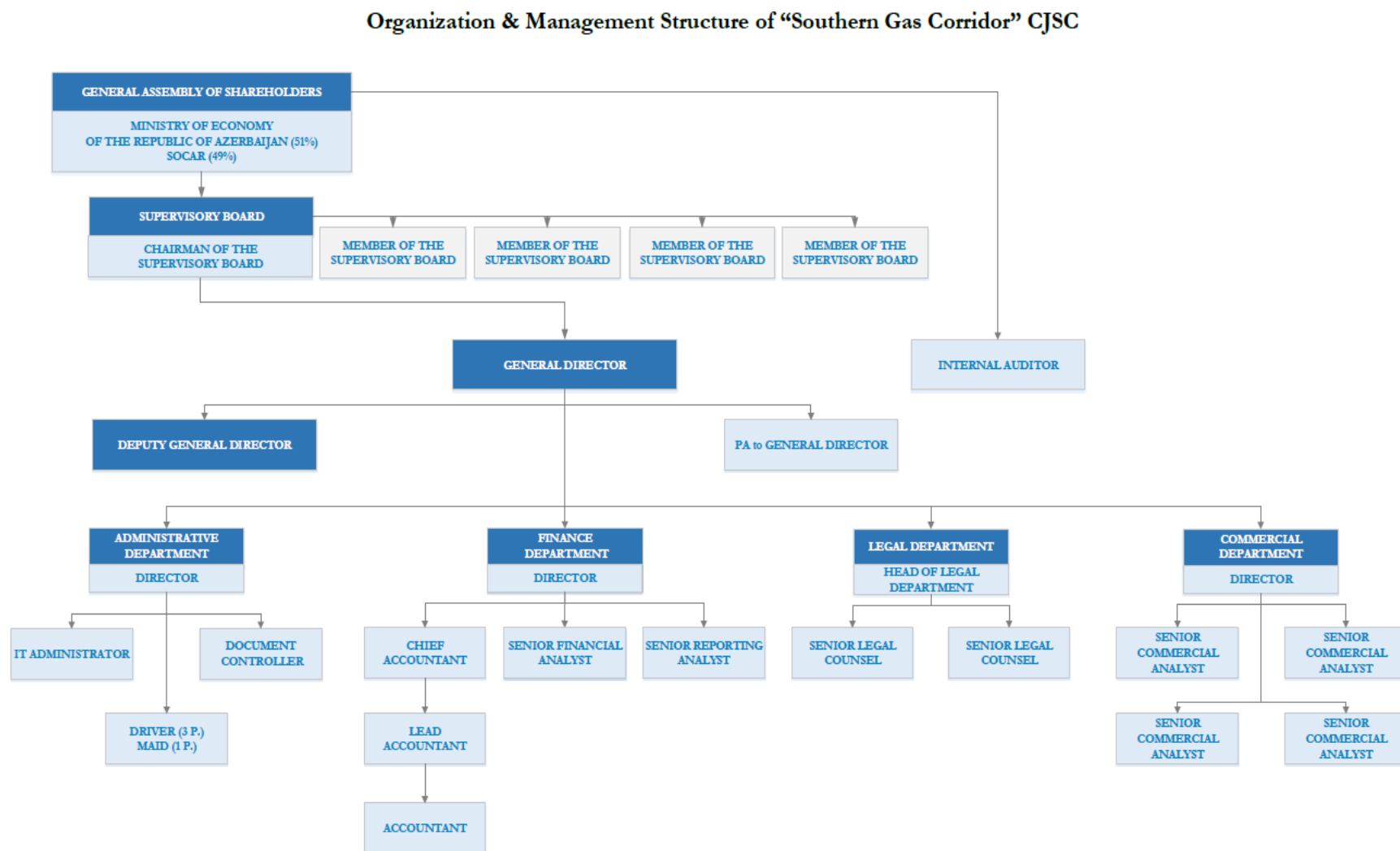
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## C. Project Organization Structure

5. SGC is a company dedicated to managing the Azerbaijan state's stakes in the projects of the Southern Gas Corridor. Its organizational structure acts as the project management structure.

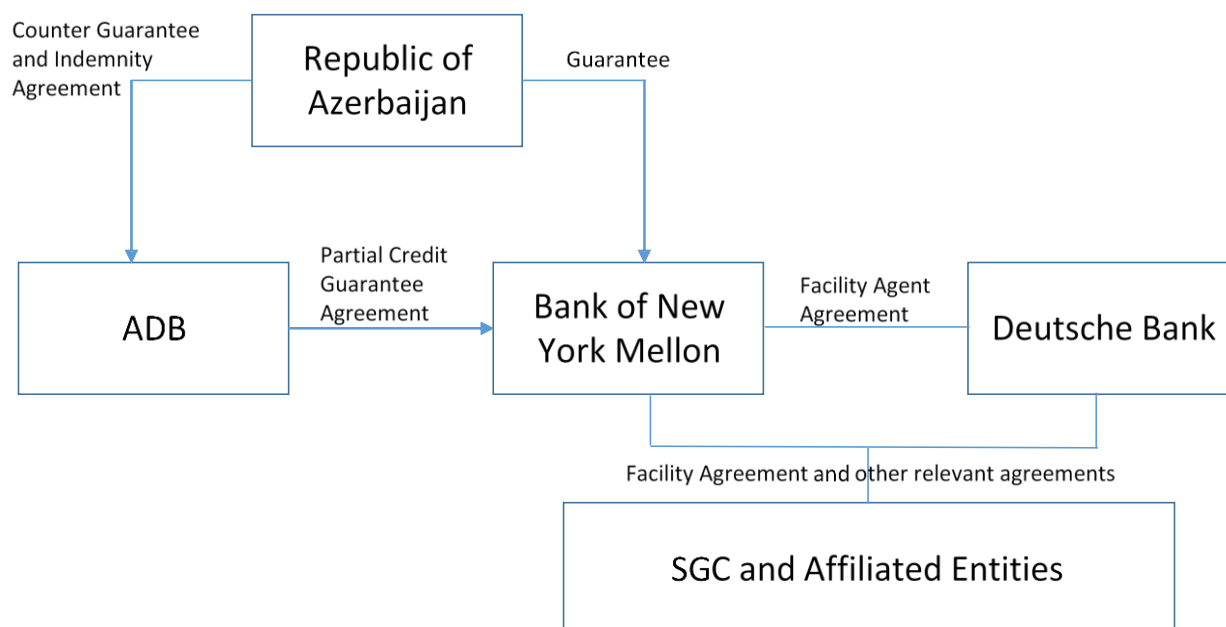
**Figure 1: Organization and management structure of Southern Gas Corridor Closed Joint Stock Company**



6. **Contractual structure of the financing.** The figure below shows the contractual structure of the transaction, which is further summarized as follows:

- The Facility Agreement was signed on 22 December 2017 by, amongst others, SGC (as Borrower and Obligor), Deutsche Bank AG, London Branch (as Original Lender) and The Bank of New York Mellon, London Branch (as Facility Agent);
- [CONFIDENTIAL INFORMATION DELETED]
- The Sovereign Guarantee was signed on 22 December 2017 by the Republic of Azerbaijan (ROA) and the Facility Agent under which ROA guaranteed payments to the commercial lenders under the Facility Agreement;
- The Partial Credit Guarantee Agreement was signed on 22 December 2017 by the Original Lender, the Facility Agent and ADB under which ADB provided a partial credit guarantee for the non-payment by ROA under the Sovereign Guarantee (non-honoring of a sovereign obligation);
- The Counter-Guarantee and Indemnity Agreement was signed on 22 December 2017 by ROA and ADB under which ROA agreed to indemnify ADB for amounts paid by ADB in respect of demands made under the PCG.

**Figure 2: Contractual structure of the ADB partial credit guarantee transaction**



#### **IV. COSTS AND FINANCING**

7. The overall Shah Deniz-II project cost estimates are prepared by the designated operator of the project, BP Exploration (Shah Deniz) (BPXSD). SGC estimates its cash requirements.

**Table 4:** [CONFIDENTIAL INFORMATION DELETED]

##### **A. Cost Estimates Preparation and Revisions**

8. Cost estimates for the whole of Shah Deniz-II project have been prepared by BPXSD as the operator of the project. Projections (forecasts) are updated regularly as the project progresses. Total project costs (Master Cost Estimates) are updated once or twice a year. The estimates of cash call and payment invoice requirements are prepared by SGC for its portion of the project cash requirements based on the cost estimates by the operator.

**B. Detailed Cost Estimates by Expenditure Category**

**Table 5:** [CONFIDENTIAL INFORMATION DELETED]

### C. ADB-Guaranteed Facility

9. During the Availability Period starting from the signing date of the Facility (22 December 2017), drawdowns (withdrawals) may be requested from time to time by SGC as the Borrower, through the Facility Agent, from the lenders for the Approved Purpose as specified in the Facility Agreement. [CONFIDENTIAL INFORMATION DELETED]

10. **Repayment.** The loan amount will be repaid by the Borrower to the lenders semi-annually in [CONFIDENTIAL INFORMATION DELETED] equal installments plus corresponding interest accrued on outstanding principal amounts [CONFIDENTIAL INFORMATION DELETED]. The interest payments will be made at the times and in the manner agreed in the Facility Agreement [CONFIDENTIAL INFORMATION DELETED].

### D. Guarantee Coverage and Fees

11. **Coverage.** The PCG will provide 95% in non-payment cover for up to \$524.5 million in principal, plus accrued regular interest, and guarantee fees. Following non-payment of principal and/or interest by the Borrower and, subsequently, MOF, the Facility Agent will submit a claim to ADB under the PCG. Upon assessment of the validity of such claim, ADB will make a guarantee payment to the lenders through the Facility Agent. ADB will charge guarantee and commitment fees<sup>1</sup> based on ADB's equivalent pricing for sovereign loans.<sup>2</sup>

12. Under the CGIA, ROA will indemnify ADB for any payments made, or any loss incurred, by ADB under the PCG.

13. **Fees.** For administration of guarantee and commitment fees, refer to Clause 8 of the PCG. There are three types of fees in relation to the administration of PCG fees: (i) front-end fee; (ii) guarantee fee; and (iii) commitment fee. The front-end fee was paid before the effective date of the PCG.

14. [CONFIDENTIAL INFORMATION DELETED]

15. [CONFIDENTIAL INFORMATION DELETED]

### E. Detailed Cost Estimates by Financier

16. Not applicable to this project.

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<sup>1</sup> For each interest period, the guarantee fees are calculated over the guaranteed percentage of the disbursed loan principal outstanding and the amount of interest payable during such period. Similarly, commitment fees are calculated over the difference between the amount of maximum aggregate liability under PCG and the guaranteed percentage of the disbursed loan principal outstanding. For ADB, administration of processes related to fees are managed by ADB's Controller's Office (CTL) and the Guarantees and Syndication Unit of ADB's Private Sector Operations Department (PSOD-GSU).

<sup>2</sup> Subject to ADB's Pricing and Credit Enhancement Committee (PCC) endorsement. This approval was obtained on 27 February 2017.

**F. Detailed Cost Estimates by Outputs and/or Components**

17. Not applicable to this project.

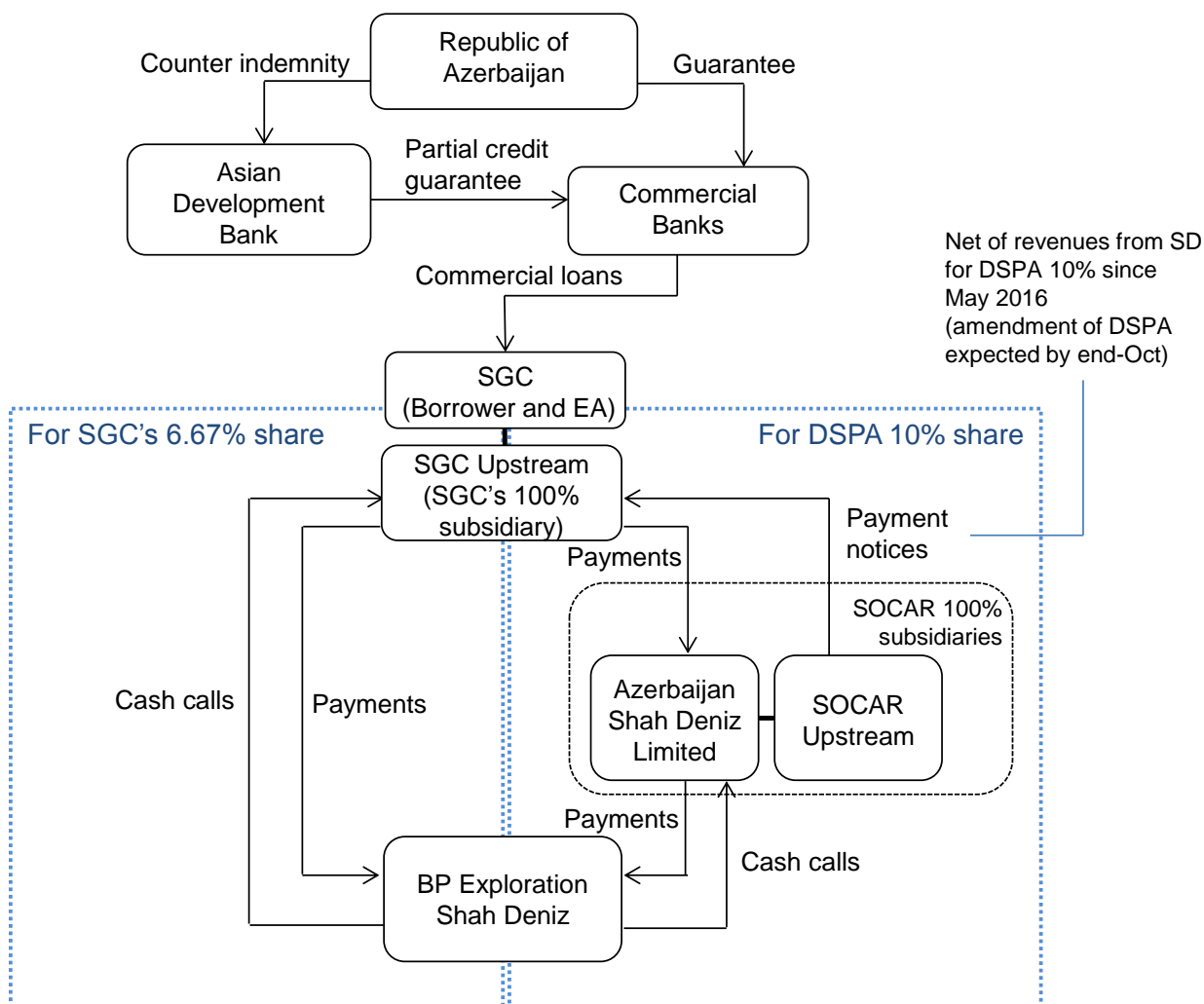


**G. Detailed Cost Estimates by Year****Table 7:** [CONFIDENTIAL INFORMATION DELETED]

## H. Contract Award and Disbursement S-Curve

18. Disbursement will be made according to the financing agreement between commercial lenders and SGC, and not applicable in PAM.

## I. Fund Flow Diagram



DSPA = deferred sale and purchase agreement, EA = executing agency, SD = Shah Deniz, SGC = Southern Gas Corridor Closed Joint-Stock Company, SOCAR = State Oil Company of Azerbaijan Republic.  
Source: Southern Gas Corridor Closed Joint-Stock Company and Asian Development Bank.

## V. FINANCIAL MANAGEMENT

### A. Financial Management Assessment

19. The financial management assessment (FMA) was conducted in September 2016 in accordance with ADB's Guidelines for the Financial Management and Analysis of Projects and the Financial Due Diligence: A Methodology Note. The FMA considered the capacity of the SGC, including funds-flow arrangements, staffing, accounting and financial reporting systems, financial information systems, and internal and external auditing arrangements.

20. SGC generally follows sound financial management principles. It has well documented financial management procedures and processes and appears to be adequately staffed by competent professionals. It is externally audited by internationally recognized firms and has not incurred any material audit qualifications since its incorporation in 2014.

21. The requirements and management of multi-billion-dollar cash calls for multiple projects is a challenge for SGC. SGC has centralized and efficient operations as a small entity of 24 staff as of September 2016 with a very focused mandate of managing investments in the pipelines and field development of the Southern Gas Corridor.<sup>3</sup> It also benefits from a well-structured management processes of the whole of Shah Deniz-II project. One of the world's leading oil and gas companies, BP, is the designated operator of the project through its subsidiary BPXSD, in charge of field development and operations. Technical verification of progress is conducted by SOCAR Upstream for SGC. SOCAR Upstream is a 100% subsidiary of the State Oil Company of Azerbaijan Republic (SOCAR), Azerbaijan's fully state-owned oil and gas company. Based on these multiple layers of verifications, SGC prepares financing and responds timely to cash calls. At the time of approval by the ADB Board of the PCG transaction loan to SGC, ADB identified that securing sufficient financing in a timely manner might have been the major challenge of SGC. However, as of the date of this updated version of the PAM, SGC has largely secured the financing that it requires and therefore has a comfortable financing position. SGC has been engaging an international financial advisory firm in preparing its financing plans and is procuring funds from the market and international financial institutions.<sup>4</sup>

22. At the time of approval by the ADB Board of the PCG transaction loan to SGC, ADB identified that the key financial management weakness might have been the absence of experience in executing a project funded by bilateral or multilateral development partners while a large portion of the financing is planned from ADB, the European Bank for Reconstruction and Development and the World Bank Group. At the time, SGC had recognized this issue and engaged with these multilateral partners early on to mitigate the potential delays of securing funds. The overall risk assessment by ADB at the time had been classified as "moderate." The challenge and risk of financial structuring had been partially addressed by SGC's engagement of a financial advisor. As of the date of this updated version of the PAM, however, SGC has secured financings from various sources, including from multilateral development institutions, such as European Bank for Reconstruction and Development and the World Bank Group and has gained a sound experience working with such institutions and therefore, ADB no longer perceives this as a key financial management weakness.

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<sup>3</sup> Southern Gas Corridor as an initiative consists of the full field development of Shah Deniz (Stage I and Stage II), SCPX, TANAP and TAP pipeline projects.

<sup>4</sup> Lazard Freres has been engaged as a financial advisor to SGC since 2014.

23. Table 8 summarizes the key financial management risks identified in the assessment.

**Table 8a: Risk Assessment and Management Plan (original)<sup>5</sup>**

<b>Risk Description</b>	<b>Risk Assessment</b>	<b>Mitigation Measures / Management Plan</b>
	<b>Assessment</b>	
<b>Inherent Risk</b>		
Country-Specific – External audit of public sector entities is effective and follow-up is comprehensive, however audit does not currently have sufficient coverage (only 30% of state expenditure is included) (from PEFA review in 2014).	Substantial	Through dialogue with the Government, ADB will request that public sector audit extends to power sector entities from 2016. <sup>6</sup>
Entity-Specific – SGC's financing needs are large and on-going. Internal processes are well established and documented, but securing large funding in a timely manner, especially working with international financial institutions' specific requirements will be a challenge for SGC.	Moderate	Financial and legal advisors have been engaged by SGC's own funding. Their resources will be kept available (an action plan item) to support SGC's management of cash requirements for its projects.
<b>Overall Inherent Risk</b>	<b>Moderate</b>	
<b>Control Risk</b>		
Internal Audit – SGC currently does not have an internal auditor but is in the process of recruiting one.	Moderate	SGC will speed up the process and recruit an internal auditor within 6 months of PCG agreement signing (an action plan item).  Internal auditor's mandates and manual are prepared and documented. Further, SGC has focused and rather straight-forward operations, the processes of which are well documented and followed.
Information Systems – although IT for financial management is strong and automated within each of SGC's project specific subsidiaries, the consolidation of accounts is conducted by Excel.	Moderate	All subsidiaries report in the same heading and format, facilitating the consolidation process by SGC. Further, external auditors will audit SGC's financial statements. SGC will also provide evidence of the use of proceeds to ADB through commercial lenders (copies of cash calls, payment notices from SOCAR Upstream, and bank transfer records).
<b>Overall Control Risk</b>	<b>Moderate</b>	
<b>Overall (Combined) Risk</b>	<b>Moderate</b>	

ADB = Asian Development Bank, IT = information technology, PEFA = public expenditure and financial accountability, PCG = partial credit guarantee, SGC = Southern Gas Corridor Closed Joint-Stock Company.

<sup>5</sup> All the references to present tense reflects the position as of the date of original PAM (2016).

<sup>6</sup> ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranchise Financing Facility for Power Distribution Enhancement Investment Program*. Manila.

**Table 8b: Risk Assessment and Management Plan (as updated in August 2018)**

<b>Risk Description</b>	<b>Risk Assessment</b>	<b>Mitigation Measures / Management Plan</b>
	<b>Assessment</b>	
<b>Inherent Risk</b>		
Country-Specific – External audit of public sector entities is effective and follow-up is comprehensive, however audit does not currently have sufficient coverage (only 30% of state expenditure is included) (from PEFA review in 2014).	Substantial	Through dialogue with the Government, ADB will request that public sector audit extends to power sector entities from 2016. Key power sector counterparts of ADB are externally audited.
Entity-Specific – SGC's financing needs are large and there are some remaining needs for securing financing.	Moderate	Financing is largely secured and remaining financing needs are rather limited. Given the track record of securing financing, the risk is no longer significant.
<b>Overall Inherent Risk</b>	<b>Moderate</b>	
<b>Control Risk</b>		
Information Systems – although IT for financial management is strong and automated within each of SGC's project specific subsidiaries, the consolidation of accounts is conducted by Excel.	Moderate	All subsidiaries report in the same heading and format, facilitating the consolidation process by SGC. Further, external auditors will audit SGC's financial statements. SGC will also provide evidence of the use of proceeds to ADB through commercial lenders (copies of cash calls, payment notices from SOCAR Upstream, and bank transfer records).
<b>Overall Control Risk</b>	<b>Moderate</b>	
<b>Overall (Combined) Risk</b>	<b>Moderate</b>	

ADB = Asian Development Bank, IT = information technology, PEFA = public expenditure and financial accountability, SGC = Southern Gas Corridor Closed Joint-Stock Company.

24. Based on this assessment, action plans to improve financial management capacity of SGC are the following.

**Table 9: Risk Action Plan (2016) and Status of Implementation of Actions (2018)**

<b>Action</b>	<b>Responsibility</b>	<b>Resources</b>	<b>Timing (T)/Result (R)</b>
Recruit an internal auditor.	SGC	SGC	T: Within 6 months from loan signing. R: SGC engaged internal auditor in late 2016.
Continued engagement of the financial advisor for updating its financing plans and procuring funds.	SGC	SGC	T: Monitored every 2 months up to the end of external debt raising process. R: Requirement to be fulfilled by the end of 2018.

SGC = Southern Gas Corridor Closed Joint-Stock Company.

**B. Disbursement (utilization)**

25. Proceeds from the ADB guaranteed commercial loans will be disbursed in accordance with the Facility Agreement. SGC as the Borrower may utilize the Facility for the Approved Purpose specified in the Facility Agreement by delivery to the Facility Agent of a Utilization Request in accordance with Clause 5 of the Facility Agreement.

26. [CONFIDENTIAL INFORMATION DELETED]

27. [CONFIDENTIAL INFORMATION DELETED]

28. [CONFIDENTIAL INFORMATION DELETED]

29. [CONFIDENTIAL INFORMATION DELETED]

30. Pursuant to ADB's Safeguard Policy Statement (2009) (SPS),<sup>7</sup> ADB-guaranteed funds may not be applied to the activities described on the ADB Prohibited Investment Activities List set forth at Appendix 5 of the SPS.

C. [CONFIDENTIAL INFORMATION DELETED]

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**D. Accounting**

40. SGC will prepare consolidated financial statements in accordance with the local accounting laws and regulations or with international accounting principles and practices.

**E. Auditing and Public Disclosure**

41. SGC will cause the consolidated company financial statements to be audited in accordance with International Standards on Auditing, by an independent and internationally recognized auditor, whose qualifications, experience and terms of reference have been evaluated

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<sup>7</sup> Available at: <https://www.adb.org/Documents/Policies/Safeguards&/Safeguard-Policy-Statement-June2009.pdf>.

by SGC.

42. The audited entity financial statements, together with the auditor's report will be submitted in the English language to ADB directly by SGC or through the Facility Agent at the times agreed in the Facility Agreement [CONFIDENTIAL INFORMATION DELETED].

43. [CONFIDENTIAL INFORMATION DELETED]

44. Compliance with financial reporting and auditing requirements will be monitored by review missions and during normal program supervision, and followed up regularly with all concerned, including the external auditor. [CONFIDENTIAL INFORMATION DELETED]

45. The Government and SGC have been made aware of ADB's approach to delayed submission for required reporting, and the requirements for satisfactory and acceptable quality of the audited company financial statements. While there will be no project specific audit reports as ADB's role is a guarantor and the Facility only finances SGC's cash call and progress payment requirements, SGC will be required to provide cash call statements, payment notice statements (as applicable) and proof of payment for the project cash calls and DSPA progress payments directly or indirectly to ADB to substantiate the intended use of proceeds of the ADB-guaranteed loans [CONFIDENTIAL INFORMATION DELETED].

#### **J. Provisions for Demands Under the PCG**

46. Following non-payment of principal and/or interest and/or PCG fees by the Borrower and subsequently by the ROA (represented by MOF), the Facility Agent may submit a Demand to ADB under the PCG. The conditions and procedures of making Demands, and ADB's determination and payment of such Demands are prescribed in Clause 4 of the PCG.

#### **K. Other Provisions of the Transaction**

47. [CONFIDENTIAL INFORMATION DELETED]

## VI. PROCUREMENT AND CONSULTING SERVICES

48. Consulting services will not be required under the Project. As the Facility will finance SGC's funding needs for its participation share in the Shah Deniz PSA, there are no specific procurement activities under the Project.

49. Advance Contracting and Retroactive Financing. There are no advance contracting activities applicable to the Project.

50. **Retroactive financing.** Retroactive financing is permitted for SGC's pro rata share in 2016 cash calls and Progress Payment Notices already paid by SGC subject to ADB's policies and procedures as specified in the Approved Purpose defined in the Facility Agreement.

## VII. SAFEGUARDS

51. **Environment.** In compliance with ADB's Safeguard Policy Statement (2009) (SPS), the project is classified category A for environment. Potential environmental impacts of the project have been identified by the environmental and social impact assessment (ESIA) conducted for the project, and effective measures to avoid, minimize, mitigate, and compensate for the adverse impacts are incorporated in the environmental management plan in the ESIA. Furthermore, as required by SPS an environmental and social compliance audit for the existing facilities of stage I of the project (Shah Deniz-I) and ongoing construction activities as part of stage II expansion of the gas field (Shah Deniz-II) was carried out. The audit did not find any non-compliance of ADB policies associated with the ongoing construction activities, and no corrective action plan is needed. The institutional capacity and commitment of the borrower to cause the operator to manage the project's social and environmental impacts are deemed adequate.

52. The ESIA indicates that construction impacts are minimal, with fish having previously demonstrated avoidance behaviors. Fishing is the dominant threat to fish populations in the Caspian Sea. Existing fish population monitoring programs established for Shah Deniz-I are satisfactory to ADB and will continue. The contract area may have some overlap with Caspian seal migration pathways. BP engages with and provides support to the Caspian Sea conservation programs, which provide a whole-of-sea approach to seal conservation. BP has in place an ecological and wildlife management plan. The Borrower will be required to procure, to the extent possible under the relevant project agreements, that the operator implements the project in compliance with the relevant plans and ADB's SPS requirements.

53. **Involuntary resettlement:** The project is classified as category B for resettlement impacts. In line with ADB's Safeguard Policy Statement (2009) requirements for financing of existing facilities, an environmental and social compliance audit for the existing facilities of Shah Deniz-I and ongoing construction activities as part of Shah Deniz-II was carried out. The audit did not find any non-compliance of ADB policies associated with the past and ongoing construction activities. All lands required for siting the project facilities are government lands and have been transferred to the operator by SOCAR. No outstanding issues with respect to usage of the lands required for the project components exist. Furthermore, additional land acquisition or physical displacement impacts are not expected.

54. On the other hand, the audit confirmed that the livelihoods of 48 fishermen carrying out small scale fishing at the Sangachal bay have been affected for a period of 10.5 months (starting December 2014) due to the enforcement of marine exclusion zone for the installation of pipelines. A Fishing Livelihood Management Plan (FLMP) was prepared to address the economic



displacement impacts in consultation with the 48 affected fishermen. While the entitlements under the FLMP have been fully paid to the affected persons, compensation for additional impacts due to increased transportation costs (reported by 6 of the 48 affected fishermen) are being finalized by the Operator, in consultation with the affected persons. The Operator will carry out monitoring of the implementation of the FLMP and prepare a closure report of FLMP implementation once all residual grievances are satisfactorily addressed.

55. **Indigenous people.** The project has been classified as Category C on indigenous peoples following ADB's Safeguard Policy Statement, 2009 (SPS). The Project is not expected to impact any distinct and vulnerable group of indigenous peoples as defined under SPS.

### VIII. GENDER AND SOCIAL DIMENSIONS

56. The project will (i) provide revenues to support non-resource sector developments, (ii) modernize the oil and gas sector, (iii) promote efficient use of energy resources, and (iv) increase sector operation efficiency. Consultations carried out reveal the people's basic concern over the lack of employment opportunities, exacerbated by the lack of adequate skills to be employed in the recent development in the area. The community engagement plan and workforce management plan developed for the project recognizes the following key social issues in engagement efforts with the communities: (i) potential for influx issues, (ii) the need to enlarge the contractors' existing workforce significantly, (iii) proximity to vulnerable communities, and (iv) communities' expectations. In line with these issues, targets for recruitment from named communities were included in the construction contracts.

57. The project is categorized as 'No Gender Elements.' Women are not expected to directly benefit from the project as far as employment is concerned. The status of women—in relation to their employment status, level of maximum education attained, and participation in society—was discussed during women's focus groups held in each community. The socioeconomic surveys indicated a lesser likelihood of women being employed (19%) in the project compared with men (79%). Women were also less likely to be interested in undertaking technical training than men. In 2012, women's employment in the energy sector was only 15%. While job vacancies are generally lacking locally, particularly fewer opportunities are (perceived to be) suitable for women. While women are the primary users of energy in the home, making them more vulnerable to risks related to fluctuating energy supply and use, men continue to make the major decisions on sources and types of energy to use. Irregular power supply has a particularly negative impact on the elderly and women in rural or remote areas. Women lack information on efficient energy use. And despite the high-income potential, the energy sector had no female private entrepreneurs in 2010.

58. The project is expected to directly benefit community members in the command areas who can avail of jobs through the project. Individuals included in the socioeconomic survey, who had previously worked on contracts with BP, consistently reported positive experiences—particularly in terms of increasing their household income, developing their skills, and improving future career prospects. To maximize benefits to the local population and address the key poverty issues associated with lack of employment opportunities, the project will encourage contractors to prioritize the recruitment of qualified local community members. Trainings on construction related jobs will be conducted before and during employment.

## IX. PERFORMANCE MONITORING, EVALUATION, REPORTING, AND COMMUNICATION

### A. Project Design and Monitoring Framework

#### DESIGN AND MONITORING FRAMEWORK

##### Impact the Project is Aligned with

Sustained revenues from oil and gas exports that will facilitate diversification of the country's economy  
(Source: Azerbaijan 2020: Look into the Future)

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
<b>Outcome</b>  Increased production and exports of gas from Shah Deniz gas field	Volume of annual peak gas production from the Shah Deniz gas field (SD1 and SD2) of 26 bcm per annum achieved by 2022 (2015 baseline: 9.8 bcm per annum)	BPXSD's annual progress report	Full operations of Shah Deniz-II delayed  Pipeline projects are not completed as planned
<b>Outputs</b>  1. Shah Deniz-II natural gas production and processing facility under construction.  2. Greater efficiency in gas sector	1a. Progress in construction of two new bridge-linked offshore platforms to be commissioned by 2020 (2015 baseline: 0) 1b. Progress in drilling of 26 new subsea wells to be operational by 2020 (2016 baseline: 10) 1c. Progress in construction of 500 km of new subsea pipeline to be completed by mid-2020 (2015 baseline: 0 km)  2a. Progress in consolidation of government's interests in Shah Deniz within a single entity (2016 baseline: Government interests represented by SOCAR and SGC)	1a-c. BPXSD's annual progress report.  2a. SGC annual financial reports	Unanticipated technical challenges during drilling of wells.  Complex structure of contracts that involve many subcontractors and joint ventures leads to delays in project implementation and/or technical or safety problems during construction.  Limited experience working with multilateral financing institutions while relying substantially on such financing, leads to delay in securing financing. <sup>8</sup>

<sup>8</sup> See para 21 and 22 for current assessment of this risk.

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting	Risks
3. Jobs created during construction and operations	3a. Creation of over 19,000 temporary jobs during construction (2014–2020) (2015 baseline: 16,000) and 1,800 permanent local jobs (15% of which are expected to be for women) during operation of Shah Deniz-II by 2022 (2016 baseline: 0)	3a. BPXSD's environment and social safeguard monitoring report	
<b>Key Activities with Milestones</b> <ol style="list-style-type: none"> <li>1. Commercial loan signing, counter-guarantee and indemnity execution, and ADB PCG execution (December 2016)</li> <li>2. Satisfaction or waivers of conditions precedent for disbursements (December 2016)</li> <li>3. Disbursement December 2016 to December 2017<sup>a</sup></li> <li>4. Continued payments of cash calls by SGC to meet participation requirements until December 2017<sup>a</sup></li> </ol>			
<b>Inputs</b> <p>ADB PCG-covered commercial loan: \$526.0 million (utilizing OCR counter-guaranteed by the Republic of Azerbaijan)<sup>b</sup></p> <p>ADB: \$500.0 million nonsovereign loan <sup>c</sup></p> <p>Commercial Financing: \$1,141.0 million</p> <p>SGC's equity and bond financing: \$2,648.0 million</p>			
<b>Assumptions for Partner Financing</b> <p>Not Applicable</p>			

ADB = Asian Development Bank, bcm = billion cubic meters, km = kilometer, PCG = Partial Credit Guarantee, Shah Deniz-II = Shah Deniz Stage II, SGC = Southern Gas Corridor Closed Joint-Stock Company, SOCAR = State Oil Company of Azerbaijan Republic.

<sup>a</sup> Should SGC's actual 2016 and 2017 financing needs be lower than currently estimated, SGC may use any undrawn principal amounts under the ADB-guaranteed commercial loan to its 2018 financing needs, resulting in potential disbursements and cash call payments in 2018.

<sup>b</sup> This value may be reduced if cofinancing or other sources of funding can be obtained. Principal amount based on 95% coverage.

<sup>c</sup> ADB's Private Sector Operations Department is also considering the provision of financing up to \$500 million.

Source: Asian Development Bank.

## B. Monitoring

59. **Project performance monitoring.** The Project's performance will be monitored through preparation of the development effectiveness report based on the Project's design and monitoring framework above (as in Clause 22.15 of the Facility Agreement and as in the "Reporting" section below of this manual).

60. **Compliance monitoring.** The Borrower will ensure that the project is undertaken, and that all project facilities are designed, implemented, operated, and maintained, in accordance with the applicable laws and regulations of the Government of Azerbaijan and the ESIA.

61. Loan covenants — policy, legal, environmental, and others — will be monitored through semi-annual project reviews and the midterm review.

62. **Safeguards monitoring.** Monitoring (and reporting) requirements on safeguards are prescribed in Clause 22.9 of the Facility Agreement [CONFIDENTIAL INFORMATION DELETED].

63. **Gender and social dimensions monitoring.** The project is categorized as “No Gender Elements”. On social dimensions regarding labor, general compliance will be monitored through safeguards monitoring and the project’s output indicators related to labor in the design monitoring framework will be monitored through preparation of the development effectiveness report.

## C. Evaluation

64. **Inception mission.** ADB will field an inception mission after PCG transaction signing to (i) establish a working relationship between ADB, government and SGC; and (ii) to ensure that the government and SGC understand ADB's procedures.

65. **Review missions.** ADB will field annual review missions to review overall implementation of the project and update project implementation schedule based on mission findings.

66. **Project completion reporting and review.** ADB will prepare a project completion report or an extended annual review report based on SGC’s quarterly and annual reports.

## D. Reporting

67. As part of the conditions precedent to the effectiveness of the Facility, all required project related documents and transaction related documents have been submitted by the Borrower to the Facility Agent and to ADB where applicable (see Clause 4 and Schedule 2 of the Facility Agreement).

68. SGC will provide the Facility Agent (and the latter will provide to ADB) with annual development effectiveness report within 45 days after the end of each financial year. The form of the development effectiveness monitoring report is attached to the Facility Agreement (see Clause 22.15 and Schedule 9 of the Facility Agreement). To ensure that projects will continue to be both viable and sustainable, the executing agency’s audited financial statement together with the associated auditor's report, should be adequately reviewed by ADB.

69. [CONFIDENTIAL INFORMATION DELETED]

70. [CONFIDENTIAL INFORMATION DELETED]

71. Each Obligor shall also provide the environmental and social consultant with information in respect of the project as such consultant may reasonably request (Clause 20.6 of the Facility Agreement).

72. [CONFIDENTIAL INFORMATION DELETED]

73. Documents related to these information and reporting requirements of the Borrower may be submitted to the Facility Agent and/or ADB, using the virtual data room specified in the Facility Agreement (Clause 21).

## E. Stakeholder Communication Strategy

74. The following table outlines the framework of communication strategy to be adopted for

the project.

<b>Project Documents*</b>	<b>Means of Communication *</b>	<b>Responsible Party</b>	<b>Frequency</b>
Project Information Documents (PID)	ADB website	ADB	Initial PID no later than 30 calendar days of approval of the concept paper, quarterly afterwards.
Design and Monitoring Framework (DMF)	ADB's website	ADB	Draft DMF after post fact-finding mission
Environment and Social Impact Assessment	ADB's website	ADB	At least 120 days before Board consideration
Resettlement Planning Documents	ADB's website	ADB	Post fact-finding mission
Report and Recommendations of the President	ADB's website	ADB	Within 2 weeks of Board approval of the loan
Sovereign counter indemnity	ADB's website	ADB	No later than 14 days of approval of the project.
Initial Poverty and Social Assessment	ADB's website	ADB	Within 2 weeks of completion
Project Administration Manual	ADB's website	ADB	After loan negotiations
Social and Environmental Monitoring Reports	ADB's website	ADB	Routinely disclosed, no specific requirements
Major Change in Scope	ADB's website	ADB	Within 2 weeks of approval of the change
Progress Reports	ADB's website	ADB	Within 2 weeks of circulation to Board or Management approval
Completion Report or Extended Annual Review Report (as applicable and prepared by ADB based on annual progress reports).	ADB's website	ADB	Within 2 weeks of circulation to Board for information
Evaluation Reports	ADB's website	ADB	Routinely disclosed, no specific requirements

ADB = Asian Development Bank, DMF = design and monitoring framework, PID = project information documents.

\* Subject to exception to presumed disclosure under ADB's Public Communications Policy para. 97 to 101 as applicable, taking into account any confidentiality undertaking existing between the Southern Gas Corridor Closed Joint-Stock Company and ADB.

## **X. ANTICORRUPTION POLICY**

75. As acknowledged at the time of ADB Board approval for the PCG by the government of Azerbaijan and SGC, the Facility Agreement and other agreements for this transaction include undertakings arising from ADB policy requirements pursuant to ADB's Anticorruption Policy with

respect to the project including those concerning prohibition of corruption, money laundering, and financing of terrorism.<sup>9</sup>

## **XI. ACCOUNTABILITY MECHANISM**

76. People who are, or may in the future be, adversely affected by the project may submit complaints to ADB's Accountability Mechanism. The Accountability Mechanism provides an independent forum and process whereby people adversely affected by ADB-assisted projects can voice, and seek a resolution of their problems, as well as report alleged violations of ADB's operational policies and procedures. Before submitting a complaint to the Accountability Mechanism, affected people should make an effort in good faith to solve their problems by working with the concerned ADB operations department. Only after doing that, and if they are still dissatisfied, should they approach the Accountability Mechanism.<sup>10</sup>

## **XII. RECORD OF CHANGES TO THE PROJECT ADMINISTRATION MANUAL**

77. All revisions/updates during course of implementation are retained in this Section to provide a chronological history of changes to implementation arrangements recorded in the PAM.

<b>Date</b>	<b>Changes made to the Project Administration Manual</b>
June 2018	Overall updates based on the Execution Copies of the Transaction Agreements.

<sup>9</sup> ADB's Integrity Office web site: <http://www.adb.org/integrity/unit.asp>

<sup>10</sup> Accountability Mechanism. <http://www.adb.org/Accountability-Mechanism/default.asp>.