Project Agreement

(Espírito Santo Water and Coastal Pollution Management Project – Projeto Águas Limpas)

between

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

and

COMPANHIA ESPÍRITO SANTENSE DE SANEAMENTO

Dated November 10, 2004
AGREEMENT, dated November 10, 2004, between the INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and COMPANHIA ESPÍRITO SANTENSE DE SANEAMENTO (CESAN).

WHEREAS by the Loan Agreement of even date herewith between the Bank and the State of Espírito Santo (the Borrower), the Bank has agreed to make available to the Borrower the amount of thirty-six million Dollars ($36,000,000), on the terms and conditions set forth in the Loan Agreement, but only on condition that CESAN agree to undertake such obligations toward the Bank as are set forth in this Agreement;

WHEREAS CESAN, in consideration of the Bank's entering into the Loan Agreement with the Borrower, has agreed to undertake the obligations set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

Definitions

Section 1.01. Unless the context otherwise requires, the several terms defined in the Loan Agreement and the General Conditions (as so defined) have the respective meanings therein set forth.

ARTICLE II

Execution of the Project

Section 2.01. (a) CESAN shall carry out Parts B, C, D and E of the Project, under the supervision and guidance of the Project Steering Committee and the assistance of the PMU, with due diligence and efficiency and in conformity with appropriate administrative, environmental, financial, technical and engineering practices and the provisions of the Operational Manual, and shall provide or cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the Project.
(b) Without limitation to the provisions of paragraph (a) above, CESAN shall, unless the Bank otherwise agrees, make an initial deposit in the Counterpart Account in the amount of two million five hundred thousand Brazilian reais (R$2,500,000), and thereafter shall deposit, at the end of each month during the execution of the Project, such amounts as shall be necessary to maintain 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 CESAN.

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

(d) CESAN shall employ, in accordance with the provisions of Section II of Schedule 4 to this Agreement, a project management consulting firm to assist the PMU in the management and supervision of the Project, and to provide support to the PMU and CESAN in administrative, technical and financial matters relating to the carrying out of the Project.

Section 2.02. Except as the Bank shall otherwise agree, procurement of the goods, works and consultants’ services required for the Project and to be financed out of the proceeds of the Loan shall be governed by the provisions of Schedule 4 to the Loan Agreement.

Section 2.03. CESAN shall carry out the obligations set forth in Sections 9.04, 9.05, 9.06, 9.07, 9.08 and 9.09 of the General Conditions (relating to insurance, use of goods and services, plans and schedules, records and reports, maintenance and land acquisition, respectively) in respect of Parts B, C, D and E of the Project.

Section 2.04. (a) CESAN shall, at the request of the Bank, exchange views with the Bank and the Project Steering Committee with regard to the progress of Parts B, C, D and E of the Project, the performance of its obligations under this Agreement, and other matters relating to the purposes of the Loan.

(b) CESAN shall promptly inform the Bank and the Project Steering Committee, of any condition which interferes or threatens to interfere with the progress of Parts B, C, D and E of the Project, the accomplishment of the purposes of the Loan, or the performance by CESAN of its obligations under this Agreement.

Section 2.05. CESAN shall:
(a) participate in the review referred to in Section 3.05 (c) of the Loan Agreement; and

(b) provide to the Borrower all assistance that the Borrower may require to comply with the Borrower’s obligations under the Loan Agreement.

Section 2.06. CESAN shall, at least twice a year, starting in July 2005, 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 CESAN’s internal performance benchmarking system referred to in Part B (a) of the Project.

ARTICLE III

Management and Operations of CESAN

Section 3.01. CESAN shall carry on its operations and conduct its affairs in accordance with sound administrative, financial, engineering, water supply, sanitation, public utility and environmental practices under the supervision of qualified and experienced management assisted by competent staff in adequate numbers.

Section 3.02. CESAN shall at all times operate and maintain its plant, machinery, equipment and other property, and from time to time, promptly as needed, make all necessary repairs and renewals thereof, all in accordance with sound engineering, financial and public utility practices.

Section 3.03. CESAN shall take out and maintain with responsible insurers, or make other provision satisfactory to the Bank for, insurance against such risks and in such amounts as shall be consistent with appropriate practice.

ARTICLE IV

Financial Covenants

Section 4.01. (a) CESAN shall maintain a financial management system, including records and accounts, and prepare financial statements in accordance with consistently applied accounting standards acceptable to the Bank, adequate to reflect its operations and financial condition and to register separately the operations, resources and expenditures related to the Project.
(b) CESAN shall:

(i) have its financial statements (balance sheets, statements of income and expenses and related statements) for each fiscal year (or other period agreed to by the Bank), audited, in accordance with consistently applied auditing standards acceptable to the Bank, by independent auditors acceptable to the Bank;

(ii) furnish to the Bank as soon as available, but in any case not later than six months after the end of each such year (or such other period agreed to by the Bank), (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year (or other period agreed to by the Bank), as so audited, and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to the Bank;

(iii) furnish to the Bank such other information concerning such records and accounts, and the audit of such financial statements, and concerning said auditors, as the Bank may from time to time reasonably request.

Section 4.02. (a) Except as the Bank shall otherwise agree, CESAN shall, during the carrying out of the Project, substantially achieve, in a manner acceptable to the Bank, the targets for CESAN's working ratio set forth in the letter, dated April 30, 2004, from the Project Steering Committee to the Bank (Ofício No. 010/2004), provided, however, that in no case CESAN'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.

(b) Before October 31 in each of its fiscal years, CESAN shall, on the basis of forecasts prepared by CESAN 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.

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

(d) 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.

Section 4.03. (a) Except as the Bank shall otherwise agree, CESAN shall not, during the carrying out of the Project, incur any debt unless a reasonable forecast of the revenues and expenditures of CESAN shows that the estimated net revenues of CESAN 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 CESAN in such year on all debt of CESAN including the debt to be incurred.

(b) For the purposes of this Section:

(i) The term "debt" means any indebtedness of CESAN 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 CESAN not earlier than twelve months prior to the incurrence of the debt in question, which both the Bank and CESAN accept as reasonable and as to which the Bank has notified CESAN 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 CESAN.

(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.

Section 4.04. CESAN shall, during the execution of the Project achieve, in a manner acceptable to the Bank, the targets set forth in the letter referred to in Section 4.02 (a) of this Agreement, for the physical, operational, environmental and financial indicators specified in such letter, as such targets and indicators may be revised by CESAN with the agreement of the Bank.

ARTICLE V

Effective Date; Termination; Cancellation and Suspension

Section 5.01. This Agreement shall come into force and effect on the date upon which the Loan Agreement becomes effective.
Section 5.02. This Agreement and all obligations of the Bank and of CESAN hereunder shall terminate on the date on which the Loan Agreement shall terminate in accordance with its terms, and the Bank shall promptly notify CESAN thereof.

Section 5.03. All the provisions of this Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the General Conditions.

ARTICLE VI

Miscellaneous Provisions

Section 6.01. Any notice or request required or permitted to be given or made under this Agreement and any agreement between the parties contemplated by this Agreement shall be in writing. Such notice or request shall be deemed to have been duly given or made when it shall be delivered by hand or by mail, telegram, cable, telex or facsimile to the party to which it is required or permitted to be given or made at such party’s address hereinafter specified or at such other address as such party shall have designated by notice to the party giving such notice or making such request. Deliveries made by facsimile transmission shall also be confirmed by mail. The addresses so specified are:

For the Bank:

International Bank for Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address: INTBAFRAD
Telex: 248423 (MCI) or 64145 (MCI)
Facsimile: (202) 477-6391
Section 6.02. Any action required or permitted to be taken, and any document required or permitted to be executed, under this Agreement on behalf of CESAN, may be taken or executed by the President of CESAN or such other person or persons as such President shall designate in writing, and such President shall furnish to the Bank sufficient evidence of the authority and the authenticated specimen signature of each such person.

Section 6.03. This Agreement may be executed in several counterparts, each of which shall be an original, and all collectively but one instrument.
IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in the city of Vitória, State of Espírito Santo, Brazil, as of the day and year first above written.

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Vinod Thomas
Authorized Representative

COMPANHIA ESPÍRITO SANTENSE DE SANEAMENTO

By /s/ Paulo Ruy Valim Carnelli
By /s/ Carlos Fernando Martinelli
Authorized Representatives