January 17, 2006

H.E. Huseyngulu Seyid oglu Bagirov  
Minister of Ecology and Natural Resources  
of the Republic of Azerbaijan.  
Baku, Republic of Azerbaijan

Re: Japanese Grant for Co-financing Rural Environment Project  
Grant Number TF054739

Excellency:

I am writing on behalf of the International Development Association (IDA) to indicate IDA’s agreement, as administrator of grant funds provided by Japan, to make a grant in an amount not exceeding two million seven hundred twenty thousand United States dollars ($2,720,000) (the Grant) to Republic of Azerbaijan (the Recipient).

The Grant is made in response to the Recipient's request for financial assistance and for the purposes and on the terms and conditions set forth in the Annex to this Letter Agreement. The Recipient represents, by confirming its agreement below, that it is authorized to contract and withdraw the Grant for the said purposes and on the said terms and conditions.

Please note that it is IDA’s policy to make publicly available this Letter Agreement and any information related thereto, after this Letter Agreement has become effective and the Recipient has given its consent to such disclosure. The Recipient, by countersigning this Letter Agreement, confirms its consent to such disclosure.

Please confirm your agreement with the foregoing, on behalf of the Recipient, by signing, dating, and returning to us the enclosed copy of this Letter Agreement. Upon receipt by IDA of the copy of this Letter Agreement countersigned by you, this Letter Agreement will become
effective following the countersignature and the date of effectiveness of the Development Credit Agreement of same date between the Recipient and IDA.

Very truly yours,

INTERNATIONAL DEVELOPMENT ASSOCIATION

By /s/ Saida R. Bagirli
Authorized Representative
South Caucasus Country Unit
Europe and Central Asia Region

AGREED:

REPUBLIC OF AZERBAIJAN

By: /s/ Huseyngulu Seyid oglu Bagirov

Name: H.E. Huseyngulu Seyid oglu Bagirov

Title: Minister of Ecology and Natural Resources

Date: January 17, 2006
ANNEX

Purposes, Terms, and Conditions of the Grant

1. Purposes and Activities

1.1. The purpose of the Grant is to provide co-financing of the Rural Environment Project (the Project), whose main objective is to improve biodiversity conservation and introduce more sustainable natural resource management and economic activities in two mountainous areas of Azerbaijan, to restore the ecological health and productivity of their natural forests and pastures. The activities (the Activities) for which the Grant is given are as follows:

(a) Establishment and Management of National Parks: Provision of technical assistance to support the establishment and build capacity for management of the Shah Dag National Park and the Ordubad National Park, including: (i) review and revision of National Park Policy and legislation, finalization of park boundaries and demarcation on the ground; biodiversity inventories and assessments; and preparation of detailed maps of forest and pastures; (ii) preparation and implementation of park zoning and management plans, design and supervision of infrastructure rehabilitation and construction, identify and prepare specifications for appropriate equipment ecological restoration and ecological monitoring; and (iii) educational and outreach campaigns for local communities and other partners about the importance of conservation and sustainable use of mountains’ ecosystems and biodiversity. These activities are estimated to cost $1,920,000 equivalent; and

(b) Rural Communities and Entrepreneurs: Provision of technical assistance to: (i) mobilize and assist rural communities to identify priority investments and prepare village-level investment plans; and (ii) provide business advisory services to local entrepreneurs to identify business opportunities and develop viable business plans, and administer a small grants program to support development of small and medium rural enterprises. These activities are estimated to cost $800,000 equivalent.

2. Implementation Generally

2.1. The Recipient, through the Ministry of Ecology and Natural Resources, shall: (a) carry out the Activities with due diligence and efficiency; (b) promptly provide the funds, facilities, services and other resources required for that purpose; (c) furnish all information covering the Activities and the use of the proceeds of the Grant as IDA shall reasonably request; (d) from time to time exchange views with IDA's representatives on the progress and results of the Activities; (e) take all necessary measures required to enable IDA to visit the territory of the Recipient for purposes related to the Grant; and (f) cause all goods and services financed out of the proceeds of the Grant to be used exclusively for the purposes of the Grant. Without limitation on the foregoing, the Recipient shall, if IDA shall so request, prepare and furnish to IDA promptly upon completion of the Activities a report, in form and substance satisfactory to IDA, on the results and impact of the Activities.

3. Procurement

3.1. Except as IDA shall otherwise agree, procurement of the services required for the carrying out of the Activities and to be financed out of the proceeds of the Grant shall be governed by the provisions of Attachment I to this Annex, as said provisions may be further elaborated in a procurement plan approved by IDA (the Procurement Plan), covering the initial eighteen (18) month (or longer) period of implementation of the Activities. The Recipient shall update the
Procurement Plan in accordance with guidelines acceptable to IDA, and furnish such update to IDA not later than twelve (12) months after the date of the preceding Procurement Plan, for IDA’s approval.

4. **Withdrawal of Grant Proceeds**

4.1. The amount of the Grant shall be credited to an account opened by the Bank on its books in the name of the Recipient (the Grant Account), and may be withdrawn therefrom by the Recipient in accordance with the provisions of this paragraph 4, to finance 100% of the reasonable cost of consultants’ services required for the Activities described in paragraph 1.1 and to be financed out of the proceeds of the Grant.

4.2. Notwithstanding the provisions of paragraph 4.1 above:

(a) No withdrawals shall be made from the Grant Account: (i) for payments made for expenditures prior to the date of signature of this Letter Agreement by IDA; and (ii) for the purpose of any payment to persons or entities if such payment, to IDA’s knowledge, is prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations;

(b) The Recipient may withdraw amounts of the Grant only to the extent that such amounts are available to IDA from Japan for the purposes of the Grant; and

(c) No withdrawals shall be made from the Grant Account after December 31, 2009, or such later date that IDA shall establish by notice to the Recipient (the Closing Date), provided that, except in special circumstances, the Closing Date shall not be extended beyond the expected date of Bank approval of financing for the Project. However, withdrawals may be made after the Closing Date for expenditures incurred prior to the Closing Date if the corresponding withdrawal application is received by IDA within four months after the Closing Date, after which time any amount of the Grant remaining unwithdrawn from the Grant Account shall be canceled.

4.3. When the Recipient shall desire to withdraw any amount from the Grant Account, it shall deliver to IDA a written application for withdrawal of such amount in the form specified by IDA. Withdrawal applications shall be: (a) signed on behalf of the Recipient by the Minister of Finance or such other person as he or she shall have authorized in writing; and (b) accompanied by such evidence in support of the application as IDA shall reasonably request. Authenticated specimen signatures of the person authorized to sign withdrawal applications shall be provided with the first application bearing his or her signature. Each withdrawal application for an amount of the Grant and its supporting evidence must be sufficient in form and substance to satisfy IDA that the Recipient is entitled to withdraw such amount from the Grant Account and that such amount is to be used in the carrying out of the Activities. IDA shall pay the amounts withdrawn by the Recipient from the Grant Account only to or on the order of the Recipient.

4.4. IDA may require withdrawals from the Grant Account to be made on the basis of statements of expenditure for expenditures under contracts for: (a) services of consulting firms costing less than $100,000 equivalent each; and (b) services of individual consultants costing less than $50,000 equivalent each, all under such terms and conditions as IDA shall specify by notice to the Recipient.

4.5. Withdrawals of the proceeds of the Grant shall be made in the currency of the Grant. IDA, at the Recipient’s request and acting as an agent of the Recipient, shall purchase with the currency of the Grant withdrawn from the Grant Account such currencies as shall be required to pay for expenditures to be financed out of the proceeds of the Grant. Whenever it shall be necessary, for the
purposes of this Letter Agreement, to determine the value of one currency in terms of another, such value shall be as reasonably determined by IDA.

4.6. To facilitate the carrying out of the Activities, the Recipient may open and maintain in U.S. Dollars a special deposit account (the Special Account) in a commercial bank on terms and conditions satisfactory to IDA, including appropriate protection against set-off, seizure or attachment. Deposits into, and payments out of, the Special Account shall be made in accordance with the provisions of Attachment II to this Annex.

5. Accounts and Audits

(a) The Recipient shall maintain or cause to be maintained a financial management system, including records and accounts, and prepare financial statements in accordance with consistently applied accounting standards acceptable to IDA, adequate to reflect the operations, resources and expenditures related to the Activities.

(b) The Recipient shall: (i) have the financial statements referred to in subparagraph (a) above for each such fiscal year (or other period agreed to by IDA), audited, in accordance with consistently applied auditing standards, acceptable to IDA, by independent auditors acceptable to IDA; (ii) furnish to IDA as soon as available, but in any case not later than six (6) months after the end of each such year (or such other period agreed to by IDA): (A) certified copies of the financial statements referred to in subparagraph (a) above for such year (or such other period agreed to by IDA), as so audited; and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to IDA; and (iii) furnish to IDA such other information concerning such records and accounts and the audit of such financial statements, and concerning said auditors, as IDA shall have reasonably requested.

(c) For all expenditures with respect to which withdrawals from the Grant Account were made on the basis of statements of expenditure, the Recipient shall: (i) retain, until at least one year after IDA has received the audit report for or covering the fiscal year in which the last withdrawal from the Grant Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures; (ii) enable IDA’s representatives to examine such records; and (iii) ensure that such statements of expenditure are included in the audit for each fiscal year, or other period agreed to by IDA, referred to in subparagraph (b) above.

6. Suspension and Cancellation

6.1. IDA may at any time, by notice to the Recipient, suspend the right of the Recipient to make further withdrawals from the Grant Account if any of the following events has occurred and is continuing: (a) the Recipient has failed to comply with any of its obligations herein specified; or (b) the right of the Recipient, or any other entity to which the International Bank for Reconstruction and Development (the Bank) has made a loan with the guarantee of the Recipient, to make withdrawals under any loan agreement with the Bank or any development credit, grant or financing agreement with IDA has been suspended.

6.2. IDA may, by written notice to the Recipient, terminate the right of the Recipient to make further withdrawals from the Grant Account: (a) at any time after the right of the Recipient to make withdrawals from the Grant Account has been suspended pursuant to the provisions of paragraph 6.1 above; or (b) if the Recipient shall has failed to take action, satisfactory to IDA, within six (6) months after the effective date of this Agreement, to carry out the Activities; (c) if IDA has decided, at any time after consultation with the Recipient, to withdraw its support to the Project; or (d) if the Credit or Project is cancelled or closed.
Attachment I

Procurement

Section I. General

A. All consultants’ services shall be procured in accordance with Sections I and IV of the “Guidelines: Selection and Employment of Consultants by World Bank Borrowers” dated May 2004 (the Consultant Guidelines), and with the provisions of this Attachment.

B. The capitalized terms used below in this Attachment to describe particular procurement methods or methods of review by IDA of particular contracts, have the meanings ascribed to them in the Consultant Guidelines.

Section II. Particular Methods of Procurement of Consultants’ Services

A. Quality- and Cost-based Selection. Except as otherwise provided in Part B of this Section, consultants’ services shall be procured under contracts awarded on the basis of Quality- and Cost-based Selection. For purposes of paragraph 2.7 of the Consultant Guidelines, the short list of consultants for services estimated to cost less than $100,000 equivalent per contract may comprise entirely national consultants.

B. Other Procedures

1. Selection Under a Fixed Budget. Services for assignments which IDA agrees meet the requirements of paragraph 3.5 of the Consultant Guidelines may be procured under contracts awarded on the basis of a Fixed Budget in accordance with the provisions of paragraphs 3.1 and 3.5 of the Consultant Guidelines.

2. Least-cost Selection. Services for assignments which IDA agrees meet the requirements of paragraph 3.6 of the Consultant Guidelines may be procured under contracts awarded on the basis of Least-cost Selection in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultant Guidelines.

3. Selection Based on Consultants’ Qualifications. Services estimated to cost less than $200,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1, 3.7 and 3.8 of the Consultant Guidelines.

4. Single Source Selection. Services for tasks in circumstances which meet the requirements of paragraph 3.10 of the Consultant Guidelines for Single Source Selection, may, with IDA’s prior agreement, be procured in accordance with the provisions of paragraphs 3.9 through 3.13 of the Consultant Guidelines.

5. Individual Consultants. Services for assignments that meet the requirements set forth in the first sentence of paragraph 5.1 of the Consultant Guidelines may be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.2 through 5.3 of the Consultant Guidelines. Under the circumstances described in paragraph 5.4 of the Consultant Guidelines, such contracts may be awarded to individual consultants on a sole-source basis, subject to prior approval of the Bank.
Section IV. Review by IDA of Procurement Decisions

The Procurement Plan referred to in paragraph 3.1 of this Letter Agreement shall set forth those contracts which shall be subject to IDA’s Prior Review, including the prior review of terms of reference for all consulting assignments. If the Procurement Plan provides for prior review of contracts for the employment of individual consultants, the report on the qualifications and experience of all evaluated candidates, the terms of reference and the terms of employment of the consultants shall be subject to prior approval by the Bank. All other contracts shall be subject to Post Review by IDA.
Attachment II

Special Account

1. For the purposes of this Attachment:
   
   (a) the term “eligible expenditures” means expenditures in respect of the reasonable cost of services required for the Activities and to be financed out of the proceeds of the Grant; and
   
   (b) the term “Authorized Allocation” means the amount of $250,000 to be withdrawn from the Grant Account and deposited into the Special Account pursuant to paragraph 3 (a) of this Attachment.

2. Payments out of the Special Account shall be made exclusively for eligible expenditures in accordance with the provisions of this Attachment.

3. After IDA has received evidence satisfactory to it that the Special Account has been duly opened, withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:
   
   (a) The Recipient shall furnish to IDA a request or requests for a deposit into the Special Account of an amount or amounts which do not exceed the aggregate amount of the Authorized Allocation. On the basis of such request or requests, IDA shall, on behalf of the Recipient, withdraw from the Grant Account and deposit into the Special Account such amount or amounts as the Recipient shall have requested.
   
   (b) (i) For replenishment of the Special Account, the Recipient shall furnish to IDA requests for deposits into the Special Account at such intervals as IDA shall specify.
   
   (ii) Prior to or at the time of each such request, the Recipient shall furnish to IDA the documents and other evidence required pursuant to paragraph 4 of this Attachment for the payment or payments in respect of which replenishment is requested. On the basis of each such request, IDA shall, on behalf of the Recipient, withdraw from the Grant Account and deposit into the Special Account such amount or amounts as the Recipient shall have requested.

4. For each payment made by the Recipient out of the Special Account, the Recipient shall, at such time as IDA shall reasonably request, furnish to IDA such documents and other evidence showing that such payment was made exclusively for eligible expenditures.

5. Notwithstanding the provisions of paragraph 3 of this Attachment, IDA shall not be required to make further deposits into the Special Account:
   
   (a) if, at any time, IDA shall have determined that all further withdrawals should be made by the Recipient directly from the Grant Account;
   
   (b) if the Recipient shall have failed to furnish to IDA, within the period of time specified in paragraph 5 (b) (ii) of the Annex to this Letter Agreement, any of the audit reports.
required to be furnished to IDA pursuant to said paragraph in respect of the audit of the records and accounts for the Special Account;

(c) if, at any time, IDA shall have notified the Recipient of its intention to suspend in whole or in part the right of the Recipient to make withdrawals from the Grant Account pursuant to the provisions of paragraph 6.1 of the Annex to this Letter Agreement; or

(d) once the total unwithdrawn amount of the Grant shall equal the equivalent of twice the amount of the Authorized Allocation.

Thereafter, withdrawals from the Grant Account of the remaining unwithdrawn amount of the Grant shall follow such procedures as IDA shall specify by notice to the Recipient. Such further withdrawals shall be made only after and to the extent that IDA shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for eligible expenditures.

6. (a) If IDA shall have determined at any time that any payment out of the Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Attachment; or (ii) was not justified by the evidence furnished to IDA, the Recipient shall, promptly upon notice from IDA: (A) provide such additional evidence as IDA may request; or (B) deposit into the Special Account (or, if IDA shall so request, refund to IDA) an amount equal to the amount of such payment or the portion thereof not so eligible or justified. Unless IDA shall otherwise agree, no further deposit by IDA into the Special Account shall be made until the Recipient has provided such evidence or made such deposit or refund, as the case may be.

(b) If IDA shall have determined at any time that any amount outstanding in the Special Account will not be required to cover further payments for eligible expenditures, the Recipient shall, promptly upon notice from IDA, refund to IDA such outstanding amount.