Project Agreement

(Additional Financing for the Espírito Santo Water and Coastal Pollution Management Project - Programa de Gerenciamento da Poluição Costeira e de Águas do Espírito Santo – Projeto Águas Limpas II)

between

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

and

COMPANHIA ESPÍRITO SANTENSE DE SANEAMENTO

Dated September 17, 2009
PROJECT AGREEMENT

Agreement dated September 17, 2009, entered into between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT ("Bank") and COMPANHIA ESPÍRITO SANTENSE DE SANEAMENTO – CESAN ("Project Implementing Entity") in connection with the Loan Agreement ("Loan Agreement") of same date between STATE OF ESPÍRITO SANTO ("Borrower") and the Bank. The Bank and the Project Implementing Entity hereby agree as follows:

ARTICLE I — GENERAL CONDITIONS; DEFINITIONS

1.01. The General Conditions (as defined in the Appendix to the Loan Agreement) constitute an integral part of this Agreement.

1.02. Unless the context requires otherwise, the capitalized terms used in this Agreement have the meanings ascribed to them in the Loan Agreement or the General Conditions.

ARTICLE II — PROJECT

2.01. The Project Implementing Entity declares its commitment to the objectives of the Project. To this end, the Project Implementing Entity shall carry out Parts B, C, D and E of the Project in accordance with the provisions of Article V of the General Conditions, and shall provide promptly as needed, the funds, facilities, services and other resources required for its Respective Parts of the Project.

2.02. Without limitation upon the provisions of Section 2.01 of this Agreement, and except as the Bank and the Project Implementing Entity shall otherwise agree, the Project Implementing Entity shall carry out its Respective Parts of the Project in accordance with the provisions of the Schedule to this Agreement.

ARTICLE III — REPRESENTATIVE; ADDRESSES

3.01. The Project Implementing Entity’s Representative is the President of the Project Implementing Entity.

3.02. The Bank’s Address is:

International Bank for Reconstruction and Development
1818 H Street, NW
Washington, DC 20433
United States of America
3.03. The Project Implementing Entity’s Address is:

Companhia Espírito Santense de Saneamento
Avenida Governador Bley, 186
29010 Vitória, Espírito Santo
Brazil
Facsimile: (55-27) 2127-5121

With copy to:

Ministério do Planejamento, Orçamento e Gestão
SEAIN - Secretaria de Assuntos Internacionais
Esplanada dos Ministérios - Bloco K - 5º andar
70040-906 Brasília, DF
Brazil
Facsimile: (55-61) 3225-4022

Comitê Diretivo do Projeto
Secretaria de Desenvolvimento
Av. Nossa Senhora de Penha 714, Ed. RS Trade Tower, 3º andar,
Praia do Canto, Vitória
Espírito Santo
Brazil
Facsimile: (55-27) 3315-7318
AGREED at Vitória, Brazil, as of the day and year first above written.

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Makhtar Diop

Authorized Representative

COMPANHIA ESPÍRITO SANTENSE DE
SANEAMENTO

By /s/ Ricardo Maximiliano Goldschmidt

Authorized Representative

By /s/ Carlos Eduardo Fernandes Saleme

Authorized Representative
SCHEDULE

Execution of the Project Implementing Entity’s Respective Parts of the Project

Section I. Implementation Arrangements

A. Institutional Arrangements.

1. The Project Implementing Entity shall:

   (a) carry out Parts B, C, D and E of the Project, under the oversight supervision and guidance of the Project Steering Committee and the assistance of the PMU in accordance with the Operational Manual.

   (b) deposit, at the end of each month during the execution of the Project, such amounts as shall be necessary to maintain in the Counterpart Account a balance of: (a) two million five hundred thousand Brazilian Reais (R$2,500,000) in the Counterpart Account at the end of each month; or (b) up to six million Brazilian Reais (R$6,000,000) in the Counterpart Account at the end of each month of peak implementation activity under the Project, as it may be required by the Bank, by notice to, and after consulting with, the Borrower and the Project Implementing Entity.

   (c) The Project Implementing Entity shall carry out Parts C and D of the Project in accordance with the recommendations of the Environmental Management Plan and the Environmental Construction Manual, and the timetable set forth therein.

   (d) maintain the contract in accordance with the provisions of Section I of Schedule to this Agreement, of the project management consulting firm to assist the PMU in the management and supervision of the Project, and to provide support to the PMU and the Project Implementing Entity in administrative, technical and financial matters relating to the carrying out of the Project.

2. The Project Implementing Entity shall, at least twice a year, provide information, certified by independent auditors acceptable to the Bank and in a manner satisfactory to the Bank, to its staff and customers with respect to the quality of its services as measured by the Project Implementing Entity’s internal performance benchmarking system referred to in Part B (a) of the Project.

B. Anti-Corruption

The Project Implementing Entity shall ensure that its Respective Parts of the Project are carried out in accordance with the provisions of the Anti-Corruption Guidelines, provided, however, that the provisions of paragraph 10 (a) will not apply with respect to contractors which are parties to the Prior Loan Goods/Works Contracts.
C. Safeguards

The Project Implementing Entity shall carry out the Project in accordance with the Operational Manual, including the Environmental Management Plan, and the Environmental Construction Manual.

Section II. Project Monitoring, Reporting and Evaluation.

A. Project Reports

The Project Implementing Entity shall monitor and evaluate the progress of its Respective Parts of the Project and prepare Project Reports for its Respective Parts of the Project in accordance with the provisions of Section 5.08 (b) of the General Conditions and on the basis of the indicators set forth in the Operational Manual and agreed with the Bank. Each such Project Report shall cover the period of one calendar semester, and shall be furnished to the Borrower not later than two weeks after the end of the period covered by such report for incorporation and forwarding by the Borrower to the Bank of the overall Project Report.

B. Financial Management, Financial Reports and Audits

1. The Project Implementing Entity shall maintain a financial management system and prepare financial statements in accordance with consistently applied accounting standards acceptable to the Bank, both in a manner adequate to reflect the operations and financial condition of the Project Implementing Entity, including the operations, resources and expenditures related to its Respective Parts of the Project.

2. The Project Implementing Entity shall have its financial statements referred to above audited by independent auditors acceptable to the Bank, in accordance with consistently applied auditing standards acceptable to the Bank. Each audit of these financial statements shall cover the period of one fiscal year of the Project Implementing Entity. The audited financial statements for each period shall be furnished to the Borrower and the Bank not later than six months after the end of the period.

3. Except as the Bank shall otherwise agree, the Project Implementing Entity shall, during the carrying out of the Project, substantially achieve, in a manner acceptable to the Bank, the targets for the Project Implementing Entity’s working ratio set forth in the letter, dated December 2, 2008, from the Project Steering Committee to the Bank (Ofício No. 082/2008), provided, however, that in no case the Project Implementing Entity’s total operating expenses for each of its fiscal years during the carrying out of the Project shall exceed the equivalent of 85% of its total operating revenues for such fiscal year.

(a) Before October 31 in each of its fiscal years, the Project Implementing Entity shall, on the basis of forecasts prepared by the Project Implementing Entity and
satisfactory to the Bank, review whether it would meet the requirements set forth in paragraph (a) above in respect of such year and the next following fiscal year and shall furnish to the Bank the results of such review upon its completion.

(b) If any such review shows that the Project Implementing Entity would not meet the requirements set forth in paragraph (a) above for the Project Implementing Entity’s fiscal years covered by such review, the Project Implementing Entity shall promptly take all necessary measures (including, inter alia, adjustments of the structure or levels of its tariffs) in order to meet such requirements.

(c) For purposes of this Section:

(i) The term "total operating revenues" means revenues from all sources related to operations.

(ii) The term "total operating expenses" means all expenses related to operations (despesas de exploração), including administration, adequate maintenance, taxes and payments in lieu of taxes incurred in the generation of total operating revenues, and provision for bad debts (provisão para devedores duvidosos) and amortization of capitalized operating costs (amortizações de despesas), but excluding depreciation, and interest and other charges on debt.

4. (a) Except as the Bank shall otherwise agree, the Project Implementing Entity shall not, during the carrying out of the Project, incur any debt unless a reasonable forecast of the revenues and expenditures of the Project Implementing Entity shows that the estimated net revenues of the Project Implementing Entity for each fiscal year during the term of the debt to be incurred shall be at least 1.5 times the estimated debt service requirements of the Project Implementing Entity in such year on all debt of the Project Implementing Entity including the debt to be incurred.

(b) For the purposes of this Section:

(i) The term "debt" means any indebtedness of the Project Implementing Entity maturing by its terms more than one year after the date on which it is originally incurred.

(ii) Debt shall be deemed to be incurred: (A) under a loan contract or agreement or other instrument providing for such debt or for the modification of its terms of payment on the date of such contract, agreement or instrument; and (B) under a guarantee agreement, on the date the agreement providing for such guarantee has been entered into.
(iii) The term "net revenues" means the difference between: (A) the sum of revenues from all sources related to operations and net non-operating income; and (B) the sum of all expenses related to operations including administration, adequate maintenance, taxes and payments in lieu of taxes (including income taxes), but excluding provision for depreciation, other non-cash operating charges and interest and other charges on debt.

(iv) The term "debt service requirements" means the aggregate amount of repayments (including sinking fund payments, if any) of, and interest (other than capitalized interest) and other charges on, debt.

(v) The term "reasonable forecast" means a forecast prepared by the Project Implementing Entity not earlier than twelve months prior to the incurrence of the debt in question, which both the Bank and the Project Implementing Entity accept as reasonable and as to which the Bank has notified the Project Implementing Entity of its acceptability, provided that no event has occurred since such notification which has, or may reasonably be expected in the future to have, a material adverse effect on the financial condition or future operating results of the Project Implementing Entity.

(vi) The term "net non-operating income" means the difference between: (A) revenues from all sources other than those related to operations; and (B) expenses, including taxes and payments in lieu of taxes, incurred in the generation of the revenues referred to in (A) above.

(vii) Whenever it shall be necessary to value, in terms of the currency of the Guarantor, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is, at the time of such valuation, obtainable for the purposes of servicing such debt, or, in the absence of such rate, on the basis of a rate of exchange acceptable to the Bank.

5. The Project Implementing Entity shall, during the execution of the Project achieve, in a manner acceptable to the Bank, the targets set forth in the Operational Manual for the physical, operational, environmental and financial indicators specified in such letter, as such targets and indicators may be revised by the Project Implementing Entity with the agreement of the Bank.

Section III. Procurement

All goods, works and services required for the Project Implementing Entity’s Respective Parts of the Project and to be financed out of the proceeds of the Loan shall be procured in accordance with the provisions of Section III of Schedule 2 to the Loan Agreement.