

**MILLENNIUM CHALLENGE
CORPORATION****[MCC FR 05-08]****Notice of Entering Into a Compact With
the Government of Honduras****AGENCY:** Millennium Challenge
Corporation.**ACTION:** Notice.

SUMMARY: In accordance with Section 610(b)(2) of the Millennium Challenge Act of 2003 (Pub. L. 108-199, Division D), the Millennium Challenge Corporation is publishing a detailed summary and text of the Millennium Challenge Compact between the United States of America, acting through the Millennium Challenge Corporation, and the Government of the Republic of

Honduras. Representatives of the United States Government and the Republic of Honduras executed the Compact documents on June 13, 2005.

Dated: June 17, 2005.

Maura E. Griffin,

*Acting General Counsel, Millennium
Challenge Corporation.*

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Millennium Challenge Corporation

Reducing Poverty Through Growth

Summary of the Millennium Challenge Compact with the Republic of Honduras

I. Introduction

Following the devastation of Hurricane Mitch in 1998 and the subsequent reconstruction effort, Honduras now enjoys a window of opportunity to capitalize on the democratic reforms begun in the 1980s, the economic liberalization of the 1990s, and increasing regional integration, trade liberalization and the promise of The Dominican Republic – Central America – United States Free Trade Agreement (“*DR-CAFTA*”). Honduras has begun to seize this opportunity and use its strategic location to generate economic growth, particularly in light manufacturing, non-traditional agriculture and tourism. However, as laid out in the country’s Poverty Reduction Strategy, Honduras needs to ensure that growth extends to the rural population by enhancing agricultural development and linking its large rural population to markets.

After considering feedback from the consultative process and the efforts of other donors, the GOH and MCC mutually agreed that the MCC Program will focus on alleviating two key impediments to economic growth: low agricultural productivity and high transportation costs. To address these two impediments, the Program will work to achieve the following two (“*Objectives*”):

- Increase the productivity and business skills of farmers who operate small- and medium-size farms and their employees (“*Agricultural Objective*”), and
- Reduce transportation costs between targeted production centers and national, regional and global markets (“*Transportation Objective*”).

There are strong synergies between the two Objectives. Reducing the cost of transporting inputs to the farm and crops to market will increase the impact of improvements in farmer productivity and business skills. The investment of \$215 million and achievement of these two Objectives will increase annual income by an estimated \$69 million by the end of the Compact. To accomplish these Objectives, the Program will undertake a **Rural Development Project** and a **Transportation Project**, as outlined below.

II. Program Activities, Costs and Performance

Program Costs (\$U.S. millions)		
Rural Development Project		72.2
1. Farmer Training and Development	27.4	
2. Farmer Access to Credit	13.8	
3. Farm to Market Roads	21.5	
4. Agricultural Public Goods Grant Facility	8.0	
5. Rural Development Project Management	1.5	
Transportation Project		125.7
1. Highway CA-5	96.4	
2. Secondary Roads	21.3	
3. Vehicle Weight Control	4.7	
4. Transportation Project Management	3.3	
Program Management and Oversight		17.1
1. Program Management Unit (PMU)	9.3	
2. Auditing	2.8	
3. Monitoring and Evaluation (in addition to PMU)	5.0	
TOTAL		215

A. Rural Development Project (\$72.2 million over 5 years)

Honduras enjoys a comparative advantage in horticulture given its rich growing conditions, year-long growing season, and close proximity to the U.S. market. Despite this advantage, Honduran farmers predominantly grow basic grains because horticultural crops require more sophisticated techniques and infrastructure for both their production and marketing. In addition, lack of access to credit makes it more difficult for farmers to meet the higher working capital requirements of horticultural crops, and poor transportation infrastructure increases the costs of getting crops to market and inputs to the farm gate.

Activities under this Project include:

1. Farmer Training and Development: Technical assistance in the production and marketing of high value horticultural crops;
2. Farmer Access to Credit: Technical assistance to financial institutions to strengthen credit risk assessment skills, loans to such institutions to improve the availability of funds for rural financial institutions, and expansion of the national lien registry system to improve the environment for asset-based lending;
3. Farm to Market Roads: Construction and improvement of feeder roads that connect farms to markets; and
4. Agricultural Public Goods Grant Facility: Support for the adaptation of global technological advances to local Honduran conditions and investments that improve the agricultural productivity of large groups of farmers (e.g., irrigation infrastructure, post-harvest facilities, watershed management, etc.).

Benefits: The Project will improve the business skills, productivity, market access and risk management practices of producers who operate small- and medium-size farms. This will result in higher incomes for the targeted farmers, their employees, and their communities and strengthen the capacity of those enterprises servicing horticultural production and trade.

B. *Transportation Project (\$125.7 million over 5 years)*

High transportation costs are a significant impediment to economic growth, particularly for agriculture and light manufacturing. Of particular importance for commercial activity is the Atlantic Corridor highway, which includes the Highway CA-5 linking the Atlantic port of Puerto Cortes to the major production and consumption centers in Honduras, El Salvador and Nicaragua. This road carries most of the country's import and export traffic and accounts for 23 percent of highway traffic volume. After more than 30 years of service, the road needs improvements as service levels have declined drastically on some stretches and road safety is poor. In addition, the lack of a system for controlling vehicle weights has contributed to the deterioration of roadways, increasing the cost of maintenance and reducing safety.

Activities under this Project include:

1. Highway CA-5: Improvement of two stretches of the Highway CA-5;
2. Secondary Roads: Upgrade of key secondary routes to improve the access of rural communities to markets; and
3. Weight Control System: Construction of an effective weight control system, and issuance of contracts to operate it effectively.

Benefits: This Project will reduce transportation costs and allow the economic development that has primarily occurred within the urban area of the Department of Cortes to expand to other parts of the country. This will help Honduras, Nicaragua and El Salvador fully realize the benefits of DR-CAFTA. The weight-control project will help to preserve the improved condition of the roads.

C. *Measuring Outcome and Impact (\$5 million)*

The purpose of the Monitoring and Evaluation (M&E) Plan is to provide information to MCA-Honduras (discussed in Section D below), MCC, and other interested parties on the pace of implementation, progress toward meeting the Objectives of each Project, and the impact on the Program Goal of increasing the incomes of beneficiaries.

Monitoring Plan: Indicators measuring the pace at which goods and services are delivered under a Project will be monitored to inform whether the implementation of Projects is progressing according to schedule. Other indicators will measure intermediate results to determine whether these delivered goods and services are having the intended effects. Finally, Program beneficiaries' income will be measured to inform the MCC of the final impact of the Program as well as inform the design of future Compacts and other donor programs. To measure the impact of the Program, the M&E Plan will require baseline data for each Indicator to provide a

comparison with data measured during and after the Program. Indicators will be disaggregated by gender, income level and age, to the extent practicable.

Measures of Success: The principal indicators are (i) at the overall Goal level, an increase in annual income of beneficiaries of \$69 million by the end of the Compact; (ii) for the Agriculture Project, an increase in number of farmers and number of hectares involved in harvesting new high value horticulture crops of 8,000 and 14,000, respectively; (iii) and for the Transportation Project, an increase in road use of 13 percent on main roads and 31 percent on secondary roads, with a decrease in freight costs on main roads of 9 percent.

Evaluation Plan: Evaluations will seek to understand and quantify the impact of the Program, including the channels through which the Projects make an impact. Data analysis will be carried out by MCA-Honduras, MCC and contracted entities unrelated to MCC or MCA-Honduras. The MCA-Honduras Program Management Unit ("**PMU**"), and in particular the Monitoring and Evaluation Coordinator therein, with approval from MCC, will be responsible for ensuring that all necessary data for evaluating impact is collected.

D. Program Management (\$9.3 million)

MCA-Honduras, a legal entity comprised of a Board of Directors ("**Board**") and the PMU, will be established to implement the Compact and is the entity ultimately responsible for Program success. The duties of MCA-Honduras will include program management, financial management and reporting, and coordination of monitoring and evaluation. The Board will be composed of five voting members, three of whom will be government ministers and two of whom will be selected from among the four observers to the Board who represent Honduran non-government organizations. The Board will have nine non-voting observers, eight of whom will be Honduran observers (i.e., four representatives from government ministries and four from non-government organizations)¹ and one observer from MCC. The PMU will be composed of full-time professional staff that will provide daily management of the entire MCC Program. In addition to having observer status on the MCA-Honduras Board, MCC will retain approval rights at a number of key decision points during implementation, including key steps in procurements, budgets for Project Activities, major re-disbursements and key personnel decisions.

The principles, rules, and procedures set out in the Honduran Organic Budget Law and the Honduran Budget Execution Law will govern the management of MCC funds, subject to certain exceptions to be documented in the Fiscal Accountability Plan to be developed by MCA-Honduras and agreed to by the MCC. Project managers and/or the PMU, as appropriate, will approve requests for payments from implementing entities; however, neither will have direct access to Program funds. As a check and balance on the PMU, the Ministry of Finance will serve as the fiscal agent and will be the sole signatory to the MCA-Honduras bank account into which MCC funds will be disbursed. This Ministry is in the process of developing a new integrated financial management system, which is scheduled to be fully operational on January 1, 2006. In the interim period, the Ministry of Finance has developed special procedures to handle MCA funds, and it plans to establish a dedicated group to handle MCC transactions.

¹ There will be four non-government organizations represented on the Board, two as voting members and two as observers. The four non-government organizations will rotate between observer and voting status.

FONADERS, a public sector entity within the Ministry of Agriculture, will serve as the Project Manager for the Rural Development Project. The Transportation Project Manager will be contracted out under a competitive international tender. Most major Program procurements will be administered by the relevant Project Manager. The PMU will also procure small to medium value goods and services. At key points in procurement, MCC and MCA-Honduras will have the right to offer a "no objection" to ensure proper procurement processes are followed. Procurements will be conducted in accordance with World Bank procurement standards, except as MCC and the GOH otherwise agree.

III. Assessment

A. *Economic Analysis*

The economic rate of return (ERR) for the Rural Development Project is estimated to be 21 percent, calculated as a weighted average of each component. The return to the Farmer Training and Development activity was estimated to be 36 percent based on actual crop profitability and projected project costs. The activities to improve access to credit were assumed to only benefit the farmers in the Farmer Training and Development activity, which underestimates the benefits from this activity. As specific activities for the public goods grants and rural roads will be determined over the course of the Project, their benefits were assumed to be the minimum required by their respective selection mechanisms, 15 percent for public goods grants and 12 percent for rural roads. The minimum required rate of return was based on the past performance of similar projects. If the selection criteria are adhered to for the roads and public goods, the observed return will likely exceed our ex-ante estimates.

The economic benefits from the Transportation Project derive both from the direct benefits of reduced transportation costs and from the stimulus to new investment from lower transport costs. The ERR for the Transportation Project is estimated to be 25 percent. This return is the weighted average of the returns for the three activities: Highway CA-5 (21 percent), Secondary Roads (40 percent), and Weight Control (25 percent).² The stimulation of new businesses and investments due to lower transport costs are more difficult to measure, but are likely to be an important part of the economic benefits. Sectors whose ratio of transport costs to production price is relatively high, such as the light manufacturing sector and agriculture, are likely to receive new investments as a result of improved infrastructure. If the improvements in the Highway CA-5 were to increase light manufacturing growth from 5 to 7 percent for the period 2007-2015, the return would increase by 7 percentage points to 28 percent. Improved transportation can have additional benefits through increased school enrollment and improved health outcomes. These indirect benefits have not been factored into the economic returns, so the ERR mentioned above is likely an underestimate of the gains from the Project.

² Based on the direct benefits accrued from reduced travel time, reduced vehicle operating costs, and reduced road maintenance.

B. Consultative Process

In 2001, the Government developed a Poverty Reduction Strategy Paper (the “*PRS Paper*”) with the participation of a broad range of Honduran society to guide the allocation of public resources to reduce poverty in Honduras. The consultative process of the PRS Paper included attendance by 3500 representatives of civil society organizations in 13 cities. Then, following consultations with national interest groups, the Government developed a Poverty Reduction Strategy - Implementation Plan for 2004 – 2006 (the “*PRS Plan*”) to prioritize the development goals of Honduras under the PRS Paper and to organize national resources and donor support to achieve such goals for the 2004 – 2006 period. The PRS Plan summarized findings from four workshops that the Government conducted in the main geographical regions of the country. The workshops included more than 650 participants and allowed the Government to receive feedback on the PRS Plan. In June 2004, the Government publicly presented the PRS Plan to the donor community in the Consultative Group meetings held in Tegucigalpa.

In developing the MCC Proposal, the Government used the priorities established in that PRS Plan and then posted the Proposal on its PRS web site (www.sierp.hn) to solicit feedback from the public at large. In addition, a summary of the Proposal appeared in a major local newspaper with the web address of the full Proposal. After submitting the Proposal to MCC, the Government held five high level meetings with the business community, civil society, non-governmental organizations, and donors, during which participants offered their insights on obstacles to economic growth and poverty reduction in Honduras.

This input along with other factors contributed to several material changes on the Program including: the inclusion of civil society as voting members of the Board of MCA-Honduras, the elimination of the tourism and urban development components, and the expansion of the geographic scope of the Rural Development Project. The GOH also has held meetings with civil society, donors, and the private sector to explain how the comments it has received have caused the final MCC Program to differ from the original proposal. There is broad agreement among the Hondurans and donors that raising agricultural productivity and reducing transportation costs are priorities for addressing poverty reduction through economic growth.

In conducting due diligence on the GOH’s consultative process for the PRS and for the MCC Proposal, representatives from MCC met with a wide selection of civil society, including international NGOs, domestic national associations of civil society groups, and domestic NGOs. Most of these groups saw the PRS process as a more transparent and participatory mechanism for setting policy priorities and coordination cooperation with donors than had previously existed.

The GOH plans to continue consultations at the project level, both in the transportation and agriculture sectors, throughout implementation. In addition, civil society representatives will participate on the MCA-Honduras Board as voting members and observers to ensure civil society oversight and input throughout the process.

MILLENNIUM CHALLENGE COMPACT

BY AND BETWEEN

**THE UNITED STATES OF AMERICA,
ACTING THROUGH THE
MILLENNIUM CHALLENGE CORPORATION,**

AND

THE GOVERNMENT OF THE REPUBLIC OF HONDURAS

Millennium Challenge Compact**Table of Contents**

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Exhibit A: Compendium of Defined Terms

Exhibit B: List of Supplemental Agreements

Annex I: Program Description

Schedule 1 – Rural Development Project

Schedule 2 – Transportation Project

Annex II: Summary of Multi-Year Financial Plan

Annex III: Description of the Monitoring and Evaluation Plan

MILLENNIUM CHALLENGE COMPACT

This MILLENNIUM CHALLENGE COMPACT (the "**Compact**") is made by and between the United States of America, acting through the Millennium Challenge Corporation, a United States Government corporation ("**MCC**"), and the Government of the Republic of Honduras (the "**Government**") (referred to herein individually as a "**Party**" and collectively, the "**Parties**"). A compendium of capitalized terms defined herein is included in Exhibit A attached hereto.

RECITALS

WHEREAS, MCC, acting through its Board of Directors, has selected the Republic of Honduras as eligible to present to MCC a proposal for the use of 2004 and 2005 Millennium Challenge Account ("**MCA**") assistance to help facilitate poverty reduction through economic growth in Honduras;

WHEREAS, the Government has carried out a consultative process with the country's private sector and civil society to outline the country's priorities for the use of MCA assistance and developed a proposal, which was submitted to MCC on August 20, 2004 (the "**Proposal**");

WHEREAS, the Proposal focused on, among other things, increasing the productivity and competitiveness of small- and medium-size farms and reducing transportation costs;

WHEREAS, MCC has evaluated the Proposal and related documents to determine whether the Proposal is consistent with core MCA principles and includes proposed activities and projects that will advance the progress of Honduras towards achieving economic growth and poverty reduction; and

WHEREAS, based on MCC's evaluation of the Proposal and related documents and subsequent discussions and negotiations between the Parties, the Government and MCC determined to enter into this Compact to implement a program using MCC Funding to advance Honduras's progress towards economic growth and poverty reduction (the "**Program**");

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants and agreements set forth herein, the Parties hereby agree as follows:

ARTICLE I.

PURPOSE AND TERM

Section 1.1 Objectives. The Parties have identified the following objectives (each, an "**Objective**" and together, the "**Objectives**") of this Compact, each of which is (i) key to advancing the goal of economic growth and poverty reduction in Honduras (the "**Compact Goal**"), and (ii) described in more detail in the Annexes attached hereto:

(a) Increase the productivity and business skills of farmers who operate small- and medium-size farms and their employees (the "**Agricultural Objective**"); and

(b) Reduce transportation costs between targeted production centers and national, regional and global markets (the ***“Transportation Objective”***).

The Government expects to achieve, and shall use its best efforts to ensure the achievement of, these Objectives during the Compact Term.

Section 1.2 **Projects**. The Annexes attached hereto describe the specific projects and the policy reforms and other activities related thereto (each, a ***“Project”***) that the Government will carry out, or cause to be carried out, in furtherance of this Compact to achieve the Objectives and the Compact Goal.

Section 1.3 **Entry into Force; Compact Term**. This Compact shall enter into force on the date of the last letter in an exchange of letters between the Principal Representatives of each Party confirming that all conditions set forth in Section 4.1 have been satisfied by the Government and MCC (such date, the ***“Entry into Force”***). This Compact shall remain in force for five (5) years from the Entry into Force, unless earlier terminated in accordance with Section 5.4 (the ***“Compact Term”***).

ARTICLE II. FUNDING AND RESOURCES

Section 2.1 **MCC Funding**.

(a) **MCC’s Contribution**. MCC hereby grants to the Government, subject to the terms and conditions of this Compact, an amount not to exceed Two Hundred and Fifteen Million United States Dollars (USD\$215,000,000) (***“MCC Funding”***) during the Compact Term to enable the Government to implement the Program and achieve the Objectives.

(i) The allocation of the MCC Funding within the Program and among and within the Projects shall be as generally described in **Annex II** or as otherwise agreed upon by the Parties from time to time.

(ii) If at any time MCC determines that a condition precedent to an MCC Disbursement has not been satisfied, MCC may, upon written notice to the Government, reduce the total amount of MCC Funding by an amount equal to the amount estimated in the applicable Spending Plan for the Program or Project activity for which such condition precedent has not been met. Upon the expiration or termination of this Compact, (A) any amounts of MCC Funding not disbursed by MCC to the Government shall be automatically released from any obligation in connection with this Compact and (B) any amounts of MCC Funding disbursed by MCC to the Government as provided in Section 2.1(b)(i), but not re-disbursed as provided in Section 2.1(b)(ii) or otherwise incurred as permitted pursuant to Section 5.4(e) prior to the expiration of the Compact, shall be returned to MCC in accordance with Section 2.5(a)(ii).

(b) **Disbursements**.

(i) **Disbursements of MCC Funding**. MCC shall from time to time make disbursements of MCC Funding (each such disbursement, an ***“MCC Disbursement”***) to a Permitted Account or through such other mechanism as agreed by the Parties in accordance with

the procedures and requirements set forth in Annex I, the Disbursement Agreement or as otherwise provided in any other relevant Supplemental Agreement.

(ii) Re-Disbursements of MCC Funding. The release of MCC Funding from a Permitted Account (each such release, a "*Re-Disbursement*") shall be made in accordance with the procedures and requirements set forth in Annex I, the Disbursement Agreement or as otherwise provided in any other relevant Supplemental Agreement.

(c) Interest. Unless the Parties agree otherwise in writing, any interest or other earnings on MCC Funding that accrue or are earned (collectively, "*Accrued Interest*") shall be held in a Permitted Account and accrue or be earned in accordance with the requirements for the treatment of Accrued Interest as specified in Annex I or any relevant Supplemental Agreement. On a quarterly basis and upon the termination or expiration of this Compact, the Government shall return, or ensure the return of, all Accrued Interest to any United States Government account designated by MCC.

(d) Conversion; Exchange Rate. The Government shall ensure that all MCC Funding in a Permitted Account into which MCC Disbursements are made is held in the currency of the United States of America ("*United States Dollars*") prior to Re-Disbursement; *provided*, that a certain portion of MCC Funding may be transferred to a Local Account and may be held in such Local Account in the currency of the Republic of Honduras prior to Re-Disbursement in accordance with the requirements of Annex I. To the extent that any amount of MCC Funding held in United States Dollars must be converted into the currency of the Republic of Honduras for any purpose, including for any Re-Disbursement or any transfer of MCC Funding into a Local Account, the Government shall ensure that such amount is converted consistent with Annex I and the requirements of the Disbursement Agreement or any other Supplemental Agreement between the Parties. The Government shall ensure that any MCC Funding that is converted into the currency of the Republic of Honduras is converted at the rate and in the manner set forth in Annex I.

(e) Guidance. From time to time, MCC may provide guidance to the Government through Implementation Letters on the frequency, form and content of requests for MCC Disbursements and Re-Disbursements or any other matter relating to MCC Funding. The Government shall apply such guidance in implementing this Compact.

Section 2.2 Government Resources.

(a) The Government shall provide, or cause to be provided, such Government funds and other resources, and shall take, or cause to be taken, such actions, including obtaining all necessary approvals and consents, as are specified in this Compact or in any Supplemental Agreement to which the Government is a party or as are otherwise necessary and appropriate to effectively carry out the Government Responsibilities or other responsibilities or obligations of the Government under or in furtherance of this Compact during the Compact Term and through the completion of any post-Compact Term activities, audits or other responsibilities.

(b) If at any time during the Compact Term, the Government materially reduces the allocation in its national budget, or any other Honduran government authority at a departmental, municipal, regional or other jurisdictional level materially reduces the allocation of its respective

budget, of the normal and expected resources that the Government or such other governmental authority, as applicable, would have otherwise received or budgeted, from external or domestic sources, for the activities contemplated herein, the Government shall notify MCC in writing within fifteen (15) days of such reduction, such notification to contain information regarding the amount of the reduction, the affected activities, and an explanation for the reduction. In the event that MCC independently determines upon review of the executed national annual budget that such a material reallocation or reduction of resources has occurred, MCC shall notify the Government and, following such notification, the Government shall provide a written explanation for such reallocation or reduction and MCC may reduce the total amount of MCC Funding or any MCC Disbursement by an amount equal to the amount estimated in the applicable Spending Plan for the activity for which funds were reduced or reallocated.

(c) The Government shall use its best efforts to ensure that all MCC Funding is fully reflected and accounted for in the annual budget of the Republic of Honduras on a multi-year basis.

Section 2.3 Limitations on the Use or Treatment of MCC Funding.

(a) Abortions and Involuntary Sterilizations. The Government shall ensure that MCC Funding shall not be used to undertake, fund or otherwise support any activity that is subject to prohibitions on use of funds contained in (i) paragraphs (1) through (3) of section 104(f) of the Foreign Assistance Act of 1961 (22 U.S.C. 2151b(f)(1)-(3)), a United States statute, which prohibitions shall apply to the same extent and in the same manner as such prohibitions apply to funds made available to carry out Part I of such Act; or (ii) any provision of law comparable to the eleventh and fourteenth provisos under the heading "Child Survival and Health Programs Fund" of division E of Public Law 108-7 (117 Stat. 162), a United States statute.

(b) United States Job Loss or Displacement of Production. The Government shall ensure that MCC Funding shall not be used to undertake, fund or otherwise support any activity that is likely to cause a substantial loss of United States jobs or a substantial displacement of United States production, including:

(i) Providing financial incentives to relocate a substantial number of United States jobs or cause a substantial displacement of production outside the United States;

(ii) Supporting investment promotion missions or other travel to the United States with the intention of inducing United States firms to relocate a substantial number of United States jobs or a substantial amount of production outside the United States;

(iii) Conducting feasibility studies, research services, studies, travel to or from the United States, or providing insurance or technical and management assistance, with the intention of inducing United States firms to relocate a substantial number of United States jobs or cause a substantial displacement of production outside the United States;

(iv) Advertising in the United States to encourage United States firms to relocate a substantial number of United States jobs or cause a substantial displacement of production outside the United States;

(v) Training workers for firms that intend to relocate a substantial number of United States jobs or cause a substantial displacement of production outside the United States;

(vi) Supporting a United States office of an organization that offers incentives for United States firms to relocate a substantial number of United States jobs or cause a substantial displacement of production outside the United States; or

(vii) Providing general budget support for an organization that engages in any activity prohibited above.

(c) Military Assistance and Training. The Government shall ensure that MCC Funding shall not be used to undertake, fund or otherwise support the purchase or use of goods or services for military purposes, including military training, or to provide any assistance to the military, police, militia, national guard or other quasi-military organization or unit.

(d) Prohibition of Assistance Relating to Environmental, Health or Safety Hazards. The Government shall ensure that MCC Funding shall not be used to undertake, fund or otherwise support any activity that is likely to cause a significant environmental, health, or safety hazard. Unless MCC and the Government agree otherwise in writing, the Government shall ensure that activities undertaken or funded in whole or in part, directly or indirectly, by MCC Funding comply with environmental guidelines delivered by MCC to the Government or posted by MCC on its website or otherwise publicly made available, as such guidelines may be amended from time to time (the "*Environmental Guidelines*"), including any definition of "likely to cause a significant environmental, health, or safety hazard" as may be set forth in such Environmental Guidelines.

(e) Taxation.

(i) Taxes. As required by applicable United States law and in furtherance of the General Agreement for Economic Cooperation between the Government of the United States of America and the Government of Honduras, dated May 27, 1961, as amended from time to time (the "*Bilateral Agreement*"), the Government shall ensure that the Program, any Program Assets, MCC Funding and Accrued Interest, shall be free from any taxes imposed under laws currently or hereafter in effect in the Republic of Honduras during the Compact Term. This exemption shall (A) be implemented in an administratively efficient manner consistent with the principles that MCC Funding will be used only to fund the Program and to achieve the Objectives and to avoid, where possible, double taxation of Providers, irrespective of their nationality and place of residence and (B) apply to any use of any Program Asset, MCC Funding and Accrued Interest, including any Exempt Uses, and to any work performed under or activities undertaken in furtherance of this Compact by any person or entity (including contractors and grantees) funded by MCC Funding, and shall apply to all taxes, tariffs, duties, and other levies (each, a "*Tax*" and collectively, "*Taxes*"), including:

(1) to the extent attributable to MCC Funding, income taxes and other taxes on profit or businesses imposed on organizations or entities, other than nationals of the Republic of Honduras, receiving MCC Funding, including taxes on the acquisition, ownership, rental, disposition or other use of real or personal property, taxes on investment or deposit requirements and currency controls in Honduras, or any other tax, duty, charge or fee of

whatever nature, except fees for specific services rendered; for purposes of this Section 2.3(e), the term "national" refers to organizations established under the laws of Honduras, other than MCA-Honduras or any other entity established solely for purposes of managing or overseeing the implementation of the Program or any wholly-owned subsidiaries, divisions, or Affiliates of entities not registered or established under the laws of Honduras;

(2) customs duties, tariffs, import and export taxes, or other levies on the importation, use and re-exportation of goods, services or the personal belongings and effects, including personally-owned automobiles, for Program use or the personal use of individuals who are neither citizens nor permanent residents of the Republic of Honduras and who are present in Honduras for purposes of carrying out the Program or their family members, including all charges based on the value of such imported goods;

(3) taxes on the income or personal property of all individuals who are neither citizens nor permanent residents of the Republic of Honduras, including income and social security taxes of all types and all taxes on the personal property owned by such individuals, to the extent such income or property are attributable to MCC Funding; and

(4) taxes or duties levied on the purchase of goods or services funded by MCC Funding, including sales taxes, tourism taxes, value-added taxes (VAT), or other similar charges.

(ii) This Section 2.3(e) shall apply, but is not limited to (A) any transaction, service, activity, contract, grant or other implementing agreement funded in whole or in part by MCC Funding; (B) any supplies, equipment, materials, property or other goods (referred to herein collectively as "goods") or funds introduced into, acquired in, used or disposed of in, or imported into or exported from, the Republic of Honduras by MCC, or by any person or entity (including contractors and grantees) or employees of any thereof, as part of, or in conjunction with, MCC Funding or the Program; and (C) any contractor, grantee, or other organization, and any employee thereof, carrying out activities funded in whole or in part by MCC Funding (the uses set forth in clauses (A) through (C) are collectively referred to herein as "*Exempt Uses*").

(iii) If a Tax has been levied and paid contrary to the requirements of this Section 2.3(e), whether inadvertently, due to the impracticality of implementation of this provision with respect to certain types or amounts of taxes or otherwise, the Government shall refund the amount of such tax to a Permitted Account designated by MCA-Honduras, subject to MCC approval, in the currency of the Republic of Honduras, within thirty (30) days (or such other period as may be agreed in writing by the Parties) after the Government is notified of such levy and tax payment; *provided, however*, the Government shall apply national funds to satisfy its obligations under this paragraph and no MCC Funding, Accrued Interest or any assets, goods, or property (real, tangible, or intangible) purchased or financed in whole or in part by MCC Funding ("*Program Assets*") may be applied by the Government in satisfaction of its obligations under this paragraph.

(iv) The Parties shall memorialize in a mutually acceptable Supplemental Agreement or other suitable document the mechanisms for implementing this Section 2.3(e), including (A) a formula for determining refunds for Taxes paid, the amount of which is not susceptible to precise determination, (B) a mechanism for ensuring the tax-free importation, use,

and re-exportation of goods, services or the personal belongings of individuals (including all Providers) described in paragraph (i)(2) of this Section 2.3(e), and (C) any other appropriate Government action to facilitate the administration of this Section 2.3(e).

(f) Alteration. The Government shall ensure that no MCC Funding, Accrued Interest, or Program Assets shall be subject to any impoundment, rescission, sequestration or any provision of law now or hereafter in effect in the Republic of Honduras that would have the effect of requiring or allowing any impoundment, rescission or sequestration of any MCC Funding, Accrued Interest, or Program Asset.

(g) Liens or Encumbrances. The Government shall ensure that no MCC Funding, Accrued Interest, or Program Assets shall be subject to any lien, attachment, enforcement of judgment, pledge, or encumbrance of any kind (each, a "*Lien*"), except with the prior approval of MCC in accordance with Section 3(c) of Annex I, and in the event of any Lien not so approved, the Government shall seek the release of such Lien and shall pay any amounts owed to obtain such release; *provided, however*, the Government shall apply national funds to satisfy its obligations under this Section 2.3(g) and no MCC Funding, Accrued Interest, or Program Assets may be applied by the Government in satisfaction of its obligations under this Section 2.3(g).

(h) Other Limitations. The Government shall ensure that the use or treatment of MCC Funding shall be subject to such other limitations (i) as required by the applicable law of the United States of America now or hereafter in effect during the Compact Term, (ii) as advisable under or required by applicable United States Government policies now or hereafter in effect during the Compact Term, or (iii) to which the Parties may otherwise agree in writing.

(i) Utilization of Goods, Services and Works. The Government shall ensure that any Program Assets, services, facilities or works funded in whole or in part, directly or indirectly, by MCC Funding, unless otherwise agreed by the Parties in writing, shall be used solely in furtherance of this Compact.

(j) Notification of Applicable Laws and Policies. MCC shall notify the Government of any applicable United States law or policy affecting the use or treatment of MCC Funding, whether or not specifically identified in this Section 2.3, and shall provide to the Government a copy of the text of any such applicable law and a written explanation of any such applicable policy.

Section 2.4 Incorporation; Notice; Clarification.

(a) The Government shall include, or ensure the inclusion of, all of the requirements set forth in Section 2.3 in all Supplemental Agreements to which MCC is not a party and shall use its best efforts to ensure that no such Supplemental Agreement is implemented in violation of the prohibitions set forth in Section 2.3.

(b) The Government shall ensure notification of all of the requirements set forth in Section 2.3 to any Provider and all relevant officers, directors, employees, agents, representatives, Affiliates, contractors, grantees, subcontractors and sub-grantees of the Government or any Provider. The term "*Provider*" shall mean (i) MCA-Honduras and any other Government Affiliate involved in any activities in furtherance of this Compact or (ii) any third

party who receives at least USD \$50,000 in the aggregate of MCC Funding (other than employees of MCA-Honduras) during the Compact Term or such other amount as the Parties may agree in writing, whether directly from MCC, indirectly through Re-Disbursements, or otherwise.

(c) In the event the Government or any Provider requires clarification from MCC as to whether an activity contemplated to be undertaken in furtherance of this Compact violates or may violate any provision of Section 2.3, the Government shall notify, or ensure that such Provider notifies, MCC in writing and provide in such notification a detailed description of the activity in question. In such event, the Government shall not proceed, and shall use its best efforts to ensure that no relevant Provider proceeds, with such activity, and the Government shall ensure that no Re-Disbursements shall be made for such activity, until MCC advises the Government or such Provider in writing that the activity is permissible.

Section 2.5 Refunds: Violation.

(a) Notwithstanding the availability to MCC, or exercise by MCC, of any other remedies, including under international law, this Compact, or any Supplemental Agreement:

(i) If any amount of MCC Funding, Accrued Interest, or any Program Asset, is used for any purpose prohibited under this Article II or otherwise in violation of any of the terms and conditions of this Compact, any guidance in any Implementation Letter, or any Supplemental Agreement between the Parties, MCC may require the Government to repay promptly to MCC to an account designated by MCC or to others as MCC may direct, the amount of such misused MCC Funding, Accrued Interest, or the cash equivalent of the value of any misused Program Asset, in United States Dollars, plus any interest that accrued or would have accrued thereon, within fifteen (15) days after the Government is notified, whether by MCC or otherwise, of such prohibited use; *provided, however*, the Government shall apply national funds to satisfy its obligations under this Section 2.5(a)(i) and no MCC Funding, Accrued Interest, or Program Assets may be applied by the Government in satisfaction of its obligations under this Section 2.5(a)(i); and

(ii) If all or any portion of this Compact is terminated or suspended and upon the expiration of the Compact, the Government shall, subject to the requirements of Sections 5.4(e) and 5.4(f), refund, or ensure the refund, to MCC to such account(s) as designated by MCC the amount of any MCC Funding, plus any Accrued Interest, promptly, but in no event later than thirty (30) days after the Government receives MCC's request for such refund; *provided*, if this Compact is terminated or suspended in part, MCC may request a refund for only the amount of funds, plus any Accrued Interest, then allocated to the terminated or suspended portion; *provided, further*, that any refund of MCC Funding or Accrued Interest shall be to such account(s) as designated by MCC.

(b) Notwithstanding any other provision in this Compact or any other agreement to the contrary, MCC's right under this Section 2.5 for a refund shall continue during the Compact Term and for a period of (i) five (5) years thereafter or (ii) one (1) year after MCC receives actual knowledge of such violation, whichever is later.

(c) If MCC determines that any activity or failure to act violates, or may violate, any Section in this Article II, MCC may refuse any further MCC Disbursements for or conditioned upon such activity, and may take any action to prevent any Re-Disbursement related to such activity.

ARTICLE III. IMPLEMENTATION

Section 3.1 Implementation Framework. This Compact shall be implemented by the Parties in accordance with this Article III and as further specified in the Annexes and in relevant Supplemental Agreements.

Section 3.2 Government Responsibilities.

(a) The Government shall have principal responsibility for oversight and management of the implementation of the Program (i) in accordance with the terms and conditions specified in this Compact and relevant Supplemental Agreements, (ii) in accordance with all applicable laws then in effect of Honduras, and (iii) in a timely and cost-effective manner and in conformity with sound technical, financial and management practices (collectively, the "***Government Responsibilities***"). Unless otherwise expressly provided, any reference to the Government Responsibilities or any other responsibilities or obligations of the Government herein shall be deemed to apply to any Government Affiliate and any of their respective employees, contractors, agents or representatives.

(b) The Government shall ensure that no person or entity shall participate in the selection, award, administration, or oversight of a contract, grant or other benefit or transaction funded in whole or in part, directly or indirectly, by MCC Funding, in which (i) the entity, the person, members of the person's immediate family or household or his or her business partners, or organizations controlled by or substantially involving such person or entity, has or have a financial interest or (ii) the person is negotiating or has any arrangement concerning prospective employment, unless such person or entity has first disclosed in writing to the Government the conflict of interest and, following such disclosure, the Parties agree in writing to proceed notwithstanding such conflict. The Government shall ensure that no person or entity involved in the selection, award, administration, oversight or implementation of any contract, grant or other benefit or transaction funded in whole or in part, directly or indirectly, by MCC Funding shall solicit or accept from, offer to a third party, or seek or be promised, directly or indirectly, for itself or for another person or entity, any gift, gratuity, favor or benefit, other than items of *de minimis* value and otherwise consistent with such guidance as MCC may provide from time to time.

(c) The Government shall designate MCA-Honduras to implement the Government Responsibilities and any other responsibilities or obligations of the Government and to exercise any rights of the Government under this Compact or any Supplemental Agreement between the Parties (referred to herein collectively as "***Designated Rights and Responsibilities***"), in accordance with the terms and conditions set forth in this Compact or such Supplemental Agreement. Notwithstanding any provision herein or any other agreement to the contrary, such designation shall not relieve the Government of such Designated Rights and Responsibilities, for

which the Government shall retain ultimate responsibility. The Government shall cause MCA-Honduras to perform such Designated Rights and Responsibilities in the same manner and to the full extent to which the Government is obligated to perform such Designated Rights and Responsibilities and shall ensure that MCA-Honduras does not assign, delegate, or contract (or otherwise transfer) any of such Designated Rights and Responsibilities to any person or entity without the prior written consent of MCC.

(d) The Government shall, upon a request from MCC, execute, or ensure the execution of, an assignment to MCC of any cause of action which may accrue to the benefit of the Government, MCA-Honduras or any other Government Affiliate in connection with or arising out of any activities funded in whole or in part, directly or indirectly, by MCC Funding.

(e) The Government shall ensure that (i) no decision of MCA-Honduras is modified, supplemented, unduly influenced or rescinded by any other governmental authority, except by a non-appealable judicial decision, and (ii) the authority of MCA-Honduras shall not be expanded, restricted or otherwise modified, except in accordance with this Compact, applicable law, the Governance Regulations or a Supplemental Agreement between the Parties.

(f) The Government shall ensure that all persons and individuals that enter into agreements to provide goods, services or works under the Program or in furtherance of this Compact shall do so in accordance with the Procurement Guidelines and shall obtain all necessary immigration, business and other permits, licenses, consents or approvals to enable them and their personnel to fully perform under such agreements.

Section 3.3 Government Deliveries. The Government shall proceed, and cause others to proceed, in a timely manner to deliver to MCC all reports, notices, documents or other deliveries by the Government under or as required to be delivered by the Government under this Compact or any Supplemental Agreement between the Parties, in form and substance as set forth in this Compact or in any such Supplemental Agreement.

Section 3.4 Government Assurances. The Government hereby provides the following assurances to MCC that as of the date this Compact is signed:

(a) The information contained in the Proposal and any agreement, report, statement, communication, document or otherwise delivered or otherwise communicated to MCC by or on behalf of the Government on or after the date of the submission of the Proposal (i) are true, accurate and complete in all material respects and (ii) do not omit any fact known to the Government that if disclosed would (A) alter in any material respect the information delivered, (B) likely have a material adverse effect on the Government's ability to effectively implement, or ensure the effective implementation of, the Program or any Project or to otherwise carry out its responsibilities or obligations under or in furtherance of this Compact, or (C) have likely adversely affected MCC's determination to enter into this Compact or any Supplemental Agreement between the Parties.

(b) Unless otherwise disclosed in writing to MCC, the MCC Funding made available hereunder is in addition to the normal and expected resources that the Government usually receives or budgets for the activities contemplated herein from external or domestic sources.

(c) This Compact does not conflict and will not conflict with any international agreement or obligation to which the Government is a party or by which it is bound.

(d) No payments have been (i) received by any official of the Government or any other government body in connection with the procurement of goods or services to be undertaken or funded in whole or in part, directly or indirectly, by MCC Funding, except fees, taxes, or similar payments legally established in Honduras or (ii) made to any third party, in connection with or in furtherance of this Compact, in violation of the United States Foreign Corrupt Practices Act of 1977, as amended (15 U.S.C. 78a *et seq.*).

Section 3.5 Implementation Letters; Supplemental Agreements.

(a) MCC may, from time to time, issue one or more letters to furnish additional information or guidance to assist the Government in the implementation of this Compact (each, an "**Implementation Letter**"). The Government shall apply such guidance in implementing this Compact.

(b) The details of any funding, implementing and other arrangements in furtherance of this Compact may be memorialized in one or more agreements between (A) the Government (or any Government Affiliate) and MCC, (B) MCC and/or the Government (or any Government Affiliate) and any third party, including any of the Providers or (C) any third parties where neither MCC nor the Government is a party, before, on or after the Entry into Force (each, a "**Supplemental Agreement**"). The Government shall deliver, or cause to be delivered, to MCC within five (5) days of its execution a copy of any Supplemental Agreement to which MCC is not a party.

Section 3.6 Procurement; Awards of Assistance.

(a) The Government shall ensure that the procurement of all goods, services and works by the Government, MCA-Honduras or any other Provider in furtherance of this Compact shall (i) conform to the terms and conditions reflected in a Supplemental Agreement between the Parties (the "**Procurement Agreement**"), and (ii) be governed by the standards and procedures of the World Bank, as codified in "Guidelines: Procurement under IBRD Loans and IDA Credits, May 2004 (ISBN 0-8213-5829-4)" (covering works and goods) and "Guidelines: Selection and Employment of Consultants by World Bank Borrowers, May 2004" (covering consultants and technical assistance), subject to the exceptions and other modifications specified in additional procurement guidelines set forth in the Procurement Agreement, as amended by MCC from time to time by publication (such World Bank standards and such published MCC guidelines are collectively, the "**Procurement Guidelines**"). The Procurement Guidelines shall include the following requirements:

(i) Open, fair and competitive procedures are used in a transparent manner to solicit, award and administer contracts, grants, and other agreements and to procure goods, services and works;

(ii) Solicitations for goods, services, and works shall be based upon a clear and accurate description of the goods, services or works to be acquired;

(iii) Contracts shall be awarded only to qualified and capable contractors that have the capability and willingness to perform the contracts in accordance with the terms and conditions of the applicable contracts and on a cost effective and timely basis; and

(iv) No more than a commercially reasonable price, as determined, for example, by a comparison of price quotations and market prices, shall be paid to procure goods, services, and works.

(b) The Government shall maintain, and shall use its best efforts to ensure that all Providers maintain, records regarding the receipt and use of goods and services acquired in furtherance of this Compact, the nature and extent of solicitations of prospective suppliers of goods and services acquired in furtherance of this Compact, and the basis of award of contracts, grants and other agreements in furtherance of this Compact.

(c) The Government shall use its best efforts to ensure that information, including solicitations, regarding procurement, grant and other agreement actions funded in whole or in part, directly or indirectly, by MCC Funding shall be made publicly available in the manner outlined in the Procurement Guidelines or in any other manner agreed upon by the Parties in writing.

(d) No goods, services or works may be funded in whole or in part, directly or indirectly, by MCC Funding which are procured pursuant to orders or contracts firmly placed or entered into prior to the Entry into Force, except as the Parties may otherwise agree in writing.

(e) In furtherance of the Procurement Guidelines, the Government shall ensure that MCA-Honduras adopts a procurement operations manual, subject to MCC approval, no later than the time specified in the Disbursement Agreement. The procurement operations manual shall be consistent with the Procurement Guidelines and may draw from relevant sections of active World Bank loan agreement operations manuals currently governing other programs in Honduras and/or the "Bank Funded Procurement Manual," as published by the World Bank's Procurement Policy and Services Group, Operations Policy and Country Services division.

(f) The Government shall ensure that MCA-Honduras follows, and uses its best efforts to ensure that all Providers follow, the Procurement Guidelines in procuring goods, services and works and in awarding and administering contracts, grants and other agreements in furtherance of this Compact and shall furnish MCC evidence of the adoption of the Procurement Guidelines by MCA-Honduras no later than the time specified in the Disbursement Agreement.

(g) The Government shall include, or ensure the inclusion of, the requirements of this Section 3.6 into all Supplemental Agreements between the Government, MCA-Honduras or any other Government Affiliate or any of their respective directors, officers, employees, Affiliates, contractors, representatives or agents, on the one hand, and a Provider, on the other hand.

Section 3.7 Policy Performance; Policy Reforms. In addition to the specific policy and legal reform commitments identified in Annex I and the Schedules thereto, the Government shall seek to maintain and improve its level of performance under the policy criteria identified in Section 607 of the Millennium Challenge Act of 2003, as amended (the "Act"), and the MCA selection

criteria and methodology published by MCC pursuant to Section 607 of the Act from time to time ("*MCA Eligibility Criteria*").

Section 3.8 Records and Information; Access; Audits; Reviews.

(a) Reports and Information. The Government shall furnish to MCC, and shall use its best efforts to ensure that all Providers and any other third party receiving MCC Funding, as appropriate, furnish to the Government, any records and other information required to be maintained under this Section 3.8 and such other information, documents and reports as may be necessary or appropriate for the Government to effectively carry out its obligations under this Compact, including under Section 3.12.

(b) Government Books and Records. The Government shall maintain, and shall use its best efforts to ensure that all Providers maintain, accounting books, records, documents and other evidence relating to this Compact adequate to show, without limitation, the use of all MCC Funding, including all costs incurred by the Government and the Providers in furtherance of this Compact, the receipt and use of goods and services acquired in furtherance of this Compact by the Government and the Providers, agreed-upon cost sharing requirements, the nature and extent of solicitations of prospective suppliers of goods and services acquired by the Government and the Providers in furtherance of this Compact, the basis of award of Government and other contracts and orders in furtherance of this Compact, the overall progress of the implementation of the Program, and any documents required by this Compact or any Supplemental Agreement between the Parties or reasonably requested by MCC upon reasonable notice ("*Compact Records*"). The Government shall maintain, and shall use its best efforts to ensure that all Covered Providers maintain, Compact Records in accordance with generally accepted accounting principles prevailing in the United States, or at the Government's option and with the prior written approval by MCC, other accounting principles, such as those (1) prescribed by the International Accounting Standards Committee (an affiliate of the International Federation of Accountants) or (2) then prevailing in Honduras. Compact Records shall be maintained for at least five (5) years after the end of the Compact Term or for such longer period, if any, required to resolve any litigation, claims or audit findings or any statutory requirements.

(c) Access. The Government shall permit, or cause to be permitted, authorized representatives of MCC, the Inspector General, the United States Government Accountability Office, any auditor responsible for an audit contemplated herein or otherwise conducted in furtherance of this Compact, and any agents or representatives engaged by MCC or MCA-Honduras to conduct any assessment, review or evaluation of the Program, at all reasonable times the opportunity to audit, review, evaluate or inspect activities funded, in whole or in part, directly or indirectly, by MCC Funding or undertaken in connection with the Program, the utilization of goods and services purchased or funded in whole or in part, directly or indirectly, by MCC Funding, and Compact Records, including of the Government or any Provider, relating to activities funded or undertaken in furtherance of, or otherwise relating to, this Compact, and shall use its best efforts to ensure access by MCC, the Inspector General, the United States Government Accountability Office or relevant auditor, reviewer or evaluator or their respective representatives or agents to all relevant directors, officers, employees, Affiliates, contractors, representatives and agents of the Government or any Provider.

(d) Audits.

(i) Government Audits. In addition to its audit responsibilities set forth in Annex I, the Government shall, on at least an annual basis and as the Parties may otherwise agree in writing, conduct, or cause to be conducted, financial audits of all MCC Disbursements and Re-Disbursements during the year since the Entry into Force or since the prior anniversary of the Entry into Force in accordance with the following terms, except as the Parties may otherwise agree in writing. As requested by MCC in writing, the Government shall use, or cause to be used, an auditor named on the approved list of auditors in accordance with the "*Guidelines for Financial Audits Contracted by Foreign Recipients*" issued by the Inspector General of the United States Agency for International Development (the "*Inspector General*"), and as approved by MCC, to conduct such annual audits. Such audits shall be performed in accordance with such Guidelines and be subject to quality assurance oversight by the Inspector General in accordance with such Guidelines. An audit shall be completed and delivered to MCC no later than 90 days after the first period to be audited and no later than 90 days after each anniversary of the Entry into Force, or such other period as the Parties may otherwise agree in writing.

(ii) Audits of U.S. Entities. The Government shall ensure that Supplemental Agreements between the Government or any Provider, on the one hand, and a United States nonprofit organization, on the other hand, state that the United States organization is subject to the applicable audit requirements contained in OMB Circular A-133, notwithstanding any other provision of this Compact to the contrary. The Government shall ensure that Supplemental Agreements between the Government or any Provider, on the one hand, and a United States for-profit Covered Provider, on the other hand, state that the United States organization is subject to audit by the cognizant United States Government agency, unless the Government and MCC agree otherwise in writing.

(iii) Audit Plan. The Government shall submit, or cause to be submitted, to MCC no later than 20 days prior to its adoption, a plan for the audit of the expenditures of any Covered Providers, which audit plan the Government shall adopt, or cause to be adopted, in form and substance as approved by MCC, no later than sixty (60) days prior to the end of the first period to be audited.

(iv) Covered Provider. A "*Covered Provider*" is (A) any non-United States Provider that receives (other than pursuant to a direct contract or agreement with MCC) USD \$300,000 or more of MCC Funding in any MCA-Honduras fiscal year or any other non-U.S. person or entity that receives, directly or indirectly, USD \$300,000 or more of MCC Funding from any Provider in such fiscal year or (B) any United States Provider that receives (other than pursuant to a direct contract or agreement with MCC) USD \$500,000 or more of MCC Funding in any MCA-Honduras fiscal year or any other United States person or entity that receives, directly or indirectly, USD \$500,000 or more of MCC Funding from any Provider in such fiscal year.

(v) Corrective Actions. The Government shall use its best efforts to ensure that Covered Providers take, where necessary, appropriate and timely corrective actions in response to audits, consider whether a Covered Provider's audit necessitates adjustment of its own records, and require each such Covered Provider to permit independent auditors to have access to its records and financial statements as necessary.

(vi) Audit Reports. The Government shall furnish, or use its best efforts to cause to be furnished, to MCC an audit report in a form satisfactory to MCC for each audit required by this Section 3.8, other than audits arranged for by MCC, no later than 90 days after the end of the period under audit, or such other time as may be agreed by the Parties from time to time.

(vii) Other Providers. For Providers who receive MCC Funding under this Compact pursuant to direct contracts or agreements with MCC, MCC shall include appropriate audit requirements in such contracts or agreements and shall, on behalf of the Government, unless otherwise agreed by the Parties, conduct the follow-up activities with regard to the audit reports furnished pursuant to such requirements.

(viii) Audit by MCC. MCC retains the right to perform, or cause to be performed, the audits required under this Section 3.8 by utilizing MCC Funding or other resources available to MCC for this purpose, and to audit, conduct a financial review, or otherwise ensure accountability of any Provider or any other third party receiving MCC Funding, regardless of the requirements of this Section 3.8.

(e) Application to Providers. The Government shall include, or ensure the inclusion of, at a minimum, the requirements of:

(i) Paragraphs (a), (b), (c), (d)(iii), (d)(vi), (d)(viii) and (e) of this Section 3.8 into all Supplemental Agreements between the Government, any Government Affiliate, MCA-Honduras or any of their respective directors, officers, employees, Affiliates, contractors, representatives or agents (each, a "**Government Party**"), on the one hand, and a Covered Provider that is not a non-profit organization domiciled in the United States, on the other hand;

(ii) Paragraphs (a), (b), (c), and (d)(viii) of this Section 3.8 into all Supplemental Agreements between a Government Party and a Provider that does not meet the definition of a Covered Provider; and

(iii) Paragraphs (a), (b), and (c) of this Section 3.8 into all Supplemental Agreements between a Government Party and a Covered Provider that is a non-profit organization domiciled in the United States.

(f) Reviews or Evaluations. The Government shall conduct, or cause to be conducted, such performance reviews, data quality reviews, environmental audits, or program evaluations during the Compact Term in accordance with the M&E Plan or as otherwise agreed in writing by the Parties.

(g) Cost of Audits, Reviews or Evaluations. MCC Funding may be used to finance the costs of any Audits, reviews or evaluations required under this Compact, including as reflected on Exhibit A to Annex II, and in no event shall the Government be responsible for the costs of any such Audits, reviews or evaluations from financial sources other than MCC Funding.

Section 3.9 Insurance; Performance Guarantees; Indemnification Claims.

(a) Insurance; Performance Guarantees. The Government shall, to MCC's satisfaction, insure or cause to be insured all Program Assets, and obtain or cause to be obtained such other appropriate protections against risks or liabilities associated with the operations of the Program, by requiring Providers to obtain adequate insurance and post adequate performance bonds or other guarantees. MCA-Honduras shall be named as the insured party on any such insurance and the beneficiary of any other such guarantee, including performance bonds. The Government shall ensure that any proceeds from claims paid under such insurance or any other form of guarantee shall be used to replace or repair any loss of Program Assets or to pursue the procurement of the covered goods or services, and otherwise shall be deposited in a Permitted Account as designated by MCA-Honduras, subject to MCC approval.

(b) Indemnification Claims. To the extent MCA-Honduras is held liable under any indemnification or other similar provision of any agreement between MCA-Honduras, on the one hand, and any other Provider or other third party, on the other hand, the Government shall pay in full on behalf of MCA-Honduras any such obligation; *provided, however*, the Government shall apply national funds to satisfy its obligations under this Section 3.9 and no MCC Funding, Accrued Interest or Program Assets may be applied by the Government in satisfaction of its obligations under this Section 3.9. If the Government believes in good faith that such liability is not caused primarily by the negligence or misconduct of MCA-Honduras or another Government Party, the Government shall so notify MCC in writing within fifteen (15) business days after such belief is formed, which notice shall contain sufficient information for MCC to independently assess the accuracy of the Government's position. If, within fifteen (15) business days after receiving such notice, MCC determines, in its sole discretion, that such liability is not caused primarily by the negligence or misconduct of MCA-Honduras or another Government Party, MCC will authorize MCA-Honduras, in writing, to use MCC Funding to fund such liability or refund to the Government the payment of the same.

Section 3.10 Domestic Requirements. The Government shall proceed in a timely manner to seek any required ratification of this Compact or similar domestic requirement, which process the Government shall initiate promptly after the conclusion of this Compact. Notwithstanding anything to the contrary in this Compact, this Section 3.10 shall provisionally apply prior to the Entry into Force.

Section 3.11 No Conflict. The Government shall undertake not to enter into any agreement in conflict with this Compact or any Supplemental Agreement during the Compact Term.

Section 3.12 Reports. The Government shall provide to MCC within thirty (30) days of any written request by MCC, or as otherwise agreed in writing by the Parties, the following information:

- (a) The name of each entity to which MCC Funding has been provided;
- (b) The amount of MCC Funding provided to such entity;
- (c) A description of the Program and each Project funded in furtherance of this Compact, including:

- (i) A statement of whether the Program or any Project was solicited or unsolicited; and
- (ii) A detailed description of the objectives and measures for results of the Program or Project;
- (d) The progress made by Honduras toward achieving the Compact Goal and Objectives;
- (e) A description of the extent to which MCC Funding has been effective in helping Honduras to achieve the Compact Goal and Objectives;
- (f) A description of the coordination of MCC Funding with other United States foreign assistance and other related trade policies;
- (g) A description of the coordination of MCC Funding with assistance provided by other donor countries;
- (h) Any report, document or filing that the Government, MCA-Honduras, or any other Government Affiliate submits to any government body in connection with this Compact;
- (i) Any report or document required to be delivered to MCC under the Environmental Guidelines, any audit plan, or any component of the Implementation Plan; and
- (j) Any other report, document or information requested by MCC or required by this Compact or any Supplemental Agreement between the Parties.

ARTICLE IV.

CONDITIONS PRECEDENT; DELIVERIES

Section 4.1 Conditions Prior to the Entry into Force and Deliveries. As conditions precedent to the Entry into Force, the Parties shall satisfy the following:

- (a) The Government (or mutually acceptable Government Affiliate) and MCC shall execute a Disbursement Agreement, which agreement shall be in full force and effect as of the Entry into Force;
- (b) The Government (or mutually acceptable Government Affiliate) and MCC shall execute one or more term sheets that set forth the material and principal terms and conditions of each of the Supplemental Agreements identified in Exhibit B attached hereto (the "***Supplemental Agreement Term Sheets***");
- (c) The Government (or mutually acceptable Government Affiliate) and MCC shall execute a Procurement Agreement, which agreement shall be in full force and effect as of the Entry into Force;
- (d) The Government shall deliver a letter signed and dated by the Principal Representative of the Government certifying:

(i) That the Government has completed all of its domestic requirements for this Compact to be fully enforceable under Honduran law;

(ii) As to the incumbency and specimen signature of the Principal Representative and each Additional Representative executing any document delivered pursuant to this Section 4.1 on behalf of the Government; and

(iii) That attached thereto are true, accurate and complete copies of any decree, legislation, regulation or other governmental document relating to its domestic requirements for this Compact to enter into force, which MCC may post on its website or otherwise make publicly available.

(e) MCC shall deliver a letter signed and dated by the Principal Representative of MCC certifying that MCC has completed its domestic requirements for this Compact to enter into force.

Section 4.2 Conditions Precedent to MCC Disbursements or Re-Disbursements. Prior to, and as condition precedent to, any MCC Disbursement or Re-Disbursement, the Government shall satisfy, or ensure the satisfaction of, any applicable conditions precedent in the Disbursement Agreement.

ARTICLE V. FINAL CLAUSES

Section 5.1 Communications. Unless otherwise expressly stated in this Compact or otherwise agreed in writing by the Parties, any notice, certificate, request, report, document or other communication required, permitted, or submitted by either Party to the other under this Compact shall be: (a) in writing; (b) in English; and (c) deemed duly given: (i) upon personal delivery to the Party to be notified; (ii) when sent by confirmed facsimile or electronic mail, if sent during normal business hours of the recipient Party, if not, then on the next business day; or (iii) two (2) business day after deposit with an internationally recognized overnight courier, specifying next day delivery, with written verification of receipt to the Party to be notified at the address indicated below, or at such other address as such Party may designate:

To MCC:

Millennium Challenge Corporation

Attention: Vice President for Country Relations

(with a copy to the Vice President and General Counsel)

875 15th Street, N.W.

Washington, D.C. 20005

United States of America

Facsimile: (202) 521-3700

Email: VPCountryRelations@mcc.gov (Vice President for Country Relations);

VPGeneralCounsel@mcc.gov (Vice President and General Counsel)

To the Government:

Minister of the Presidency
Casa Presidencial
Tegucigalpa, F.M.
Honduras, C.A.

Notwithstanding the foregoing, any audit report delivered pursuant to Section 3.8, if delivered by facsimile or electronic mail, shall be followed by an original in overnight express mail. This Section 5.1 shall not apply to the exchange of letters contemplated in Section 1.3 or any amendments under Section 5.3.

Section 5.2 Representatives. Unless otherwise agreed in writing by the Parties, for all purposes relevant to this Compact, the Government shall be represented by the individual holding the position of, or acting as, the Minister of the Presidency of the Republic of Honduras, and MCC shall be represented by the individual holding the position of, or acting as, Vice President for Country Relations (each, a "**Principal Representative**"), each of whom, by written notice, may designate one or more additional representatives (each, an "**Additional Representative**") for all purposes other than signing amendments to this Compact. The names of the Principal Representative and any Additional Representative of each of the Parties shall be provided, with specimen signatures, to the other Party, and the Parties may accept as duly authorized any instrument signed by such representatives relating to the implementation of this Compact, until receipt of written notice of revocation of their authority. A Party may change its Principal Representative to a new representative of equivalent or higher rank upon written notice to the other Party, which notice shall include the specimen signature of the new Principal Representative.

Section 5.3 Amendments. The Parties may amend this Compact only by a written agreement signed by the Principal Representatives of the Parties.

Section 5.4 Termination; Suspension.

(a) Subject to Section 2.5 and paragraphs (e) through (h) of this Section 5.4, either Party may terminate this Compact in its entirety by giving the other Party thirty (30) days' written notice.

(b) Notwithstanding any other provision of this Compact, including Section 2.1, or any Supplemental Agreement between the Parties, MCC may suspend or terminate MCC Funding, in whole or in part, and any obligation or sub-obligation related thereto, upon giving the Government written notice, if MCC determines that:

(i) Any use or proposed use of MCC Funding or Program Assets or continued implementation of the Compact would be in violation of applicable law or U.S. Government policy, whether now or hereafter in effect;

(ii) The Government, any Provider, or any other third party receiving MCC Funding or using Program Assets is engaged in activities that are contrary to the national security interests of the United States;

(iii) The Government has committed an act or an event has occurred that would render the Republic of Honduras ineligible to receive United States economic assistance under Part I of the Foreign Assistance Act of 1961, as amended (22 U.S.C. 2151 *et seq.*), by reason of the application of any provision of the Foreign Assistance Act of 1961 or any other provision of law;

(iv) The Government has engaged in a pattern of actions or omissions inconsistent with the MCA Eligibility Criteria, or there has occurred a significant decline in the performance of the Republic of Honduras on one or more of the eligibility indicators contained therein;

(v) The Government or any Provider, in MCC's sole opinion, has materially breached one or more of its assurances or any other covenants, obligations or responsibilities under this Compact or any Supplemental Agreement;

(vi) An audit, review, report or any other document or other evidence reveals that actual expenditures for the Program or any Project or Project Activity were greater than the projected expenditure for such activities identified in the applicable Spending Plan or are projected to be greater than projected expenditures for such activities;

(vii) If the Government (A) materially reduces the allocation in its national budget or any other Government budget of the normal and expected resources that the Government would have otherwise received or budgeted, from external or domestic sources, for the activities contemplated herein, (B) fails to contribute or provide the amount, level, type and quality of resources required to effectively carry out the Government Responsibilities or any other responsibilities or obligations of the Government under or in furtherance of this Compact, or (C) fails to pay any of its obligations as required under this Compact or any Supplemental Agreement, including such obligations which are required to be paid solely out of national funds;

(viii) If the Government, any Provider, or any other third party receiving MCC Funding or using Program Assets, or any of their respective directors, officers, employees, Affiliates, contractors, representatives or agents, is found to have been convicted of a narcotics offense or to have been engaged in drug trafficking;

(ix) Any MCC Funding or Program Assets are applied, directly or indirectly, to the provision of resources and support to, individuals and organizations associated with terrorism, sex trafficking or prostitution;

(x) An event or condition of any character has occurred that, in MCC's sole opinion: (A) materially and adversely affects, or is likely to materially and adversely affect, the ability of the Government or any other party to effectively implement, or ensure the effective implementation of, the Program or any Project or to otherwise carry out its responsibilities or obligations under or in furtherance of this Compact or any Supplemental Agreement or to perform its obligations under or in furtherance of this Compact or any Supplemental Agreement or to exercise its rights thereunder; (B) makes it improbable that the Objectives will be achieved during the Compact Term; (C) materially and adversely affects the Program Assets or any Permitted Account; or (D) constitutes misconduct injurious to MCC, or the commission of an act constituting fraud or a felony, by the Government, MCA-Honduras, any other Government

Affiliate or Provider, or any officer, director, employee, agent, representative, contractor, grantee, subcontractor or sub-grantee thereof;

(xi) The Government, MCA-Honduras or any Provider has taken any action or omission or engaged in any activity in violation of, or inconsistent with, the requirements of this Compact or any Supplemental Agreement to which the Government, MCA-Honduras or any Provider is a party; or

(xii) There has occurred, in MCC's sole opinion, a failure to meet a condition precedent or series of conditions precedent or any other requirements or conditions to MCC Disbursement as set out in and in accordance with any Supplemental Agreement between the Parties.

(c) MCC may reinstate any suspended or terminated MCC Funding under this Compact or any Supplemental Agreement if MCC determines, in its sole discretion, that the Government or other relevant party has demonstrated a commitment to correcting each condition for which MCC Funding was suspended or terminated.

(d) The authority to suspend or terminate this Compact or any MCC Funding under this Section 5.4 includes the authority to suspend or terminate any obligations or sub-obligations relating to MCC Funding under any Supplemental Agreement without any liability to MCC whatsoever.

(e) All MCC Funding shall terminate upon expiration or termination of the Compact Term; *provided, however*, reasonable expenditures for goods, services and works that are properly incurred under or in furtherance of this Compact before expiration or termination of the Compact Term may be paid from MCC Funding, provided that the request for such payment is properly submitted within sixty (60) days after such expiration or termination.

(f) Except for payments which the Parties are committed to make under noncancelable commitments entered into with third parties before such suspension or termination, the suspension or termination of this Compact or any Supplemental Agreement, in whole or in part, shall suspend, for the period of the suspension, or terminate, or ensure the suspension or termination of, as applicable, any obligation or sub-obligation of the Parties to provide financial or other resources under this Compact or any Supplemental Agreement, or to the suspended or terminated portion of this Compact or such Supplemental Agreement, as applicable. In the event of such suspension or termination, the Government shall use its best efforts to suspend or terminate, or ensure the suspension or termination of, as applicable, all such noncancelable commitments related to the suspended or terminated MCC Funding. Any portion of this Compact or any such Supplemental Agreement that is not suspended or terminated shall remain in full force and effect.

(g) Upon the full or partial suspension or termination of this Compact or any MCC Funding, MCC may, at its expense, direct that title to Program Assets be transferred to MCC if such Program Assets are in a deliverable state; *provided*, for any Program Asset(s) partially purchased or funded, directly or indirectly, by MCC Funding, the Government shall reimburse to a U.S. Government account designated by MCC the cash equivalent of the portion of the value of such Program Asset(s).

(h) Prior to the expiration of this Compact or upon the termination of this Compact, the Parties shall consult in good faith with a view to reaching an agreement in writing on (i) the post-Compact Term treatment of MCA-Honduras, (ii) the process for ensuring the refunds of MCC Disbursements that have not yet been released from a Permitted Account through a valid Re-Disbursement or otherwise committed in accordance with Section 5.4(e) or (iii) any other matter related to the winding up of the Program and this Compact.

Section 5.5 Privileges and Immunities; Bilateral Agreement.

(a) MCC is an agency of the Government of the United States of America and its personnel assigned to the Republic of Honduras will be notified pursuant to the Vienna Convention on Diplomatic Relations as members of the mission of the Embassy of the United States of America. The Government shall ensure that any personnel of MCC so notified, including individuals detailed to or contracted by MCC, and the members of the families of such personnel, while such personnel are performing duties in the Republic of Honduras, shall enjoy the privileges and immunities that are enjoyed by a member of the United States Foreign Service, or the family of a member of the United States Foreign Service so notified, as appropriate, of comparable rank and salary of such personnel, if such personnel or the members of the families of such personnel are not a national of, or permanently resident in, the Republic of Honduras.

(b) All MCC Funding shall be considered United States assistance furnished under the Bilateral Agreement, as amended from time to time.

Section 5.6 Attachments. Any annex, schedule, exhibit, table, appendix or other attachment expressly attached hereto (collectively, the "Attachments") is incorporated herein by reference and shall constitute an integral part of this Compact.

Section 5.7 Inconsistencies.

(a) Conflicts or inconsistencies between any parts of this Compact shall be resolved by applying the following descending order of precedence:

- (i) Articles I through V
- (ii) Any Attachments

(b) In the event of any conflict or inconsistency between this Compact and any Supplemental Agreement between the Parties, the terms of this Compact shall prevail. In the event of any conflict or inconsistency between any Supplemental Agreement between the Parties and any other Supplemental Agreement, the terms of the Supplemental Agreement between the Parties shall prevail. In the event of any conflict or inconsistency between Supplemental Agreements between any parties, the terms of a more recently executed Supplemental Agreement between such parties shall take precedence over a previously executed Supplemental Agreement between such parties. In the event of any inconsistency between a Supplemental Agreement between the Parties and any component of the Implementation Plan, the terms of the relevant Supplemental Agreement shall prevail.

Section 5.8 Indemnification. The Government shall indemnify and hold MCC and any MCC officer, director, employee, Affiliate, contractor, agent or representative (each of MCC and any

such persons, an "**MCC Indemnified Party**") harmless from and against, and shall compensate, reimburse and pay such MCC Indemnified Party for, any liability or other damages which (i) are directly or indirectly suffered or incurred by such MCC Indemnified Party or to which any MCC Indemnified Party may otherwise become subject, regardless of whether or not such damages relate to any third-party claim, and (ii) arise from or as a result of the negligence or willful misconduct of the Government, MCA-Honduras or any other Government Affiliate, directly or indirectly, connected with, any activities (including acts or omissions) undertaken in furtherance of this Compact; *provided, however*, the Government shall apply national funds to satisfy its obligations under this Section 5.8 and no MCC Funding, Accrued Interest, or Program Asset may be applied by the Government in satisfaction of its obligations under this Section 5.8.

Section 5.9 Headings. The Section and Subsection headings used in this Compact are included for convenience only and are not to be considered in construing or interpreting this Compact.

Section 5.10 Interpretation; Definitions.

(a) Any reference to the term "including" in this Compact shall be deemed to mean "including without limitation" except as expressly provided otherwise.

(b) Any reference to activities undertaken "in furtherance of this Compact" or similar language shall include activities undertaken by the Government, any Provider or any other third party receiving MCC Funding involved in carrying out the purposes of this Compact or any Supplemental Agreement, including their officers, directors, employees, Affiliates, contractors, grantees, sub-contractors, sub-grantees, agents and representatives, whether pursuant to the terms of this Compact, any Supplemental Agreement or otherwise.

(c) References to "day" or "days" shall be calendar days unless provided otherwise.

(d) The term "**U.S. Government**" shall mean any branch, agency, bureau, government corporation, government chartered entity or other body of the Federal government of the United States.

(e) The term "**Affiliate**" of a party is a person or entity that controls, is controlled by, or is under the same control as the party in question, whether by ownership or by voting, financial or other power or means of influence.

(f) The term "**Government Affiliate**" is an Affiliate, ministry, bureau, department, agency, government corporation or any other entity chartered or established by the Government.

References to any Affiliate or Government Affiliate herein shall include any of their respective directors, officers, employees, affiliates, contractors, grantees, sub-contractors, sub-grantees, representatives, and agents.

(g) Any references to "Supplemental Agreement between the Parties" shall mean any agreement between MCC on the one hand, and the Government or any Government Affiliate on the other hand.

Section 5.11 Signatures. Other than a signature to this Compact or an amendment to this Compact pursuant to Section 5.3, a signature delivered by facsimile or electronic mail in accordance with Section 5.1 shall be deemed an original signature, and the Parties hereby waive any objection to such signature or to the validity of the underlying document, certificate, notice, instrument or agreement on the basis of the signature's legal effect, validity or enforceability solely because it is in facsimile or electronic form. Such signature shall be accepted by the receiving Party as an original signature and shall be binding on the Party delivering such signature.

Section 5.12 Designation. MCC may designate any Affiliate, agent, or representative to implement, in whole or in part, its obligations, and exercise any of its rights, under this Compact or any Supplemental Agreement between the Parties.

Section 5.13 Survival. Any Government Responsibilities, covenants or obligations or other responsibilities to be performed by the Government after the Compact Term shall survive the termination or expiration of this Compact and expire in accordance with their respective terms. Notwithstanding the termination or expiration of this Compact, the following provisions shall remain in force: Sections 2.2, 2.3, 2.5, 3.2, 3.3, 3.4, 3.5, 3.8, 3.9 (for one year), 3.12, 5.1, 5.2, 5.4(d), 5.4(e) (for sixty days), 5.4(f), 5.4(g), 5.4(h), 5.5, 5.6, 5.7, 5.8, 5.9, 5.10, 5.11, 5.12, this Section 5.13, 5.14, and 5.15.

Section 5.14 Consultation. Either Party may, at any time, request consultations relating to the interpretation or implementation of this Compact or any Supplemental Agreement between the Parties. Such consultations shall begin at the earliest possible date. The request for consultations shall designate a representative for the requesting Party with the authority to enter consultations and the other Party shall endeavor to designate a representative of equal or comparable rank. If such representatives are unable to resolve the matter within 20 days from the commencement of the consultations then each Party shall forward the consultation to the Principal Representative or such other representative of comparable or higher rank. The consultations shall last no longer than 45 days from date of commencement. If the matter is not resolved within such time period, either Party may terminate this Compact pursuant to Section 5.4(a). The Parties shall enter any such consultations guided by the principle of achieving the Compact Goal in a timely and cost-effective manner.

Section 5.15 MCC Status. MCC is a United States government corporation acting on behalf of the United States Government in the implementation of this Compact. As such, MCC has no liability under this Compact, is immune from any action or proceeding arising under or relating to this Compact and the Government hereby waives and releases all claims related to any such liability. In matters arising under or relating to this Compact, MCC is not subject to the jurisdiction of the courts or other body of Honduras.

Section 5.16 Language. This Compact is prepared in English and in the event of any ambiguity or conflict between this official English version and any other version translated into any language for the convenience of the Parties, this official English version shall prevail.

Section 5.17 Publicity, Information and Marking. The Parties shall give appropriate publicity to this Compact as a program to which the United States, through MCC, has contributed, including by posting this Compact, and any amendments thereto, on the MCC website and the

MCA-Honduras Website, identifying Program activity sites, and marking Program Assets; *provided*, any announcement, press release or statement regarding MCC or the fact that MCC is funding the Program or any other publicity materials referencing MCC, including the publicity described in this Section 5.17, shall be subject to prior approval by MCC and shall be consistent with any instructions provided by MCC from time to time in relevant Implementation Letters. Upon the termination or expiration of this Compact, MCC may request the removal of, and the Government shall, upon such request, remove, or cause the removal of, any such markings and any references to MCC in any publicity materials or on the MCA-Honduras Website.

[SIGNATURE PAGE BEGINS ON THE NEXT PAGE.]

IN WITNESS WHEREOF, the undersigned, duly authorized by their respective governments, have signed this Compact this 13th day of June, 2005 and this Compact shall enter into force in accordance with Section 1.3.

Done at Washington, D.C. in the English language.

FOR MILLENNIUM CHALLENGE
CORPORATION, ON BEHALF OF
THE UNITED STATES OF AMERICA

FOR THE GOVERNMENT OF THE
REPUBLIC OF HONDURAS

/ s /

Name: Paul V. Applegarth
Title: Chief Executive Officer

/ s /

Name: Luis Cosenza Jiménez
Title: Minister of the Presidency

SIGNATURE PAGE TO MILLENNIUM CHALLENGE COMPACT BY AND BETWEEN
THE UNITED STATES OF AMERICA, ACTING THROUGH THE MILLENNIUM CHALLENGE CORPORATION,
AND THE GOVERNMENT OF THE REPUBLIC OF HONDURAS

EXHIBIT A

COMPENDIUM OF DEFINED TERMS

The following compendium of capitalized terms that are used herein is provided for the convenience of the reader. To the extent that there is a conflict or inconsistency between the definitions in this Exhibit A and the definitions elsewhere in the text of this Compact, the definition elsewhere in this Compact shall prevail over the definition in this Exhibit A.

Accrued Interest is any interest or other earnings on MCC Funding that accrues or is earned.

Act means the Millennium Challenge Act of 2003.

Activity Indicator means an Indicator that measures the delivery of key goods and services in order to monitor the pace of Project Activity execution.

Additional Representative is a representative as may be designated, by written notice, by the Principal Representative of the Government or by MCC for all purposes other than signing amendments to this Compact.

Affiliate means a person or entity that controls, is controlled by, or is under the same control as the party in question, whether by ownership or by voting, financial or other power or means of influence.

Agribusiness Assistance means the market-oriented technical assistance that the Agribusiness Service Providers will provide to farmers.

Agribusiness Service Providers are those service providers that MCC will fund to provide farmer training and development under the Rural Development Project.

Agricultural Objective is an Objective of this Compact to increase the productivity and business skills of Honduran farmers who operate small- and medium-size farms and their employees.

Atlantic Corridor is one of the main corridors of the International Network of Mesoamerican Highways that runs along the coast of the Atlantic Ocean.

Attachments are any annex, schedule, exhibit, table, appendix or other attachment expressly attached to this Compact.

Auditor is the person or entity that MCA-Honduras shall engage to carry out the Government's audit responsibilities as provided in Sections 3.8(d-f) of this Compact.

Auditor/Reviewer Agreement is a Material Agreement that MCA-Honduras will enter into with each Auditor or Reviewer, in form and substance satisfactory to MCC, that sets forth the roles and responsibilities of the Auditor or Reviewer with respect to the audit, review or evaluation.

Bank(s) means any bank holding an account referenced in Section 4(d) of Annex I.

Bank Agreement is a Material Agreement that MCA-Honduras will enter into with each Bank, satisfactory to MCC, that sets forth the signatory authority, access rights, anti-money laundering and anti-terrorist financing provisions, and other terms related to the Permitted Account.

Baseline means the value of an Indicator prior to it being affected by the Program.

Beneficiaries are the Hondurans who participate in the Program or are covered by the Program.

Benefit Stream means the increase in income accrued to a group of Beneficiaries as a result of one or more Project Activities over a period of time.

Bilateral Agreement means the General Agreement for Economic Cooperation between the Government of the United States of America and the Government of Honduras, dated May 27, 1961, as amended from time to time.

Board means the independent Board of Directors of MCA-Honduras, which shall oversee MCA-Honduras's responsibilities and obligations under this Compact.

CABEI means the Central American Bank for Economic Integration.

CAFTA means the Central American Free Trade Agreement.

Chairman is the individual who will act as the Chairman of the Board.

CIDA means the Canadian International Development Agency.

Civil Board Members are the two Civil Observers who are chosen from time to time to serve as voting members on the Board.

Civil Observer means those representatives appointed by Honduran civil society organizations to serve as Observers to the Board.

Compact means the agreement made by and between the United States of America, acting through the Millennium Challenge Corporation, and the Government of the Republic of Honduras.

Compact Goal means the achievement of the Objectives to advance economic growth and poverty reduction in Honduras.

Compact Records are accounting books, records, documents and other evidence that the Government shall maintain, and shall use its best efforts to ensure that all Providers maintain, relating to this Compact adequate to show, to the satisfaction of MCC, without limitation, the use of all MCC Funding.

Compact Reports are any documents or reports delivered to MCC in satisfaction of the Government's reporting requirements under this Compact or any Supplemental Agreement between the Parties and certified by the Chairman and/or General Director of MCA-Honduras or other designated officer, as provided in applicable law and the Governance Regulations.

Compact Term means this Compact shall remain in force for five (5) years from the Entry into Force, unless earlier terminated.

Covered Provider means (i) any non-United States Provider that receives (other than pursuant to a direct contract or agreement with MCC) USD \$300,000 or more of MCC Funding in any MCA-Honduras fiscal year or any other non-United States person or entity that receives, directly or indirectly, USD \$300,000 or more of MCC Funding from any Provider in such fiscal year or (ii) any United States Provider that receives (other than pursuant to a direct contract or agreement with MCC) USD \$500,000 or more of MCC Funding in any MCA-Honduras fiscal year or any other United States party that receives, directly or indirectly, USD \$500,000 or more of MCC Funding from any Provider in such fiscal year.

Designated Rights and Responsibilities means the Government shall designate MCA-Honduras to implement the Government's Responsibilities and any other responsibilities or obligations of the Government and to exercise any rights of the Government under this Compact or any Supplemental Agreement between the Parties in accordance with the terms and conditions set forth in this Compact or such Supplemental Agreement.

Disbursement Agreement is a Supplemental Agreement that the Parties shall enter into prior to any MCC Disbursement or Re-Disbursement that (i) further specifies the terms and conditions of such MCC Disbursements and Re-Disbursements, (ii) is in a form and substance mutually satisfactory to the Parties, and (iii) is signed by the Principal Representative of each Party (or in the case of the Government, the principal representative of the applicable Government Affiliate).

Entry into Force means this Compact shall enter into force on the date of the last letter in an exchange of letters between the Principal Representatives of each Party confirming that all conditions set forth in Section 4.1 have been satisfied by the Government and MCC.

Environmental Guidelines are the environmental guidelines delivered by MCC to the Government or posted by MCC on its website or otherwise made available, as amended from time to time.

ESI Director means the Environment and Social Impact Director within the PMU, who will ensure that environmental and social mitigation measures (including resettlement and gender issues) are followed for all Project Activities in accordance with the provisions set forth in this Compact and other documents.

Evaluation Component is the portion of the M&E Plan that specifies a process and timeline for the assessment of planned, ongoing, or completed Project Activities to determine their efficiency, effectiveness, impact and sustainability.

Exempt Uses means the application of Section 2.3(e) to exempt from any tax (i) any transaction, service, activity, contract, grant or other implementing agreement funded in whole or in part by MCC Funding; (ii) any supplies, equipment, materials, property or other goods (referred to herein collectively as "goods") or funds introduced into, acquired in, used or disposed of in, or imported into or exported from, the Republic of Honduras by MCC, or by any person or entity (including contractors and grantees) as part of, or in conjunction with, MCC Funding or the Program; (iii) any contractor, grantee, or other organization carrying out activities funded in whole or in part by MCC Funding; (iv) any employee of such organizations; and (v) any individual contractor or grantee carrying out activities funded in whole or in part by MCC Funding.

FHIS means the Minister of the Honduran Social Investment Fund, which is one of the Government ministries that will appoint a representative to serve as a non-voting Observer on the Board.

Final Evaluation means the evaluation that will be conducted at the completion of the Program by an independent evaluator engaged by MCA-Honduras, with the prior approval of MCC.

Financial Plan means collectively, the Multi-Year Financial Plan and each Spending Plan, each amendment, supplement or other change thereto.

Financial Plan Annex means Annex II of this Compact, which summarizes the Multi-Year Financial Plan for the Program.

Fiscal Accountability Plan is the plan that identifies the principles and mechanisms to ensure appropriate fiscal accountability for the use of MCC Funding provided under this Compact.

Fiscal Agent is the person or entity that MCA-Honduras shall engage, who shall be responsible for, among other things, the matters set forth in Annex I, Section 3(g).

Fiscal Agent Agreement is a Material Agreement that MCA-Honduras enters into with each Fiscal Agent, in form and substance satisfactory to MCC, that sets forth the roles and responsibilities of the Fiscal Agent and other appropriate terms and conditions.

General Director means the individual who will act as General Director of MCA-Honduras.

Goal Indicator is an Indicator that measures the impact of the Program on the incomes of Beneficiaries.

Governance Regulations means the governance regulations promulgated in furtherance of the Compact and applicable law, which shall be in a form and substance satisfactory to MCC and which specify how MCA-Honduras shall be organized and what its roles and responsibilities are.

Government means the Government of the Republic of Honduras that is a Party to this Compact with MCC.

Government Affiliate is an Affiliate, ministry, bureau, department, agency, government corporation or any other entity chartered or established by the Government.

Government Board Members are the three Government voting members on the Board: (i) the Secretary of State of the Office of the Presidency of Honduras, (ii) the Secretary of State of the Office of Finances of Honduras, and (iii) the Secretary of State of the Office of Industry and Commerce.

Government Observer(s) are individuals who shall serve as non-voting observers to the Board, who are appointed by the following Government ministries: (i) SAG; (ii) SOPRAVI; (iii) FHIS and (iv) SERNA.

Government Party means (i) the Government, (ii) any Government Affiliate, or (iii) MCA-Honduras or any of their respective directors, officers, employees, Affiliates, contractors, representatives or agents.

Government Responsibilities means the Government shall have principal responsibility for oversight and management of the implementation of the Program (i) in accordance with the terms and conditions specified in this Compact and relevant Supplemental Agreements, (ii) in accordance with all applicable laws then in effect in Honduras, and (iii) in a timely and cost-effective manner and in conformity with sound technical, financial and management practices.

Grant Committee is a committee that shall provide oversight of the Agriculture Public Goods Grant Facility funded by MCC.

Highway CA-5 is the Honduran portion of the Atlantic Corridor, which carries most of Honduras' import and export traffic from Puerto Cortes to the major production and consumption centers in and around the cities of San Pedro Sula, Comayagua and Tegucigalpa.

IDB means the Inter-American Development Bank.

IFAD means the International Fund for Agricultural Development.

Implementation Letter is a letter issued by MCC from time to time to furnish additional information or guidance to assist the Government in the implementation of this Compact.

Implementation Plan means the implementation framework and the plan for ensuring adequate governance, oversight, management, monitoring, evaluation and accountability for the use of MCC Funding and for the implementation of the Program and each Project, which are described in the Compact, relevant Supplemental Agreements and other documents and which consist of: (i) a Financial Plan, (ii) Fiscal Accountability Plan, (iii) Procurement Plan, (iv) Program and Project Work Plans, and (v) the M&E Plan.

Implementing Entity means the government agencies or nongovernmental agencies or other public- or private-sector entities or persons that MCA-Honduras may provide MCC funding to, directly or indirectly, through an Outside Project Manager, to implement and carry out Projects or any other activities to be carried out in furtherance of this Compact.

Implementing Entity Agreement is a Material Agreement that MCA-Honduras (or the appropriate Outside Project Manager) enters into with each Implementing Entity, in form and substance satisfactory to MCC, that sets forth the roles and responsibilities of such Implementing Entity and other appropriate terms and conditions.

Indicators are the objective data that the M&E Plan will use to measure the results of the Program and which are divided into four types: (i) Goal Indicator, (ii) Objective Indicator, (iii) Outcome Indicator, and (iv) Activity Indicator.

Inspector General shall mean the Inspector General of the United States Agency for International Development.

Lien means any lien, attachment, enforcement of judgment, pledge, or encumbrance of any kind.

Local Account means an interest-bearing local currency of Honduras bank account.

M&E Annex means Annex III of this Compact, which generally describes the components of the M&E Plan for the Program.

M&E Plan means the Monitoring and Evaluation Plan to measure and evaluate progress toward achievement of the Objectives of this Compact, a general description of which is set forth in Annex III.

Material Agreement is any agreement (i) between the Government and MCA-Honduras, (ii) between the Government, MCA-Honduras or other Government Affiliate, on the one hand, and any Provider or Affiliate of a Provider, on the other hand, which require such MCC approval under applicable law, the Governance Regulations, Procurement Agreement, Procurement Guidelines or any Supplemental Agreement, or (iii) in which the Government, MCA-Honduras or other Government Affiliate appoints, hires or engages any of the persons or entities listed in Annex I Section 3(c)(i)(3) in furtherance of this Compact and any amendments and supplements thereto.

Material Re-Disbursement means any Re-Disbursement that requires MCC approval under applicable law, the Governance Regulations, Procurement Agreement, Procurement Guidelines or any Supplemental Agreement.

Material Terms of Reference means the terms of reference for the procurement of goods or services that require MCC approval under applicable law, the Governance Regulations, the Procurement Guidelines or any Supplemental Agreement.

MCA means the Millennium Challenge Account, which is the account that provides MCC Funding to implement this Compact.

MCA Eligibility Criteria means the MCA selection criteria and methodology published by MCC pursuant to Section 607 of the Act from time to time.

MCA-Honduras is the legal entity established by the Government in a form mutually agreeable to the Parties, which shall be responsible for the oversight and management of the implementation of this Compact on behalf of the Government.

MCA-Honduras Website is the website that MCA-Honduras shall develop and maintain in a timely, accurate and appropriately comprehensive manner, to include postings of information and documents in English and Spanish relating to the Program and Projects.

MCC means the Millennium Challenge Corporation, which is the United States government corporation that is a Party to this Compact with the Government.

MCC Disbursement means the release of MCC Funding to a Permitted Account or through such other mechanism agreed by the Parties.

MCC Disbursement Request is the applicable request that the Government and MCA-Honduras will jointly submit for an MCC Disbursement as may be specified in the Disbursement Agreement.

MCC Funding means the amount of funding that MCC shall grant to the Government (USD \$215,000,000) during this Compact Term to enable the Government to implement the Program and achieve the Objectives.

MCC Indemnified Party means MCC and any MCC officer, director, employee, Affiliate, contractor, agent or representative, who the Government shall indemnify and hold harmless from and against and shall compensate, reimburse and pay for any liability or other damages which are stated in Section 5.8.

MCC Representative is an individual appointed by MCC who will serve as a non-voting observer to the Board.

Monitoring Component is the portion of the M&E Plan that specifies how the implementation of the Program and progress toward the achievement of the Objectives and Compact Goal will be monitored.

Multi-Year Financial Plan is a plan for the Program and for each Project that includes: (i) the multi-year summary of anticipated estimated MCC Funding and the Government's contribution of funds and resources, (ii) an estimated draw-down rate for the first year of this Compact based on the achievement of performance milestones and the satisfaction or waiver of conditions precedent, and (iii) a Spending Plan for the upcoming year of the Program.

North Segment is a 50 kilometer segment of Highway CA-5 between Taulabe and Comayagua.

Objective(s) are the objectives of this Compact that have been identified by the Parties, each of which is key to reducing poverty through economic growth in Honduras, i.e., the Agricultural Objective and the Transportation Objective.

Objective Indicator is an Indicator that measures the final results of the Projects in order to monitor their success in meeting the Objectives.

Observers are the non-voting observers to the Board.

Officers are the persons holding Project Director positions in the Program Management Unit.

Outcome Indicator is an Indicator that measures the intermediate results of goods and services delivered under a Project in order to provide an early measure of the likely impact of the Projects on the Objectives.

Outside Project Managers are the qualified entities that may be engaged by the PMU, or as instructed by the Board to be engaged, as necessary, for the proper and efficient day-to-day management of a Project.

Pacific Corridor is one of the main corridors of the International Network of Mesoamerican Highways that runs along the Pacific Ocean.

Party means (i) the United States, acting through MCC or (ii) the Government.

Permitted Account(s) are those accounts that the Government shall establish, or cause to be established, as may be agreed by the Parties in writing from time to time to receive MCC Disbursements.

Pledge means any (i) MCC Funding, (ii) any Program Assets, or (iii) any guarantee directly or indirectly of any indebtedness.

PMU means the Program Management Unit.

PPP means Plan Puebla-Panama, which is a plan to create a reliable Mesoamerican network of highways known as the International Network of Mesoamerican Highways.

Principal Representative means (i) for the Government, the individual holding the position of, or acting as, Minister of the Presidency of the Republic of Honduras, and (ii) for MCC, the individual holding the position of, or acting as, the Vice President for Country Relations.

Procurement Agent is the person or entity that MCA-Honduras shall engage to carry out and/or certify specified procurement activities in furtherance of this Compact on behalf of the Government, MCA-Honduras, any Outside Project Manager or Implementing Entity.

Procurement Agent Agreement is a Material Agreement that MCA-Honduras will enter into with the Procurement Agent, in form and substance satisfactory to MCC, that sets forth the roles and responsibilities of the Procurement Agent with respect to the conduct, monitoring and review of procurements and other appropriate terms and conditions.

Procurement Agreement is a Supplemental Agreement between the Parties wherein the Government shall ensure that the procurement of all goods, services and works by the Government, MCA-Honduras or any other Provider in furtherance of this Compact shall be consistent with the Procurement Guidelines.

Procurement Guidelines are (i) the procurement standards and procedures of the World Bank, as codified in the "Guidelines: Procurement under IBRD Loans and IDA Credits, May 2004 (ISBN 0-8213-5829-4)" (covering works and goods) and "Guidelines: Selection and Employment of Consultants by World Bank Borrowers, May 2004" (covering consultants and technical assistance) and (ii) subject to any exceptions and other modifications specified by the procurement guidelines set forth in the Procurement Agreement, which MCC may modify by publication from time to time.

Procurement Plan is a plan adopted by MCA-Honduras, which shall forecast the upcoming eighteen month procurement activities and be updated every six months.

Procurement Supervisor is the person or entity that MCA-Honduras shall engage, if requested by MCC, to supervise specified procurement activities in furtherance of this Compact on behalf of the Government, MCA-Honduras, any Outside Project Manager or any Implementing Entity.

Procurement Supervisor Agreement is a Material Agreement that MCA-Honduras will enter into with the Procurement Supervisor, in form and substance satisfactory to MCC, that sets forth the roles and responsibilities of the Procurement Supervisor with respect to the conduct, monitoring and review of procurements and other appropriate terms and conditions.

Program is what the Parties will implement under this Compact using MCC Funding to advance Honduras's progress towards economic growth and poverty reduction.

Program Annex means the section of this Compact (Annex I) that generally describes the Program that MCC Funding will support in Honduras during the Compact Term and the results to be achieved from the investment of MCC Funding.

Program Assets means (i) MCC Funding, (ii) Accrued Interest, or (iii) any asset, good, or property (real, tangible, or intangible) purchased or financed in whole or in part by MCC Funding.

Program Farmers are the owners, operators and employees of small- and medium-size farms covered by the Program.

Program Management Unit (PMU) is the management team of MCA-Honduras, which shall report to the Board and have overall management responsibility for the implementation of this Compact.

Project(s) are the specific projects and the policy reforms and other activities that the Government will carry out, or cause to be carried out, using MCC Funding, in furtherance of this Compact to achieve the Objectives and the Compact Goal, i.e., the Rural Development Project and the Transportation Project.

Project Activity means the activities that will be undertaken in furtherance of each Project using MCC Funding, which are identified in the Schedules to Annex I.

Project Director(s) are the Rural Development Project Director and Transportation Project Director.

Proposal is the document submitted to MCC by the Government on August 20, 2004 to request MCA assistance.

Provider means (i) MCA-Honduras and any other Government Affiliate involved in any activities in furtherance of this Compact or (ii) any third party who receives at least USD \$50,000 in the aggregate of MCC Funding (other than employees of MCA-Honduras) during this Compact Term or such other amount as the Parties may agree in writing, whether directly from MCC, indirectly through Re-Disbursements, or otherwise.

PRS means the Honduran Poverty Reduction Strategy, which describes the macroeconomic, structural and social policies and programs needed to promote growth and reduce poverty.

Re-Disbursement is the release of MCC Funding from a Permitted Account.

Reviewer is an independent person or entity that MCA-Honduras shall engage to (i) conduct reviews of performance and compliance under this Compact pursuant to Section 3.8(f) of this Compact, who shall (A) conduct general reviews of performance or compliance, (B) conduct environmental audits, and (C) have the capacity to conduct data quality assessments in accordance with the M&E Plan, and/or (ii) assess performance as required under the M&E Plan.

Road Fund is the Honduran Fondo Vial that maintains the Honduran Highway system.

Rural Development Project is a Project of the Program (Schedule I to Annex I) that the Parties intend to implement in furtherance of the Agricultural Objective and Transportation Objective, which is designed to increase the productivity and improve the competitiveness of Program Farmers.

SAG means the Secretary of State of the Office of Agriculture and Livestock, which is one of the Government ministries that will appoint a representative to serve as a non-voting Observer on the Board.

SERNA means the Government's Secretary of State of the Office of Natural Resources and Environment, which is one of the Government ministries that will appoint a representative to serve as a non-voting Observer on the Board.

SOPTRAVI means the Government's Secretary of State of the Office of Public Works, Transportation and Housing, which is one of the Government ministries that will appoint a representative to serve as a non-voting Observer on the Board.

South Segment is a 59 kilometer segment of Highway CA-5 between Villa de San Antonio and Tegucigalpa.

Spending Plan is a financial plan that MCA-Honduras shall periodically deliver to MCC during this Compact Term, which will specify the annual and quarterly spending requirements for the Program and each Project, projected both on a commitment and cash requirement basis.

Supplemental Agreement is an agreement between (i) the Government (or any Government Affiliate) and MCC, (ii) MCC and/or the Government (or any Government Affiliate) and any third party, including any of the Providers or (iii) any third parties where neither MCC nor the Government is a party, before, on or after the Entry into Force, which details any funding, implementing and other arrangements in furtherance of this Compact.

Supplemental Agreement between the Parties means any agreement between MCC on the one hand, and the Government or any Government Affiliate on the other hand.

Supplemental Agreement Term Sheets means the term sheets that the Government (or mutually acceptable Government Affiliate) and MCC shall execute that set forth the material and principal terms and conditions of each of the Supplemental Agreements identified in Exhibit B.

Target(s) mean the expected results of the Indicators that specify the expected value and the expected time by which that result will be achieved.

Tax(es) means all taxes, tariffs, duties and other levies in Honduras.

Transportation Objective is an Objective of this Compact to reduce transportation costs between targeted production centers and national, regional and global markets.

Transportation Project is a Project of the Program (Schedule 2 to Annex I) in furtherance of the Transportation Objective, which is designed to reduce transportation costs between Honduran production centers and national, regional and global markets.

U.S. Government means the United States Government and refers to any branch, agency, bureau, government corporation, government chartered entity or other body of the Federal government of the United States.

United States Dollars (USD) means the currency of the United States of America.

USAID means the U.S. Agency for International Development.

USDA means the U.S. Department of Agriculture.

Work Plans are those plans MCA-Honduras shall adopt for the overall administration of the Program and each activity and shall set forth the details of each activity to be undertaken or funded by MCC Funding as well as the allocation of roles and responsibilities for specific Project activities, or other programmatic guidelines, performance requirements, targets, or other expectations for a Project.

EXHIBIT B
LIST OF SUPPLEMENTAL AGREEMENTS

1. Governance Regulations
2. Fiscal Agent Agreement
3. Bank Agreement
4. Procurement Supervisor Agreement

ANNEX I

PROGRAM DESCRIPTION

This Annex I to the Compact (the "*Program Annex*") generally describes the Program that MCC Funding will support in Honduras during the Compact Term and the results to be achieved from the investment of MCC Funding. Prior to any MCC Disbursement or Re-Disbursement, including for the Projects described herein, the Parties shall enter into a Supplemental Agreement that (i) further specifies the terms and conditions of such MCC Disbursements and Re-Disbursements, (ii) is in a form and substance mutually satisfactory to the Parties, and (iii) is signed by the Principal Representative of each Party (or in the case of the Government, the principal representative of the applicable Government Affiliate (the "*Disbursement Agreement*").

Except as specifically provided herein, the Parties may amend this Program Annex only by written agreement signed by the Principal Representative of each Party. Each capitalized term in this Program Annex shall have the same meaning given such term elsewhere in this Compact. Unless otherwise expressly stated, each Section reference herein is to the relevant Section of the main body of the Compact.

1. Background; Consultative Process.

Following the devastation of Hurricane Mitch in 1998 and the subsequent reconstruction effort, Honduras now enjoys a window of opportunity to capitalize on the democratic reforms begun in the 1980s, the economic liberalization of the 1990s, and increasing regional integration, trade liberalization and the promise of The Dominican Republic-Central America-United States Free Trade Agreement. Honduras has begun to seize this opportunity and use its strategic location to generate economic growth, particularly in light manufacturing, non-traditional agriculture and tourism. However, Honduras needs to ensure that growth extends to the rural population, where most of its poverty is concentrated, by enhancing agricultural development and linking its large rural population to markets.

The Honduran Poverty Reduction Strategy ("*PRS*")¹ describes the macroeconomic, structural and social policies and programs needed to promote growth and reduce poverty. Among its priorities, the PRS seeks to improve agricultural productivity and access to markets. These two objectives of the PRS are essential to increasing exports, particularly in light manufacturing and non-traditional agriculture, which are the two sectors that have accounted for most of Honduras' recent economic growth and poverty reduction.

To reduce rural poverty, the PRS contemplates increasing production and improving the efficiency and competitiveness of rural producers by providing them with better access to market-support services throughout the production cycle (e.g., market research, production, post-harvest and processing technical assistance), financing (e.g., credit from traditional and non-

¹ The Honduran Poverty Reduction Strategy is articulated in the Poverty Reduction Strategy Paper developed in 2001, and a Poverty Reduction Strategy - Implementation Plan for 2004 - 2006 developed in 2004.

traditional financing sources), technology (e.g., on-farm irrigation systems), and infrastructure (e.g., building and maintaining rural roads, improving the efficiency of property registries).

The PRS also seeks to integrate the Honduran economy into channels of world trade by completing (i) the main Honduran highway artery that directly connects Puerto Cortes (Honduras' Atlantic port) to Puerto Cutuco (El Salvador's Pacific port), major production centers within Honduras, and the country's Central American trading partners, and (ii) the access roads that feed into this artery. The goal is to guarantee the access of national products to export markets under competitive conditions as a means to achieve a freer and more competitive flow of products and inputs on a national, regional and global basis.

The PRS consultative process was based on, among other things, dialogue with donors, meetings with over 3,500 representatives of civil society organizations from diverse economic groups and geographic areas in 13 cities, and workshops conducted in the main geographical regions of the country that included more than 650 participants. The Honduran Poverty Reduction Strategy Consultative Council, a representative group headed by a vice minister of the Honduran Presidency, headed this process. Implementation of the PRS involves extensive and on-going consultations with stakeholders to set priorities and monitor implementation.

In developing the MCC Proposal, the Government reviewed the PRS and other agreed upon national priorities and consulted with the donor community and civil society to determine which components of the PRS should be incorporated into the Proposal. The Government then solicited feedback on the Proposal from the public at large by posting the document on its PRS website (www.sierp.hn) and publishing a summary of the Proposal in a major local newspaper. After submitting the Proposal to MCC, the Government held five high level meetings with civil society organizations and donors to gather more feedback, including participants' insights on obstacles to economic growth and poverty reduction in Honduras. This input informed the Government in the negotiation of the Program and contributed to several material changes to the Program, including the inclusion of civil society as voting members of the Board of Directors of MCA-Honduras. The Government then held three separate meetings with civil society organizations in March 2005, to explain how such feedback had caused the final MCC Program to differ from the original proposal. The Government plans to continue consultations with civil society and donors throughout the implementation of the Program. The civil society representatives who participate on the MCA-Honduras Board also will help ensure civil society oversight and input throughout the implementation process.

The Proposal itself focuses on, among other things, raising agricultural productivity and reducing transportation costs. MCC found that these two objectives are widely accepted as deep-rooted factors affecting economic growth and poverty reduction on a national level. The main projects that the Proposal identifies to achieve these objectives enjoy broad support from civil society and donors.

Following MCC's review of the Proposal, the consultative process and negotiations, the Parties identified certain mutually acceptable components of the Proposal and other components developed through such discussions that together constitute the Program. The Parties mutually agreed that the Program will focus on alleviating two key impediments to economic growth: high

transportation costs and low agricultural productivity. The Program is fully consistent with, and directly supports, the Objectives of raising agricultural productivity and reducing transportation costs.

2. Overview.

(a) **Program Objectives.** The Program involves a series of specific and complementary interventions that the Parties expect will achieve the Agricultural Objective and the Transportation Objective and advance the progress of Honduras towards the Compact Goal, particularly in rural areas.

(b) **Projects.** The Parties have identified, for each Objective, Projects that they intend for the Government to implement, or cause to be implemented, using MCC Funding, each of which is described in the Schedules to this Program Annex. The Schedules to this Program Annex identify the activities that will be undertaken in furtherance of each Project (each, a "**Project Activity**"). Notwithstanding anything to the contrary in this Compact, the Parties may agree to amend, terminate or suspend these Projects or create a new project by written agreement signed by the Principal Representative of each Party without amending this Compact; *provided, however*, any such amendment of a Project or creation of a new project is (i) consistent with the Objectives; (ii) does not cause the amount of MCC Funding to exceed the aggregate amount specified in Section 2.1(a) of this Compact; (iii) does not cause the Government's responsibilities or contribution of resources to be less than specified in Section 2.2 of this Compact or elsewhere in this Compact; and (iv) does not extend the Compact Term.

(c) **Beneficiaries.** The intended beneficiaries of each Project are described in the respective Schedule to this Program Annex and Annex III to the extent identified as of the date hereof.

(d) **Civil Society.** Civil society shall participate in overseeing the implementation of the Program through its representation on, and as Observers to, the Board, as provided in Section 3(d) of this Program Annex. In addition, the Work Plans or Procurement Plans for each Project shall note the extent to which civil society will have a role in the implementation of a particular Project or Project Activity. Finally, members of civil society may be recipients of training or other public awareness programs that are integral to the Project Activities.

(e) **Monitoring and Evaluation.** Annex III of this Compact generally describes the plan to measure and evaluate progress toward achievement of the Compact Goal and Objectives of this Compact (the "**M&E Plan**"). As outlined in the Disbursement Agreement and other Supplemental Agreements, continued disbursement of MCC Funding under this Compact (whether as MCC Disbursements or Re-Disbursements) shall be contingent, among other things, on successful achievement of targets set forth in the M&E Plan.

3. Implementation Framework.

The implementation framework and the plan for ensuring adequate governance, oversight, management, monitoring, evaluation and fiscal accountability for the use of MCC Funding is summarized below and in the Schedules attached to this Program Annex, or as may otherwise be agreed in writing by the Parties.

(a) **General.** The elements of the implementation framework will be further described in relevant Supplemental Agreements and in a detailed plan for the implementation of the Program and each Project (the "**Implementation Plan**"), which will be memorialized in one or more documents and shall consist of a Financial Plan, Fiscal Accountability Plan, Procurement Plan, Program and Project Work Plans, and M&E Plan. MCA-Honduras shall adopt each component of the Implementation Plan in accordance with the requirements and timeframe as may be specified in this Program Annex, the Disbursement Agreement or as may otherwise be agreed by the Parties from time to time. MCA-Honduras may amend the Implementation Plan or any component thereof without amending this Compact, provided any material amendment of the Implementation Plan or any component thereof has been approved by MCC and is otherwise consistent with the requirements of this Compact and any relevant Supplemental Agreement between the Parties. By such time as may be specified in the Disbursement Agreement or as may otherwise be agreed by the Parties from time to time, MCA-Honduras shall adopt one or more work plans for the overall administration of the Program and for each Project (collectively, the "**Work Plans**"). The Work Plan(s) shall set forth the details of each activity to be undertaken or funded by MCC Funding as well as the allocation of roles and responsibilities for specific Project activities, or other programmatic guidelines, performance requirements, targets, or other expectations for a Project.

(b) **Government.**

(i) The Government shall promptly take all necessary and appropriate actions to carry out the Government Responsibilities and other obligations or responsibilities of the Government under and in furtherance of this Compact, including undertaking or pursuing such legal, legislative or regulatory actions, procedural changes and contractual arrangements as may be necessary or appropriate to achieve the Objectives, to successfully implement the Program, and to establish a legal entity, in a form mutually agreeable to the Parties ("**MCA-Honduras**"), which shall be responsible for the oversight and management of the implementation of this Compact on behalf of the Government. The Government shall promptly deliver to MCC certified copies of any documents, orders, decrees, laws or regulations evidencing such legal, legislative, regulatory, procedural, contractual or other actions.

(ii) During the Compact Term, the Government shall ensure that MCA-Honduras is duly authorized and organized and sufficiently staffed and empowered to fully carry out the Designated Rights and Responsibilities. Without limiting the generality of the preceding sentence, MCA-Honduras shall be organized, and have such roles and responsibilities, as described in Section 3(d) of this Program Annex and as provided in applicable law and in governance regulations promulgated in furtherance thereof ("**Governance Regulations**"), which shall be in a form and substance satisfactory to MCC ; *provided, however*, the Government may,

subject to MCC approval, carry out any of the roles and responsibilities designated to be carried out by MCA-Honduras and described in Section 3(d) of this Program Annex or elsewhere in this Program Annex, applicable law, the Governance Regulations, or any Supplemental Agreement prior to and during the initial period of the establishment and staffing of MCA-Honduras, but in no event longer than the earlier of (i) the formation of the Board and the engagement of each of the Officers and (ii) six months from the Entry into Force, unless otherwise agreed by the Parties in writing.

(c) MCC.

(i) Notwithstanding Section 3.1 of this Compact or any provision in this Program Annex to the contrary, and except as may be otherwise agreed upon by the Parties from time to time, MCC must approve in writing each of the following transactions, activities, agreements and documents prior to the execution or carrying out of such transaction, activity, agreement or document and prior to MCC Disbursements or Re-Disbursements in connection therewith:

- (1) MCC Disbursements;
- (2) The Financial Plan and any amendments and supplements thereto;

(3) Agreements (i) between the Government and MCA-Honduras, (ii) between the Government, MCA-Honduras or other Government Affiliate, on the one hand, and any Provider or Affiliate of a Provider, on the other hand, which require such MCC approval under applicable law, the Governance Regulations, Procurement Agreement, Procurement Guidelines or any other Supplemental Agreement, or (iii) in which the Government, MCA-Honduras or other Government Affiliate appoints, hires or engages any of the following in furtherance of this Compact:

- (A) Auditor and Reviewer;
- (B) Fiscal Agent;
- (C) Bank;
- (D) Procurement Agent and Procurement Supervisor;
- (E) Outside Project Manager;
- (F) Implementing Entity; and
- (G) Director, Observer, Officer and/or other key employee or contractor of MCA-Honduras, including any compensation for such person.

(Any agreement described in clause (i) through (iii) of this Section 3(c)(i)(3) and any amendments and supplements thereto, each, a "**Material Agreement**");

(4) Any modification, termination or suspension of a Material Agreement, or any action that would have the effect of such a modification, termination or suspension of a Material Agreement;

(5) Any agreement that is (i) not at arm's length or (ii) with a party related to the Government, including MCA-Honduras, or any of their respective Affiliates;

(6) Any Re-Disbursement (each, a "**Material Re-Disbursement**") that requires such MCC approval under applicable law, the Governance Regulations, Procurement Agreement, Procurement Guidelines or any Supplemental Agreement;

(7) Any terms of reference for the procurement of goods, services or works that require such MCC approval under applicable law, the Governance Regulations, Procurement Agreement, Procurement Guidelines or any Supplemental Agreement (each, a "**Material Terms of Reference**");

(8) The Implementation Plan, including each component plan thereto, and any material amendments and supplements to the Implementation Plan or any component thereto;

(9) Any pledge of any MCC Funding or any Program Assets or any guarantee directly or indirectly of any indebtedness (each, a "**Pledge**");

(10) Any decree, legislation, regulation, contractual arrangement or other document establishing or governing MCA-Honduras, including the Governance Regulations, and any disposition (in whole or in part), liquidation, dissolution, winding up, reorganization or other change of (A) MCA-Honduras, including any revocation or modification of, or supplement to, any decree, legislation, contractual arrangement or other document establishing MCA-Honduras, or (B) any subsidiary or Affiliate of MCA-Honduras;

(11) Any change in character or location of any Permitted Account;

(12) Formation or acquisition of any subsidiary (direct or indirect) or other Affiliate of MCA-Honduras;

(13) Any (A) change of a Director, Observer, Officer or other key employee or contractor of MCA-Honduras, or in the composition of the Board, including approval of the nominee for Chairman, (B) filling of any vacant seat of the Chairman, a Director or an Observer or vacant position of an Officer or other key employee or contractor of MCA-Honduras, or (C) change of the Director of the *Fondo Nacional de Desarrollo Rural Sostenible* (FONADERS);

(14) The management information system to be developed and maintained by the PMU of MCA-Honduras, and any material modifications to such system;

(15) Any decision to amend, supplement, replace, terminate or otherwise change any of the foregoing; and

(16) Any other activity, agreement, document or transaction requiring the approval of MCC in this Compact, applicable law, the Governance Regulations, Procurement Agreement, Procurement Guidelines, Disbursement Agreement, or any other Supplemental Agreement between the Parties.

The Chairman of the Board (the "**Chairman**") and/or the General Director of MCA-Honduras (the "**General Director**") or other designated officer, as provided in applicable law and the Governance Regulations, shall certify any documents or reports delivered to MCC in satisfaction of the Government's reporting requirements under this Compact or any Supplemental Agreement between the Parties (the "**Compact Reports**").

(ii) MCC shall have the authority to exercise its approval rights set forth in this Section 3(c) in its sole discretion and independent of any participation or position taken by the MCC Representative at a meeting of the Board. MCC retains the right to revoke its approval of any matter, agreement or action if MCC concludes, in its sole discretion, that its approval was issued on the basis of incomplete, inaccurate or misleading information furnished by the Government or MCA-Honduras. Notwithstanding any provision in this Compact or any Supplemental Agreement to the contrary, the exercise by MCC of its approval rights under this Compact or any Supplemental Agreement shall not (i) diminish or otherwise affect any obligations or responsibilities of the Government under this Compact, (ii) transfer any such Government obligations or responsibilities to MCC, or (iii) otherwise subject MCC to any liability.

(d) **MCA-Honduras.**

(i) **General.** Unless otherwise agreed by the Parties in writing, MCA-Honduras shall be responsible for the oversight and management of the implementation of this Compact. MCA-Honduras shall be governed by the terms and conditions set forth in applicable law and in the Governance Regulations based on the following principles:

(1) The Government shall ensure that MCA-Honduras shall not assign, delegate or contract any of the Designated Rights and Responsibilities without the prior written consent of the Government and MCC. MCA-Honduras shall not establish any Affiliates or subsidiaries (direct or indirect) without the prior written consent of the Government and MCC.

(2) Unless otherwise agreed by the Parties in writing, MCA-Honduras shall consist of (a) an independent board of directors (the "**Board**") to oversee MCA-Honduras' responsibilities and obligations under the this Compact (including any Designated Rights and

Responsibilities) and (b) a management team (the "**Program Management Unit**" or "**PMU**") to have overall management responsibility for the implementation of this Compact.

(ii) Board.

(1) Formation. The Government shall ensure that the Board shall be formed, constituted, governed and operated in accordance with applicable law and the terms and conditions set forth in the Governance Regulations and relevant Supplemental Agreements.

(2) Composition. Unless otherwise agreed by the Parties in writing, the Board shall consist of (i) five voting members, one of whom shall be appointed the Chairman as provided in applicable law and the Governance Regulations and (ii) non-voting observers (the "**Observers**").

(A) The voting members shall be as follows, provided that the Government members identified in subsections (i) - (iii) below (the "**Government Board Members**") may be replaced by another government official, subject to approval by the Government and MCC:

- (i) The Secretary of State of the Office of the Presidency of Honduras;
- (ii) The Secretary of State of the Office of Finances of Honduras;
- (iii) The Secretary of State of the Office of Industry and Commerce; and
- (iv) Two Civil Observers (each, a "**Civil Board Member**").

(B) The Observers shall be:

- (i) A representative (the "**MCC Representative**") appointed by MCC;
- (ii) A representative (each, a "**Government Observer**") appointed by each of the following Government ministries:
 - a. The Secretary of State of the Office of Agriculture and Livestock ("**SAG**");

- b. The Secretary of State of the Office of Public Works, Transportation and Housing ("*SOPTRAVT*");
 - c. The Minister of the Honduran Social Investment Fund ("*FHIS*"); and
 - d. The Secretary of State of the Office of Natural Resources and Environment ("*SERNA*");
- (iii) A representative (each, a "*Civil Observer*") appointed by each of the following Honduran civil society organizations:
- a. National Anticorruption Council (*Consejo Nacional Anticorrupcion - CNA*);
 - b. National Convergence Forum (*Foro Nacional de Convergencia - FNC*);
 - c. Poverty Reduction Strategy Consultative Council (*Consejo Consultivo de la Estrategia de la Reduccion de Pobreza - CCERP*);
 - d. Honduran Council for Private Enterprise (*Consejo Hondureno de la Empresa Privada - COHEP*); and
 - e. such other organizations to which the Parties mutually agree.
- (C) Each Government Board Member position shall be filled by the individual then holding the office identified and such individuals shall serve in their capacity as the applicable Government official and not in their personal capacity.
- (D) Subject to applicable law and the Governance Regulations, the Parties contemplate that the Secretary of State of the Office of the Presidency of Honduras shall initially fill the seat of Chairman.

- (E) Each Observer shall have rights to attend all meetings of the Board, participate in the discussions of the Board, and receive all information and documents provided to the Board, together with any other rights of access to records, employees or facilities as would be granted to a member of the Board under applicable law and in the Governance Regulations.
 - (F) The Chairman, in the presence of the other Government Board Members and the MCC Representative, shall choose by lot the initial two (2) Civil Board Members from among the four (4) Civil Observers who shall serve as voting members of the Board for two non-consecutive terms of fifteen (15) months each beginning on the Entry into Force and the day following the 30-month anniversary of the Compact, respectively. The remaining two (2) Civil Observers shall serve as voting members of the Board for two non-consecutive terms of fifteen (15) months each beginning on the day following the expiration of the 15-month anniversary of the Compact and the 45-month anniversary of the Compact, respectively. This Compact, applicable law, the Governance Regulations and relevant Supplemental Agreements between the Parties shall govern the terms and conditions of the participation of the Civil Observers on the Board. For purposes of this paragraph, a "15-month" term shall equal 457 days for terms 1 and 2 and 456 days for terms 3 and 4.
- (3) Role and Responsibilities.
- (A) The Board shall oversee the PMU, the overall implementation of the Program and the performance of the Designated Rights and Responsibilities.
 - (B) Certain actions may be taken, and certain agreements and other documents may be executed and delivered, by MCA-Honduras only upon the approval and authorization of the Board as provided under applicable law and in the Governance Regulations, including each MCC Disbursement Request, selection or termination of certain Providers, any component of the Implementation Plan, certain Re-Disbursements and certain terms of reference.
 - (C) The Chairman shall certify the approval by the Board of all Compact Reports or any other documents or reports from time to time delivered to MCC by MCA-Honduras

(whether or not such documents or reports are required to be delivered to MCC), and that such documents or reports are true, accurate and complete.

- (D) Without limiting the generality of the Designated Rights and Responsibilities, and subject to MCC's contractual rights of approval as set forth in Section 3(c) of this Program Annex or elsewhere in this Compact or any relevant Supplemental Agreement, the Board shall have the exclusive authority as between the Board and the PMU for all actions defined for the Board under applicable law and in the Governance Regulations and which are expressly designated therein as responsibilities that cannot be delegated further.

(4) Indemnification of MCC Representative. Pursuant to Section 5.5 and Section 5.8 of this Compact, the Government and MCA-Honduras shall hold harmless the MCC Representative for any liability or action arising out of the MCC Representative's role as a non-voting observer on the Board. The Government hereby waives and releases all claims related to any such liability and acknowledges that the MCC Representative has no fiduciary duty to MCA-Honduras. MCA-Honduras shall provide a written waiver and acknowledgement that no fiduciary duty to MCA-Honduras is owed by the MCC Representative. In matters arising under or relating to the Compact, the MCC Representative is not subject to the jurisdiction of the courts or other body of Honduras.

(iii) PMU. Unless otherwise agreed in writing by the Parties, the PMU shall report, through the General Director or other Officer as designated in applicable law and the Governance Regulations, directly to the Board and shall have the composition, roles and responsibilities described below and set forth more particularly in applicable law and the Governance Regulations.

(1) Appointment of General Director. The General Director of MCA-Honduras shall be nominated by the Board after an open and competitive selection process, which nomination shall be subject to MCC approval, and appointed by the President of the Republic of Honduras.

(2) Appointment of Other Officers. The other Officers of MCA-Honduras shall be appointed by the General Director after an open and competitive selection process, which appointment shall be subject to Board and MCC approval.

(3) Composition. The Government shall ensure that the PMU shall be composed of qualified experts from the public or private sectors, including such offices and staff as may be necessary to carry out effectively its responsibilities, each with such powers and responsibilities as set forth in applicable law and the Governance Regulations and from time to time in any Supplemental Agreement, including without limitation the following: (i) General Director; (ii) Administration and Finance Director; (iii) Monitoring and Evaluation Director; (iv)

Environmental and Social Impact Director, (v) Rural Development Project Director; and (vi) Transportation Project Director (the Rural Development Project Director and the Transportation Project Director are each, a "**Project Director**") (the persons holding the positions in sub-clauses (i) through (vi) shall be collectively referred to as "**Officers**"). The Parties contemplate that for purposes of the initial period of operations, and in no event longer than six months, MCA-Honduras may appoint an acting General Director, subject to the prior approval of MCC; *provided*, during such period, the Board shall ratify the actions of such acting General Director and MCA-Honduras shall select a permanent General Director through a competitive selection process and subject to MCC prior approval in accordance with this Annex I.

(4) Role and Responsibilities.

- (A) The PMU shall assist the Board in overseeing the implementation of the Program and shall have principal responsibility (subject to the direction and oversight of the Board and subject to MCC's contractual rights of approval as set forth in Section 3(c) of this Program Annex or elsewhere in this Compact or any relevant Supplemental Agreement) for the overall management of the implementation of the Program.
- (B) Without limitation of the foregoing general responsibilities or the generality of the Designated Rights and Responsibilities, the PMU shall develop the components of the Implementation Plan, oversee the implementation of the Projects, manage and coordinate monitoring and evaluation, maintain internal accounting records, conduct and oversee certain procurements, and perform such other responsibilities as set forth in applicable law and the Governance Regulations or delegated to the PMU by the Board from time to time.
- (C) The PMU shall have the obligation and right to approve certain actions and documents or agreements, including certain Re-Disbursements, MCC Disbursement Requests, Compact Reports, certain human resources decisions, and certain procurement actions, as provided in applicable law and the Governance Regulations and the Procurement Guidelines.

(e) **Outside Project Manager.** The PMU shall have the authority to engage qualified entities to serve as outside project managers (each, an "**Outside Project Manager**") in the event that it is advisable to do so for the proper and efficient day-to-day management of a Project; *provided, however*, that the appointment or engagement of any Outside Project Manager after a competitive selection process shall be subject to approval by the Board and MCC prior to such appointment or engagement. Upon Board approval, the PMU may delegate, assign, or

contract to the Outside Project Managers such duties and responsibilities as it deems appropriate with respect to the management of the Implementing Entities and the implementation of the specific Projects; and *provided, further*, that the PMU and the relevant Project Director shall remain accountable for those duties and responsibilities and all reports delivered by the Outside Project Manager notwithstanding any such delegation, assignment or contract. The Board may, independent of any request from the PMU, determine that it is advisable to engage one or more Outside Project Managers and instruct the PMU or, where appropriate, a Procurement Agent to commence and conduct the competitive selection process for such Outside Project Manager.

(f) **Implementing Entities.** Subject to the terms and conditions of this Compact and any other Supplemental Agreement between the Parties, MCA-Honduras may provide MCC Funding, directly or indirectly through an Outside Project Manager, to one or more Government agencies or to one or more nongovernmental or other public- or private-sector entities or persons to implement and carry out the Projects or any other activities to be carried out in furtherance of this Compact (each, an "***Implementing Entity***"). The Government shall ensure that MCA-Honduras (or the appropriate Outside Project Manager) enters into an agreement with each Implementing Entity, in form and substance satisfactory to MCC, that sets forth the roles and responsibilities of such Implementing Entity and other appropriate terms and conditions, such as payment of the Implementing Entity (the "***Implementing Entity Agreement***"). An Implementing Entity shall report directly to the relevant Project Director or Outside Project Manager, as designated in the applicable Implementing Entity Agreement or as otherwise agreed by the Parties.

(g) **Fiscal Agent.** The Government shall ensure that MCA-Honduras engages one or more fiscal agents (each, a "***Fiscal Agent***"), who shall be responsible for, among other things, (i) ensuring and certifying that Re-Disbursements are properly authorized and documented in accordance with established control procedures set forth in the Disbursement Agreement, the Fiscal Agent Agreement and other relevant Supplemental Agreements, (ii) Re-Disbursement and cash management, including instructing a Bank to make Re-Disbursements from a Permitted Account (to which the Fiscal Agent has sole signature authority), following applicable certification by the Fiscal Agent, (iii) providing applicable certifications for MCC Disbursement Requests, (iv) maintaining proper accounting of all MCC Funding financial transactions and certain other accounting functions, (v) producing reports on MCC Disbursements and Re-Disbursements (including any requests therefore) in accordance with established procedures set forth in the Disbursement Agreement, the Fiscal Agent Agreement or any other relevant Supplemental Agreements, and (vi) funds control. Upon the written request of MCC, the Government shall ensure that MCA-Honduras terminates a Fiscal Agent, without any liability to MCC, and the Government shall ensure that MCA-Honduras engages a new Fiscal Agent, subject to the approval by the Board and MCC. The Government shall ensure that MCA-Honduras enters into an agreement with each Fiscal Agent, in form and substance satisfactory to MCC, that sets forth the roles and responsibilities of the Fiscal Agent and other appropriate terms and conditions, such as payment of the Fiscal Agent ("***Fiscal Agent Agreement***").

(h) **Auditors and Reviewers.** The Government shall ensure that MCA-Honduras carries out the Government's audit responsibilities as provided in Sections 3.8(d), (e) and (f) of this Compact, including engaging one or more auditors (each, an "***Auditor***") required by Section 3.8(d) of this Compact. As requested by MCC in writing from time to time, the Government

shall ensure that MCA-Honduras shall also engage an independent (i) reviewer to conduct reviews of performance and compliance under this Compact pursuant to Section 3.8(f) of this Compact, which reviewer shall (A) conduct general reviews of performance or compliance, (B) conduct environmental audits, and (C) have the capacity to conduct data quality assessments in accordance with the M&E Plan, as described more fully in Annex III, and/or (ii) an independent evaluator to assess performance as required under the M&E Plan (each, a "**Reviewer**"). MCA-Honduras shall select the Auditor(s) or Reviewers in accordance with the Governance Regulations or relevant Supplemental Agreement. The Government shall ensure that MCA-Honduras enters into an agreement with each Auditor or Reviewer, in form and substance satisfactory to MCC, that sets forth the roles and responsibilities of the Auditor or Reviewer with respect to the audit, review or evaluation, including access rights, required form and content of the applicable audit, review or evaluation and other appropriate terms and conditions such as payment of the Auditor or Reviewer (the "**Auditor / Reviewer Agreement**"). In the case of a financial audit required by Section 3.8(f) of this Compact, such Auditor / Reviewer Agreement shall be effective no later than 120 days prior to the end of the relevant fiscal year or other period to be audited; *provided, however*, if MCC requires concurrent audits of financial information or reviews of performance and compliance under this Compact, then such Auditor / Reviewer Agreement shall be effective no later than a date agreed by the Parties in writing.

(i) **Procurement Agent.** If requested by MCC, the Government shall ensure that MCA-Honduras engages one or more procurement agents (each, a "**Procurement Agent**") to carry out and/or certify specified procurement activities in furtherance of this Compact on behalf of the Government, MCA-Honduras, any Outside Project Manager or Implementing Entity. The role and responsibilities of such Procurement Agent and the criteria for selection of a Procurement Agent shall be as set forth in the applicable Implementation Letter or Supplemental Agreement. The Government shall ensure that MCA-Honduras enters into an agreement with the Procurement Agent, in form and substance satisfactory to MCC, that sets forth the roles and responsibilities of the Procurement Agent with respect to the conduct, monitoring and review of procurements and other appropriate terms and conditions, such as payment of the Procurement Agent (the "**Procurement Agent Agreement**"). Any Procurement Agent shall adhere to the procurement standards set forth in the Procurement Guidelines and ensure procurements are consistent with the procurement plan (the "**Procurement Plan**") adopted by MCA-Honduras, which plan shall forecast the upcoming eighteen month procurement activities and be updated every six months.

(j) **Procurement Supervisor.** If requested by MCC, the Government shall ensure that MCA-Honduras engages one or more procurement supervisors (each, a "**Procurement Supervisor**") to supervise specified procurement activities in furtherance of this Compact on behalf of the Government, MCA-Honduras, any Outside Project Manager or any Implementing Entity. The role and responsibilities of such Procurement Supervisor and the criteria for selection of a Procurement Supervisor shall be as set forth in the applicable Implementation Letter or Supplemental Agreement. The Government shall ensure that MCA-Honduras enters into an agreement with the Procurement Supervisor, in form and substance satisfactory to MCC, that sets forth the roles and responsibilities of the Procurement Supervisor with respect to the conduct, monitoring and review of procurements and other appropriate terms and conditions, such as payment of the Procurement Supervisor (the "**Procurement Supervisor Agreement**"). Any Procurement Supervisor shall ensure that the procurement standards set forth in the

Procurement Guidelines are adhered to and ensure procurements are consistent with the Procurement Plan.

4. Finances and Fiscal Accountability.

(a) **Financial Plan.**

(i) **Multi-Year Financial Plan.** The multi-year financial plan for the Program and for each Project (the "***Multi-Year Financial Plan***") is summarized in Annex II to this Compact.

(ii) **Spending Plan.** During the Compact Term, the Government shall ensure that MCA-Honduras delivers to MCC timely financial plans that specify, respectively, the annual and quarterly detailed spending requirements for the Program and each Project (including monitoring, evaluation and administrative costs), projected both on a commitment and cash requirement basis (each a "***Spending Plan***"). Each Spending Plan shall be delivered by such time as specified in the Disbursement Agreement or as may otherwise be agreed by the Parties. The Multi-Year Financial Plan and each Spending Plan and each amendment, supplement or other change thereto are collectively, the "***Financial Plan***."

(iii) **Expenditures.** No financial commitment involving MCC Funding shall be made, no obligation of MCC Funding shall be incurred, and no Re-Disbursement shall be made or MCC Disbursement Request submitted for any activity or expenditure, unless the expense is provided for in the applicable Spending Plan and unless uncommitted funds exist in the balance of the Spending Plan for the relevant period or unless the Parties otherwise agree in writing.

(iv) **Modifications to Financial Plan.** Notwithstanding anything to the contrary in this Compact, MCA-Honduras may amend or supplement the Financial Plan or any component thereof without amending this Compact, provided any material amendment or supplement has been approved by MCC and is otherwise consistent with the requirements of this Compact and any relevant Supplemental Agreement between the Parties.

(b) **Disbursement and Re-Disbursement.** The Disbursement Agreement (and disbursement schedules thereto), as amended from time to time, shall specify the terms, conditions and procedures on which MCC Disbursements and Re-Disbursements shall be made. The obligation of MCC to make MCC Disbursements or approve Re-Disbursements is subject to the fulfillment, waiver or deferral of any such terms and conditions. The Government and MCA-Honduras shall jointly submit the applicable request for an MCC Disbursement (the "***MCC Disbursement Request***") as may be specified in the Disbursement Agreement. MCC will make MCC Disbursements in tranches to a Permitted Account from time to time as provided in the Disbursement Agreement or as may otherwise be agreed by the Parties, subject to Program requirements and performance by the Government, MCA-Honduras and other relevant parties in furtherance of this Compact. Re-Disbursements will be made from time to time based on requests by an authorized representative of the appropriate party designated for the size and type of Re-Disbursement in accordance with the Governance Regulations and Disbursement

Agreement; *provided, however*, unless otherwise agreed by the Parties in writing, no Re-Disbursement shall be made unless and until the written approvals specified herein or in the Governance Regulations and Disbursement Agreement for such Re-Disbursement have been obtained and delivered to the Fiscal Agent.

(c) **Fiscal Accountability Plan.** By such time as specified in the Disbursement Agreement or as otherwise agreed by the Parties, MCA-Honduras shall adopt as part of the Implementation Plan a fiscal accountability plan that identifies the principles and mechanisms to ensure appropriate fiscal accountability for the use of MCC Funding provided under this Compact, including the process to ensure that open, fair, and competitive procedures will be used in a transparent manner in the administration of grants or cooperative agreements and the procurement of goods and services for the accomplishment of the Objectives (the "***Fiscal Accountability Plan***"). The Fiscal Accountability Plan shall set forth, among other things, requirements with respect to the following matters: (i) funds control and documentation; (ii) separation of duties and internal controls; (iii) accounting standards and systems; (iv) content and timing of reports; (v) policies concerning public availability of all financial information; (vi) cash management practices; (vii) procurement and contracting practices, including timely payment to vendors; (viii) the role of independent auditors; and (ix) the roles of fiscal agents and procurement agents.

(d) **Permitted Accounts.** The Government shall establish, or cause to be established, such accounts (each, a "***Permitted Account***," and collectively "***Permitted Accounts***") as may be agreed by the Parties in writing from time to time to receive MCC Disbursements, including:

(i) Either (A) a single, completely separate non-interest bearing account at the Honduran Central Bank, or (B) a single, completely separate U.S. Dollar interest-bearing account at a commercial bank that is procured through a competitive process, whichever bank offers terms that are the most economical to MCC;

(ii) If necessary, an interest-bearing local currency of Honduras account (the "***Local Account***") at the bank selected under Section 4(d)(i) above to which the Fiscal Agent may authorize transfer from any U.S. Dollar Permitted Account for the purpose of making Re-Disbursements payable in local currency; and

(iii) Such other interest-bearing accounts to receive MCC Disbursements in such bank as the Parties mutually agree upon in writing.

No other funds shall be commingled in a Permitted Account other than MCC Funding and Accrued Interest thereon. All MCC Funding held in an interest-bearing Permitted Account shall earn interest at a rate of no less than such amount as the Parties may agree in the respective Bank Agreement or otherwise. MCC shall have the right, among other things, to view any Permitted Account statements and activity directly on-line or at such other frequency as the Parties may otherwise agree. By such time as shall be specified in the Disbursement Agreement or as otherwise agreed by the Parties, the Government shall ensure that MCA-Honduras enters into an agreement with each Bank, respectively, satisfactory to MCC, that sets forth the signatory authority, access rights, anti-money laundering and anti-terrorist financing provisions, and other

terms related to the Permitted Account, respectively (each a "**Bank Agreement**"). For purposes of this Compact, any bank holding an account referenced in Section 4(d) of this Program Annex are each a "**Bank**" and, are collectively referred to as the "**Banks**."

(e) **Currency Exchange.** The Bank shall convert MCC Funding to the currency of Honduras at a rate to which the Parties mutually agree with the Bank in the Bank Agreement.

5. Transparency; Accountability.

Transparency and accountability to MCC and to the beneficiaries are important aspects of the Program and Projects. Without limiting the generality of the foregoing, in an effort to achieve the goals of transparency and accountability, the Government shall ensure that MCA-Honduras:

- (a) Establishes an e-mail suggestion box as well as a means for other written comments that interested persons may use to communicate ideas, suggestions or feedback to MCA-Honduras;
- (b) Considers as a factor in its decision-making the recommendations of the Observers, particularly in MCA-Honduras's deliberations over pending key PMU decisions and key Board decisions as shall be specified in applicable law and the Governance Regulations;
- (c) Develops and maintains a website (the "**MCA-Honduras Website**") in a timely, accurate and appropriately comprehensive manner, such MCA-Honduras Website to include postings of information and documents in English and Spanish; and
- (d) Posts on the MCA-Honduras Website and otherwise makes publicly available from time to time the following documents or information, including by posting on the MCA-Honduras Website, with links to and from the official website of the Government (www.casapresidencial.hn) and the website of the Embassy of Honduras in the United States (<http://www.hondurasemb.org>), from time to time:
 - (i) All minutes of the meetings of the Board;
 - (ii) The M&E Plan, as amended from time to time, along with periodic reports on Program performance;
 - (iii) All relevant Environmental Impact Assessments and supporting documents;
 - (iv) Such financial information as may be required by this Compact or as may otherwise be agreed from time to time by the Parties;
 - (v) All Compact Reports;

(vi) All audit reports by an Auditor and any periodic reports or evaluations by a Reviewer;

(vii) A copy of the Disbursement Agreement, amended from time to time;

(viii) A copy of the Procurement Agreement (including Procurement Guidelines), each Procurement Plan, as amended from time to time, all procurement agreements (including policies, standard documents, procurement plans, and required procedures), bid requests, and awarded contracts; and

(ix) A copy of any legislation and other documents related to the formation, organization and governance of MCA-Honduras, including the Governance Regulations, and any amendments thereto.

SCHEDULE 1 to ANNEX I**RURAL DEVELOPMENT PROJECT**

This Schedule 1 generally describes and summarizes the key elements of a rural development Project that the Parties intend to implement in furtherance of the Agricultural Objective and Transportation Objective (the "*Rural Development Project*"). Additional details regarding the implementation of the Rural Development Project will be included in the Implementation Plan and in relevant Supplemental Agreements.

1. Background.

Honduras enjoys a comparative advantage in horticulture given its rich growing conditions, year-long growing season, and close proximity to the U.S. market. Despite this advantage, Honduran farmers predominantly grow basic grains because horticultural crops require more sophisticated techniques and infrastructure for both their production and marketing. In addition, lack of access to credit makes it more difficult for farmers to meet the higher working capital requirements of horticultural crops and poor transportation infrastructure increases the costs of getting crops to market and inputs to the farm-gate. To help producers to diversify into high-value horticultural crops and to increase their productivity and competitiveness, the Honduran PRS contemplates providing them with better access to market-support services throughout the production cycle (e.g., technical assistance in market research, production, post-harvest support and processing), financing (e.g., increase credit from financing sources), technology (e.g., help producers obtain and use on-farm irrigation systems), and infrastructure (e.g., build and maintain rural roads, improve the efficiency of property registries).

2. Summary of Project Activities.

The Rural Development Project is designed to increase the productivity and improve the competitiveness of owners, operators and employees of small- and medium-size farms covered by the Program ("*Program Farmers*"). The key activities of the Rural Development Project include:

- (a) **Farmer Training and Development.** The provision of technical assistance in the production and marketing of high value horticultural crops.
- (b) **Farmer Access to Credit.** The provision of technical assistance to financial institutions, loans to such institutions and support in expanding the national lien registry system.
- (c) **Farm to Market Roads.** The construction and improvement of feeder roads to connect farms to markets.
- (d) **Agricultural Public Goods Grant Facility.** The provision of grants to fund agricultural "public goods" projects that the private sector cannot provide on its own.

The following summarizes the contemplated Rural Development Project Activities. The M&E Plan (described in Annex III) will set forth anticipated results and, where appropriate, regular benchmarks that may be used to monitor implementation progress. Performance against the benchmarks and the overall impact of the Rural Development Project will be assessed and reported at the intervals to be specified in the M&E Plan or as otherwise agreed by the Parties from time to time. The Parties expect that additional benchmarks will be identified during the implementation of the Rural Development Project. Estimated amounts of MCC Funding for each Project Activity for the Rural Development Project are identified in Annex II of this Compact. Conditions precedent to each Rural Development Project Activity and sequencing of the Rural Development Project Activities shall be set forth in the Disbursement Agreement or other relevant Supplemental Agreements.

(a) ***Activity: Farmer Training and Development***

MCC Funding will fund training provided by one or more service providers ("**Agribusiness Service Providers**") with proven experience in providing market-oriented technical assistance ("**Agribusiness Assistance**") that combines training in agronomy and small business skills relevant to small- and medium-sized farms. Specifically, the Agribusiness Service Providers will:

- (i) Identify existing market demand for commercial crops that Program Farmers can supply;
- (ii) Identify Program Farmers who are willing and able to supply such demand;
- (iii) Develop business plans that enable Program Farmers to meet such demand;
- (iv) Work with lenders, suppliers and customers of Program Farmers to ensure that such business plans are realistic;
- (v) Develop instruments (e.g., purchase contracts) and market-based support services (e.g., farmer associations, processing arrangements) to help Program Farmers to successfully execute their business plans;
- (vi) Help Program Farmers obtain credit to finance their business plans;
- (vii) Provide agronomic and business assistance to Program Farmers, including training in complying with sanitary and phytosanitary standards, for a period of up to three years to help them to successfully execute their business plans;
- (viii) Ensure that Program Farmers employ environmentally sustainable agricultural practices; and

(ix) Certify that no crops supported by the Rural Development Project will substantially displace U.S. production.

The *expected results* from, and the *key benchmarks* to measure progress on, these activities are set forth in Annex III.

(b) *Activity: Farmer Access to Credit*

MCC Funding will fund the following activities to increase the supply of credit to rural borrowers, including farmers and other agribusiness borrowers:

(i) Technical assistance to help financial institutions better analyze credit risk and administer credit in rural communities;

(ii) Loans in an aggregate principal amount of up to \$6 million that MCA-Honduras will make to regulated financial institutions to either lend directly to Program Farmers or on-lend to a rural financial institution that, in turn, will lend to Program Farmers. The Government shall ensure that all such loans mature no later than six months prior to the expiration of the Compact Term;

(iii) The expansion of the national property registration system to include a new registry of movable property and liens, interconnecting this new registry with the land title registry and commercial (mercantile) registry, and connecting registry system offices with each other and key clients; and

(iv) Technical assistance to develop collateral-based credit products that will improve access to credit by farmers, among others;

Loan repayments from financial institutions to MCA-Honduras may be used to fund Rural Development Project Activities in the following order, as specified in the Financial Plan or as otherwise agreed by the Parties:

(i) \$1 million to fund the Agricultural Public Goods Grant Facility;

(ii) \$3 million to fund the Farmer Training and Development Project Activities; and

(iii) \$2 million in grant funding to augment the capital base of non-profit financial institutions that successfully manage the loans to Program Farmers described above.

The *expected results* from, and the *key benchmarks* to measure progress on, these activities are set forth in Annex III.

(c) **Activity: Farm to Market Roads**

MCC Funding will fund the construction or improvement of approximately 1,500 kilometers of rural roads to improve the access of rural communities (including Program Farmers) to markets and to social services. Specific roads will be funded in two phases: (i) a pilot phase that will use approximately 30% of the total funds allocated to the Farm to Market Roads Project Activity; and (ii) a second phase that will use the balance of such funds to build the roads that MCA-Honduras selects.

Subject to the prior approval of MCC, MCA-Honduras will select Farm to Market Roads among the range of proposed rural roads that promise the highest economic rate of return among such roads (12% minimum rate of return), subject to the conditions that each selected road must:

- (i) Conform to the Environmental Guidelines;
- (ii) Conform to the World Bank policy on Involuntary Resettlement, where relevant;
- (iii) Be fully designed to the satisfaction of MCA-Honduras and MCC;
- (iv) Be properly documented to the satisfaction of MCA-Honduras and MCC, including having an agreement in which the applicable municipality agrees to assume the cost of permanently maintaining the road and to pay 20% of the cost of upgrading the road to a Permitted Account; and
- (v) Have been approved by a rural road supervisory firm and the rural roads advisory committee, which committee will consist of representatives from the PMU, FHIS, SAG, SOPTRAVI, SERNA and the Association of Honduran Municipalities (AHMON).

The *expected results* from, and the *key benchmarks* to measure progress on, these activities are set forth in Annex III.

(d) **Activity: Agricultural Public Goods Grant Facility**

MCC Funding will fund a small competitive grants facility that will provide funding to support projects that enhance and accelerate the development of market-based commercial agriculture, particularly the horticultural sector. The Parties expect that these grants will fund two types of projects:

- (i) Pure Public Goods. Examples of "pure public goods" include development of improved crop germ plasm or animal genetics in sub-sectors with competitive potential. Support to such initiatives may be granted without any requirement for repayment, subject to demonstrating that the benefit stream will surpass the cost; and

(ii) **Quasi-Public Goods.** Examples of "quasi-public goods" include collective infrastructure projects that benefit groups of producers but cannot be financed by individual farmers, such as upgrades or extensions to district irrigation systems, construction of primary power supply lines, collective cold storage and packing facilities, area pest or disease control measures, and other similar investments. Cost-sharing may be appropriate for some categories of investments.

The facility will be managed by the Rural Development Project Director within the PMU, subject to oversight by a committee (the "**Grant Committee**") consisting of the Rural Development Project Director, a representative from SAG, and three representatives from civil society, whose selection and compensation must be approved by MCC.

Invitations to submit proposals for up to \$1 million per grant will be publicly posted. The facility's operating rules, subject to the prior approval of the Board and MCC, shall ensure fair and transparent selection criteria and procedures and shall conform to the Environmental Guidelines and other limitations on the use of MCC Funding. The Parties expect that a total of up to \$9 million in grants of MCC Funding will be made during the Compact Term, subject to receiving sufficient satisfactory proposals. Funding decisions will be taken by a majority of the members of the Grant Committee, subject to the approval of MCC.

The *expected results* from, and the *key benchmarks* to measure progress on, these activities are set forth in Annex III.

3. **Beneficiaries.**

The principal beneficiaries of the Rural Development Project are expected to be: (i) Program Farmers, due to improvements in the productivity and business skills of such producers; (ii) the communities of the Program Farmers, due to increased employment and reduced transportation costs to markets and social service delivery points (e.g., hospitals, schools); and (iii) the agricultural sectors, due to public goods and quasi-public goods funded by the Agricultural Public Goods Grant Facility. When MCA-Honduras identifies potential areas where the Farmer Training and Development, Agricultural Public Goods Grant Facility and Farm to Market Roads may be provided, the Government shall ensure that MCA-Honduras provides to MCC information on the population of such areas, disaggregated by gender, income level and age, where possible. After such areas have been selected: (i) the Government shall ensure that MCA-Honduras presents to the Board and MCC (a) a detailed description of the intended beneficiaries and (b) the methodology used to determine the intended beneficiaries within thirty (30) days after the selection of such areas and completion of the analysis of the intended beneficiaries therein, disaggregated, to the maximum extent practicable, by income level, gender, and age; (ii) the Parties shall agree upon the description of the intended beneficiaries; and (iii) the Parties will make publicly available a more detailed description of the intended beneficiaries of the Program, including publishing such description on the MCA-Honduras Website.

4. Coordination with USAID and Other Donors.

In developing the Rural Development Project, the Parties investigated the work of the donors described below in an effort to ensure that the Rural Development Project complements, and does not duplicate, replace or harm, such work.

The U.S. Agency for International Development ("**USAID**") has three projects that relate to or may support the Rural Development Project: (i) the *Centro Desarolla Agricultura* (CDA) project, which is run by a private company, Fintrac, to increase sales, incomes, employment of, and local investment in, the Honduran agribusiness sector by providing market-oriented technical assistance to producers and processors; (ii) the Productivity and Policy Enhancement Program project, which serves to strengthen the National Banking and Insurance Commission's supervision of financial private voluntary organizations, transition such organizations into the regulated banking environment, and help stimulate commercial banks to lend to small businesses and rural producers; and (iii) the Development Credit Authority, which signed two portfolio guarantee agreements targeted at providing guarantees of up to 50% of loans to micro, small and medium enterprises.

The U.S. Department of Agriculture ("**USDA**"), through Food for Progress donations to the Honduran Ministry of Agriculture, funded: (i) the National Agribusiness Development Centers program; (ii) the Sanitary and Phytosanitary Systems Animal and Plant Health program; and (iii) the implementation of recommendations produced from agricultural roundtable discussions. USDA also has a program with Technoserve to assist small farmers in northern Honduras, and has begun to fund a similar program in southwestern Honduras. The 2005 Food for Progress donation is expected to be used to help corn farmers transition to new crops, continue improvements to the Sanitary and Phytosanitary Systems Animal and Plant Health program, and further develop value-added chains.

The World Bank (i) funded the first phase of a land titling project (PATH) that will automate, consolidate and make property information more publicly accessible, and (ii) approved a loan to recapitalize the deposit insurance fund and reduce systemic risk in the banking sector, among other objectives.

The Inter-American Development Bank ("**IDB**") funded the Government's principal integrated rural development program (PRONADERS), which used such funds to implement (i) the RERURAL project that invested in irrigation, milk collection and refrigeration centers, coffee "green" projects, rural electrification, rural highways, and water and sanitation projects, and (ii) the MARENA project that invested in local initiatives such as basin management, irrigation systems, livestock production, reforestation, and environmental protection. The IDB also (i) finances a watershed management project, and (ii) has provided complementary support in plant and animal disease control for imports and exports and for agricultural policy work.

The International Fund for Agricultural Development ("**IFAD**") also funded PRONADERS, which used such funds to finance (i) the PROSOC project in southwestern Honduras and (ii) the PRONADEL project that focuses on local development. PRONADERS assists rural families to

finance agricultural production, livestock activities, irrigation systems, and improving rural infrastructure.

The Canadian International Development Agency ("*CIDA*") funds the ProMesas project that assists farmers in the Olancho region and finances forestry development projects in northern Honduras.

5. Sustainability.

The implementation of the Rural Development Project is designed to support the development of local capacity (yet maintain tight fiduciary risk controls) by providing Honduran professionals and institutions with experience in implementing the Program. This design is expected to add to Honduras' soft infrastructure — the human capital base that is essential for the successful design, management, and oversight of public and private projects. The Rural Development Project will use qualified staff within SAG to procure services needed to implement the Program.

While all contracts will be open to international bidding, local and regional firms are expected to be very competitive in most activities. Even in activities where an international firm may win the contract, there will be opportunities to employ Honduran individuals or firms under those contracts. For example, the Farmer Training and Development activity will be designed to allow for the participation of local firms while ensuring they work under the supervision of an internationally qualified Agribusiness Service Provider. As another example, the rural roads supervisory firm will be selected through international competitive bidding, but the construction contracts will be relatively small contracts in which national and regional firms will be very competitive.

The key issue with respect to financial sustainability of the Rural Development Project is ensuring that Program Farmers who graduate from the program are able to maintain their level of productivity under the Program and expand their business. Farmers who have successfully absorbed the intensive transformational Agribusiness Assistance will then have sufficient income to pay for less intensive periodic technical assistance to allow them to keep current with future innovations in agronomy and changes in the market structure for agricultural products. Equally important, marketing and agro-export businesses often are willing to provide technical assistance and inputs (e.g., seeds) to producers once those producers are established.

The Program promises to increase the supply of credit to stronger rural borrowers. Those farmers who have successfully learned how to access credit and have established a credit history will be in a better position to access credit in the future, thereby creating a larger demand for financial services. As bankers expand to profit from this demand, they will develop the financial products and contract the required expertise (e.g., agronomists) to service this growing market. Similarly, expanded horticultural production will create economies of scale that reduce the unit costs of inputs and post-harvesting services.

The key to ensuring environmental and social sustainability of the Program is ongoing public consultation to ensure optimal design and implementation and to ensure full country-ownership

of the Program. The Environment and Social Impact Director ("*ESI Director*") within the PMU will ensure that environmental and social mitigation measures (including resettlement and gender issues) are followed for all Project Activities in accordance with the provisions set forth in the Compact and other documents. The ESI Director also will serve as the point of contact for comments and concerns of Project-affected parties regarding the implementation of all segments of the Compact, and lead the effort to find feasible resolutions to those problems. The ESI Director will convene periodic public meetings to provide implementation updates and to identify and address public concerns.

6. Policy and Legal Reform.

The Parties have identified the following policy, legal and regulatory reforms and actions that the Government shall pursue in support, and to reach the full benefits, of the Rural Development Project, the satisfactory implementation of which will be conditions precedent to certain MCC Disbursements as provided in the Disbursement Agreement:

(a) Pass the Access to Credit Law (*Ley para facilitar el Acceso al Credito*) to improve the process for pledging collateral and foreclosing on liens and other security interests in collateral; and

(b) Maintain a clear policy stance against the adoption of any action that limits or otherwise alters the original terms of an obligation of any borrower to repay a properly documented loan obligation without the agreement of the lender.

To improve its level of performance under the policy criteria identified in Section 607 of the Act and the MCA Eligibility Criteria, the Government will pursue the following legislative and policy reforms:

(a) Enact new anti-trust legislation that reduces constraints on commerce and competition;

(b) Enact new civil service legislation, issue the corresponding regulations, appoint the head of the new civil service supervisory authority, and satisfactorily implement the new law; and

(c) Reform the civil procedures code to make all new lawsuits more transparent and expeditious by making them oral and public.

SCHEDULE 2 to ANNEX I**TRANSPORTATION PROJECT**

This Schedule 2 generally describes and summarizes the key elements of a Transportation Project in furtherance of the Transportation Objective (the "*Transportation Project*"). Additional details regarding the implementation of the Transportation Project will be included in the Implementation Plan and in relevant Supplemental Agreements.

1. Background.

High transportation costs are a significant impediment to economic growth, particularly for agriculture and light manufacturing. Consequently, the PRS proposed an ambitious plan to strengthen the Honduran primary, secondary and rural road network. This fits within the broader strategy developed in the Plan Puebla-Panama ("*PPP*" to create a reliable Mesoamerican network of highways known as the International Network of Mesoamerican Highways. This network comprises two main corridors on the Atlantic and the Pacific (the "*Atlantic Corridor*" and "*Pacific Corridor*," respectively) and a series of complementary routes. Under this initiative, member countries have pledged to work toward harmonizing transportation regulations and standards, modernizing customs procedures and border crossings, and strengthening airport security. The Atlantic and Pacific Corridors are vital to the integration of Central America and will have a significant economic impact on this region by creating an efficient connection between the production centers in Central America and major port facilities on the Atlantic and Pacific Oceans.

The 1,746 kilometer Atlantic Corridor links Mexico, Belize, Guatemala, Honduras and El Salvador. The Honduran portion of the Atlantic Corridor includes (i) portions of the CA-5 Norte Highway (the "*Highway CA-5*"), which carries most of Honduras' import and export traffic between Puerto Cortes and the major production and consumption centers in and around the cities of San Pedro Sula, Comayagua and Tegucigalpa, and (ii) a new road that will connect Comayagua directly to the Pacific Corridor and the Pacific port facility at Puerto Cutuco in El Salvador. The 294 kilometer Highway CA-5 carries most of the country's import and export traffic and accounts for 23% of highway traffic volume. After more than 30 years of service, the road needs improvements as service levels have declined drastically on some stretches and road safety is poor. Average annual traffic volume on the Highway CA-5 varies between 5,400 and 8,300 vehicles, with a high proportion (35%) of heavy vehicles.

Many productive areas in Honduras are connected to the main road arteries by unpaved secondary roads, whose uneven surfaces do not permit rapid transit. These poor roads cause high vehicle operating and maintenance costs and spoilage of delicate products, which undermines the competitiveness of the producers who must use them. These roads also are expensive to maintain, requiring periodic re-grading following the rainy season. For these reasons, the paving of high-volume secondary roads is a profitable investment which contributes decisively to the competitive potential of the areas they serve.

Since the mid 1990s, Honduras has not had a system for controlling weights and measures in place for its roads network. The lack of a system of control of weights and measures contributed

to the premature deterioration of the roadways, increasing the cost of maintenance and reducing safety. A recent study found that 23% of passenger and cargo vehicles carry excessive weight. Trucks with more than 2 axels record the most excess weight, and these also represent a large percentage (41%) of vehicles that travel through the national roads. Excess weight significantly reduces the lifespan of roads and bridges, decreases the safety of the roadways and, as a result, increases the costs of maintenance programs.

2. Summary of Project Activities.

The Transportation Project is designed to reduce transportation costs between Honduran production centers and national, regional and global markets. The key activities of the Transportation Project include:

- (a) **Highway CA-5.** The improvement of a 50 kilometer segment of Highway CA-5 between Taulabe and Comayagua (the "*North Segment*") and a 59 kilometer segment of Highway CA-5 between Villa de San Antonio and Tegucigalpa (the "*South Segment*").
- (b) **Secondary Roads.** The upgrade of key secondary routes to improve the access of rural communities to markets.
- (c) **Weight Control System.** The construction of an effective weight control system and the issuance of contracts to operate it effectively.

The following summarizes the contemplated Transportation Project Activities. The M&E Plan (described in Annex III) will set forth anticipated results and, where appropriate, regular benchmarks that may be used to monitor implementation progress. Performance against the benchmarks and the overall impact of the Transportation Project will be assessed and reported at the intervals to be specified in the M&E Plan or as otherwise agreed by the Parties from time to time. The Parties expect that additional benchmarks will be identified during the implementation of the Transportation Project. Estimated amounts of MCC Funding for each Project Activity for the Transportation Project are identified in Annex II of this Compact. Conditions precedent to each Transportation Project Activity and sequencing of the Transportation Project Activities shall be set forth in the Disbursement Agreement or other relevant Supplemental Agreements.

(a) *Activity: North and South Segments of Highway CA-5*

MCC Funding will support the following improvements to the North and South Segments:

- (i) Construction along the North and South Segments, including building (A) a third ascending lane in highway segments of steep and sustained inclination, (B) "passing lanes" in high volume highway sections, (C) interchanges and bridges, (D) pavement construction, (E) appropriate entrance and exit lanes, and (F) parking bays for buses and other protection and security measures;

(ii) Making important geometrical changes to improve visibility and safety in curves in the North Segment and South Segment;

(iii) Utility relocations as may be necessary to accommodate the rehabilitation of the North and South Segments;

(iv) Drainage and environmental mitigation;

(v) Providing signage and other safety improvements;

(vi) Supervision over the construction activities described above; and

(vii) Compensation for individuals, residences and businesses affected by the rehabilitation of the North and South Segments consistent with the World Bank policy on Involuntary Resettlement.

The *expected results* from, and the *key benchmarks* to measure progress on, these activities are set forth in Annex III.

(b) *Activity: Secondary Roads*

MCC Funding will fund the paving of up to 91 kilometers of key secondary routes with a "double treatment" of asphalt to improve velocity and reduce maintenance costs.

Subject to the prior approval of MCC, MCA-Honduras will select secondary roads among the range of proposed roads that promise the highest economic rate of return among such roads, subject to the conditions that each selected road must:

(i) Conform to the Environmental Guidelines;

(ii) Conform to the World Bank policy on Involuntary Resettlement, where relevant,

(iii) Be fully designed to the satisfaction of MCA-Honduras and MCC;

(iv) Be properly documented to the satisfaction of MCA-Honduras and MCC, including a description of the location of the proposed road, necessary type of works, estimation of costs, a technical and economic assessment, and land acquisition required, including information on the status of the environmental and other requisite licenses; and

(v) Be consistent with the long-term plans of SOPTRAVI.

The *expected results* from, and the *key benchmarks* to measure progress on, these activities are set forth in Annex III.

(c) **Activity: Vehicle Weight Controls**

To increase road life and safety, MCC Funding will support:

(i) The construction of eight weight control stations along the Highway CA-5 or along major arteries feeding into the Highway CA-5, which areas MCA-Honduras shall select, subject to the prior approval of MCC, based on criteria that includes the proximity of areas that generate cargo, the level of traffic flow and the absence of means to easily avoid the controls set in place; and

(ii) The acquisition of ancillary weight control equipment.

The Government must enter into contractual arrangements with one or more private companies to administer the weight control stations and to charge fees to unload overweight vehicles. The selection of such private companies shall be through competitive, transparent bidding and hiring mechanisms. To guarantee the transparency and efficiency of the administration of the weight control system, the parties administering the system shall be subject to the following:

- (i) Evaluations and control mechanisms of the personnel responsible for systems operation;
- (ii) Reporting requirements on all income collected through fees;
- (iii) Requirements that over-weight trucks be charged to reduce loads to legal standards;
- (iv) Internal financial audits;
- (v) External financial audits to be performed by one or more companies or firms selected through a public bidding process;
- (vi) On-going technical audits performed by SOPTRAVI; and
- (vii) A requirement to conduct periodic public awareness and information dissemination campaigns geared to informing users and the general public about the benefits of the weight control system, its operating procedures, and other necessary information.

The *expected results* from, and the *key benchmarks* to measure progress on, these activities are set forth in Annex III.

3. Beneficiaries.

The principal beneficiaries of the Transportation Project are expected to be (i) users of the improved roads by decreasing transportation costs to markets and social service delivery points (e.g., hospitals, schools), and (ii) employees and owners of urban and rural businesses that rely on the Honduran road network. The Transportation Project also promises to have a significant economic impact in the greater Central American region since it constitutes a key component of the Atlantic Corridor.

4. Coordination with USAID and Other Donors.

(a) **Coordination during Project Development.** In developing the Transportation Project, the Parties investigated the work of the donors described below in an effort to ensure that the Transportation Project complements, and does not duplicate, replace or harm, such work.

The World Bank is financing (i) the improvement of sections of the Highway CA-5 that are adjacent to the sections that MCC will improve, (ii) the reconstruction of several highways and bridges (including rural roads), (iii) a project with the Honduran Fondo Vial ("**Road Fund**") to use micro-enterprises for routine maintenance, and (iv) technical assistance to SOPTRAVI to support its planning unit and to strengthen the Road Fund to better ensure the sustainability of road investments.

The IDB is financing (i) the improvement of two sections of the Highway CA-5 that are adjacent to the sections that MCC will improve, (ii) the vehicle weight control study that informed the design of the vehicle weight control component that MCC will fund, and (iii) the Program for Sustainable Institutional Strengthening of the Road Sector, which seeks to institutionally strengthen SOPTRAVI to improve the quality of road construction, the reliability of resources allocated to the sector, road safety, and environmental management.

The Central American Bank for Economic Integration ("**CABEI**") is financing (i) the section of the PPP's Atlantic Corridor that connects the Highway CA-5 to the Pacific Corridor, and (ii) the section of the Atlantic Corridor between Puerto Cortez and the Guatemalan border.

(b) **Coordination during Project Implementation.** In an effort to ensure that the Government, MCC and the other financial institutions involved in upgrading the Highway CA-5 coordinate their efforts, the Parties and other donors are committed to instituting a mechanism for coordination, dialogue and exchange of current information among such parties. Consistent with what has already been established between other donors and the Government, SOPTRAVI will prepare a semiannual report on works in execution on the Highway CA-5 and distribute it to each participating institution. The report will indicate progress toward physical and financial targets for the projects funded by each donor, summarize the number, description and status of physical and financial progress under each works and supervision contract, and offer a brief summary of critical aspects encountered that might affect successful completion and achievement of objectives for each project at a given time. After the report is distributed, SOPTRAVI will convene a meeting of participating financial institutions and development agencies.

5. Sustainability.

The implementation of the Transportation Project is designed to support the development of local capacity (yet maintain tight fiduciary risk controls) by providing Honduran professionals and institutions with experience in implementing the Program. This design is expected to add to Honduras's soft infrastructure — the human capital base that is essential for the successful design, management and oversight of public and private projects. While most procurement for the Transportation Project will be managed by a private firm that will be selected through an international competitive bidding process, local staff will be involved in each step of the process.

While all contracts will be open to international bidding, local and regional firms are expected to be very competitive in most activities. Even in activities where an international firm may win the contract, there will be opportunities to employ Honduran individuals or firms under those contracts. Construction contracts for the secondary roads will be relatively small contracts in which national and regional firms will be competitive. The Program also contemplates opportunities for small and medium size enterprises to participate in the maintenance of the roads, through coordination by the Road Fund.

In terms of developing the institutional capacity in the Honduran transportation sector, both the World Bank and IDB have, in recent years, funded programs to restructure and develop SOPTRAVI, activities from which the Transportation Project will benefit. These activities include building capacity to manage the transportation sector, strengthening investment selection (e.g., analytical capabilities, economic evaluation, etc.), introducing an emphasis on maintenance, and expanding the capacity of the private sector in the provision of transport services (e.g., maintenance contracting). In addition, the institutional framework for transportation now has a safety component. A bill before the Honduran Congress calls for establishing a national road safety council, establishing road safety units, implementation of an accident reporting system, police enforcement of traffic laws, and providing funding for road safety.

The key issue with respect to financial sustainability of the Transportation Project is road maintenance. The Road Fund is the agency responsible for routine, periodic and emergency road maintenance. The Road Fund, funded by a fixed charge on fuel sales, prepares annual road network maintenance plans, establishes and maintains road maintenance budgets, and executes the maintenance plan. As of 2002, the portion reserved for road conservation may not be less than 40%, and the Government has been increasing the funds devoted to road maintenance through the Road Fund. A condition precedent in the Disbursement Agreement for the continued disbursement of funds will be that the Government meet certain funding and maintenance targets. The Government has stated its intention to continue increasing the funds for maintenance to achieve 75% coverage by the end of 2005, and 80% by the end of 2006. The Road Fund will also be responsible for the managing the contracts to operate the weight control stations. These contracts are expected to generate income for the Road Fund as all (i) trucks weighed will be charged a toll for road usage and (ii) overweight trucks will be charged a fee to be unloaded.

The key to ensuring environmental and social sustainability of the Program is ongoing public consultation to ensure optimal design and implementation and to ensure full country-ownership of the Program. The PMU will include an ESI Director whose job will be to ensure that environmental and social mitigation measures (including resettlement and gender issues) are followed for all Project Activities in accordance with the provisions set forth in the Compact and other documents. The ESI Director also will serve as the point of contact for comments and concerns of Project-affected parties regarding the implementation of all segments of the Compact, and lead the effort to find feasible resolutions to those problems. The ESI Director will convene periodic public meetings to provide implementation updates and to identify and address public concerns.

6. Policy and Legal Reform.

The Parties have identified the following policy, legal and regulatory reforms and actions that the Government shall pursue in support, and to reach the full benefits, of the Transportation Project, the satisfactory implementation of which will be conditions precedent to certain MCC Disbursements as provided in the Disbursement Agreement:

- (a) Enact adequate regulatory changes to enable the proper operation of a weight control system on the national highway network;
- (b) Approve the issuance of one or more contracts to build and operate a weight control system on the national highway network, collect any necessary tolls and fees, and conduct maintenance on the Highway CA-5 sections and secondary roads that MCC Funding is used to improve;
- (c) Enact adequate legislation on national road safety and enforcement; and
- (d) Approve legislation and budget providing adequate planning and funding for sustainable road maintenance for the Highway CA-5 sections and secondary roads that MCC Funding is used to improve, including adequate funding to the Road Fund for road maintenance (funding targets will be agreed upon in the Disbursement Agreement) consistent with a commitment to properly maintain the roads in accordance with generally accepted technical standards and to provide annual maintenance reports.

To improve its level of performance under the policy criteria identified in Section 607 of the Act and the MCA Eligibility Criteria, the Government will pursue the following legislative and policy reforms:

- (a) Enact new anti-trust legislation that reduces constraints on commerce and competition;
- (b) Enact new civil service legislation, issue the corresponding regulations, appoint the head of the new civil service supervisory authority, and satisfactorily implement the new law; and

(c) Reform the civil procedures code to make all new lawsuits more transparent and expeditious by making them oral and public.

ANNEX II

FINANCIAL PLAN SUMMARY

This Annex II to the Compact (the "*Financial Plan Annex*") summarizes the Multi-Year Financial Plan for the Program. Each capitalized term in this Financial Plan Annex shall have the same meaning given such term elsewhere in this Compact.

1. **General.** A Multi-Year Financial Plan Summary is attached hereto as Exhibit A. By such time as specified in the Disbursement Agreement, MCA-Honduras will adopt, subject to MCC approval, a Multi-Year Financial Plan that includes, in addition to the multi-year summary of anticipated estimated MCC Funding and the Government's contribution of funds and resources, an estimated draw-down rate for the first year of the Compact based on the achievement of performance milestones, as appropriate, and the satisfaction or waiver of conditions precedent. Each year, at least 30 days prior to the anniversary of the Entry Into Force, the Parties shall mutually agree in writing to a Spending Plan for the upcoming year of the Program, which shall include a more detailed plan for such year, taking into account the status of the Program at such time and making any necessary adjustments to the Multi-Year Financial Plan.
2. **Implementation and Oversight.** The Financial Plan shall be implemented by MCA-Honduras, consistent with the approval and oversight rights of MCC and the Government as provided in this Compact, the Governance Agreement and the Disbursement Agreement.
3. **Estimated Contributions of the Parties.** The Multi-Year Financial Plan Summary, attached hereto as Exhibit A, identifies the estimated annual contribution of MCC Funding for Program administration and each Project. The Government's contribution of resources to Program administration and each Project shall consist of (i) "in-kind" contributions in the form of Government Responsibilities and any other obligations and responsibilities of the Government identified in the Compact, including contributions identified in the notes to the Multi-Year Financial Plan Summary, and (ii) such other contributions or amounts as may be identified in relevant Supplemental Agreements between the Parties or as may otherwise be agreed by the Parties; *provided*, in no event shall the Government's contribution of resources be less than the amount, level, type and quality of resources required to effectively carry out the Government Responsibilities or any other responsibilities or obligations of the Government under or in furtherance of this Compact.
4. **Modifications.** The Parties recognize that the anticipated distribution of MCC Funding between and among the various Program activities and Project Activities will likely require adjustment from time to time during the Compact Term. In order to preserve flexibility in the administration of the Program, the Parties may, upon agreement of the Parties in writing and without amending the Compact, change the designations and allocations of funds between Program administration and a Project, between one Project and another Project, between different activities within a Project, or between a Project identified as of the entry into force of this Compact and a new Project, without amending the Compact; *provided, however*, that such reallocation (i) is consistent with the Objectives, (ii) does not cause the amount of MCC Funding to exceed the aggregate amount specified in Section 2.1(a) of this Compact, and (iii) does not

cause the Government's responsibilities or overall contribution of resources to be less than specified in Section 2.2(a) of this Compact, this Annex II or elsewhere in the Compact.

5. Conditions Precedent; Sequencing. MCC Funding will be disbursed in tranches. The obligation of MCC to approve MCC Disbursements and Material Re-Disbursements for the Program and each Project is subject to satisfactory progress in achieving the Objectives and on the fulfillment or waiver of any conditions precedent specified in the Disbursement Agreement for the relevant Program activity or Project Activity. The sequencing of Project Activities and other aspects of how the Parties intend the Projects to be implemented will be set forth in the Implementation Plan, including Work Plans for the applicable Project, and MCC Disbursements and Re-Disbursements will be disbursed consistent with that sequencing.

EXHIBIT A: MULTI-YEAR FINANCIAL PLAN SUMMARY

Re-Disbursements Funded Directly from MCC Disbursements						
Component	Year 1	Year 2	Year 3	Year 4	Year 5¹	Total
1. <u>Rural Development Project</u>²						
(a) Farmer Training and Development ¹	1,525 ⁴	4,722	10,548	10,242	377	27,415
(b) Farmer Access to Credit ⁵	2,860	8,160	1,277	1,217	258	13,773
(c) Farm to Market Roads ⁶		6,450	15,050			21,500
(d) Agricultural Public Goods Grant Facility ⁷		3,000	3,000	2,000		8,000
Rural Development Project Manager	270	304	324	304	304	1,509
Sub-Total	4,656	22,636	30,200	13,764	939	72,195
2. <u>Transportation Project</u>⁸						
(a) Highway CA-5 ⁹	15,705	35,157	36,278	9,272		96,412
(b) Secondary Roads ¹⁰			5,320	15,960		21,280
(c) Weight Control System ¹¹	2,219	248	2,263			4,730
Transportation Project Manager	742	846	846	846		3,279
Sub-Total	18,666	36,250	44,706	26,078		125,700
3. <u>Monitoring and Evaluation</u>¹²	1,623	578	1,320	143	1,320	4,983
Sub-Total	1,623	578	1,320	143	1,320	4,983
4. <u>Program Administration and Control</u>						
(a) Program administration	2,389	1,952	1,952	1,793	1,181	9,268
(b) Audit	327	824	1,049	572	83	2,855
Sub-Total	2,715	2,777	3,001	2,365	1,264	12,122
Source of Funds:						
MCC CONTRIBUTION¹³	27,659	62,240	79,227	42,350	3,523	215,000
Re-Disbursements Funded from Loan Repayment (Financial Institutions to MCA-Honduras)						
Component	Year 1	Year 2	Year 3	Year 4	Year 5¹	Total
1. <u>Rural Development Project</u>²						
(a) Farmer Training and Development ¹					3,000	3,000
(b) Farmer Access to Credit ⁵					2,000	2,000
(c) Farm to Market Roads ⁶						
(d) Agricultural Public Goods Grant Facility ⁷				1,000		1,000
Sub-Total				1,000	5,000	6,000
Source of Funds:						
Repayment of Loans (Farmer Access to Credit)				1,000	5,000	6,000

EXHIBIT A: MULTI-YEAR FINANCIAL PLAN SUMMARY (Notes)

¹ Although most Project Activities will take place from Year 1 through Year 4, the five-year Compact Term will allow additional time to ensure that Project Activities are completed. Monitoring and Evaluation will continue after the completion of the Project Activities.

² The Government will provide in-kind contributions in the form of staff time and resources from Secretary of Agriculture ("SAG"), Secretary of Public Works, Transportation and Housing ("SOPTRAVI"), Secretary of National Resources and Environment ("SERNA"), Honduran Social Investment Fund ("FHIS"), and National Commission of Banks and Insurance ("CNBS") to work towards the expected results of this Project. All of these contributions will be more specifically set forth in the relevant components of the Implementation Plan or relevant Supplemental Agreement between the Parties.

³ The Government has provided in-kind contributions in the form of SAG staff time and responses used for developing this Project Activity and will provide in-kind contributions in the form of SAG staff time and resources to work towards the expected results of this Project Activity, which contributions will be more specifically set forth in the relevant components of the Implementation Plan or relevant Supplemental Agreement between the Parties.

⁴ Amounts shown are U.S. Dollars in thousands.

⁵ The Government will provide in-kind contributions in the form of CNBS, Ministry of Finance and Central Bank staff time and resources to work towards the expected results for this Project Activity, which contributions will be more specifically set forth in the relevant components of the Implementation Plan or relevant Supplemental Agreement between the Parties.

⁶ These amounts will be disbursed only upon satisfaction of (i) agreements executed with municipalities to pay 20% of the cost of selected roads and to permanently maintain them, (ii) completion of full design studies, (iii) obtaining requisite approvals by the rural road advisory committee and others, and (iv) other conditions set out in the Disbursement Agreement. The Government will provide in-kind contributions in the form of staff time and resources from FHIS to work towards the expected results of this Project Activity, which contributions will be more specifically set forth in the relevant components of the Implementation Plan or relevant Supplemental Agreement between the Parties.

⁷ These amounts will be disbursed only upon satisfaction of (i) obtaining requisite approvals by the Grant Committee and others, and (ii) other conditions set out in the Disbursement Agreement.

⁸ The Government will provide in-kind contributions in the form of staff time and resources from SOPTRAVI and SERNA to work towards the expected results of this Project. All of these contributions will be more specifically set forth in the relevant components of the Implementation Plan or relevant Supplemental Agreement between the Parties.

⁹ These amounts will be disbursed only upon satisfaction of (i) completion of a detailed Project management plan and coordination plan by MCA-Honduras in conjunction with Transportation Project Manager, and (ii) other conditions set out in the Disbursement Agreement.

¹⁰ These amounts will be disbursed only upon satisfaction of (i) completion of a detailed Project management plan and coordination plan by MCA-Honduras in conjunction with Transportation Project Manager, and (ii) other conditions set out in the Disbursement Agreement. The amounts in Year 4 will be disbursed only upon satisfaction of a detailed vehicle weight control plan and other conditions set out in the Disbursement Agreement.

¹¹ These amounts will be disbursed only upon satisfaction of (i) completion of a detailed vehicle weight control plan, and (ii) other conditions set out in the Disbursement Agreement.

¹² The Government will provide in-kind contributions in the form of SAG, SOPTRAVI, FHIS and INE staff time and resources towards data collection and other monitoring and evaluation functions, which contributions will be more specifically set forth in the relevant components of the Implementation Plan or relevant Supplemental Agreement between the Parties.

¹³ The Government will pursue legislative and policy reforms to improve its level of performance under the policy criteria identified in Section 607 of the Millennium Challenge Act of 2003, including by enacting new anti-trust, civil service and civil procedure legislation.

ANNEX III

DESCRIPTION OF THE M&E PLAN

This Annex III to the Compact (the "*M&E Annex*") generally describes the components of the M&E Plan for the Program. Each capitalized term in this Annex III shall have the same meaning given such term elsewhere in this Compact.

1. Overview.

The Parties shall implement an M&E Plan that specifies (i) how the implementation of the Program and progress toward the achievement of the Objectives and Compact Goal will be monitored ("*Monitoring Component*"), (ii) a process and timeline for the assessment of planned, ongoing, or completed Project Activities to determine their efficiency, effectiveness, impact and sustainability ("*Evaluation Component*"), and (iii) other components described below. Information regarding the Program's performance, including the M&E Plan, and any amendments or modifications thereto, and periodic reports, will be made publicly available on the MCA-Honduras Website and elsewhere.

2. Monitoring Component.

To monitor the implementation of the Program and progress toward the achievement of the Objectives and Compact Goal, the Monitoring Component shall define the Indicators (defined below), the party responsible for reporting each Indicator to MCA-Honduras, and the method by which the reported data will be validated.

(a) **Indicators.** The M&E Plan shall measure the results of the Program using objective data ("*Indicators*"). Each Indicator will have one or more expected results that specify the expected value and the expected time by which that result will be achieved ("*Targets*"). The M&E Plan will measure and report four types of Indicators. First, the Compact Goal Indicator ("*Goal Indicator*") will measure the impact of the Program on the incomes of Hondurans who participate or are covered by the Program (collectively, "*Beneficiaries*"). Second, Objective Indicators (each, an "*Objective Indicator*") will measure the final results of the Projects in order to monitor their success in meeting the Objectives. Third, Outcome Indicators (each, an "*Outcome Indicator*") will measure the intermediate results of goods and services delivered under the Project in order to provide an early measure of the likely impact of the Projects on the Objectives. Fourth, Project Activity Indicators (each, an "*Activity Indicator*") will measure the delivery of key goods and services in order to monitor the pace of Project Activity execution. For each Outcome, Objective and Goal Indicator, the M&E Plan will define a strategy for validating the value of such Indicator prior to being affected by the Program ("*Baseline*"). All Indicators will be disaggregated by gender, income level and age, to the extent practicable.

(i) **Compact Goal Indicator.** The Project Activities undertaken in connection with the Program are expected to increase the incomes of Beneficiaries. The increase in income accrued to a group of Beneficiaries as a result of one or more Project Activities over a period of time constitutes a benefit stream ("*Benefit Stream*"). The M&E Plan shall contain one Goal Indicator, listed in the table below, which is the change in the income of

Beneficiaries attributable to the Program. The Goal Indicator will be calculated as the sum of the Benefit Streams. MCA-Honduras, with approval from MCC, must define a methodology for estimating a Benefit Stream prior to the disbursement of funds for any Project Activity that may influence that Benefit Stream. Such a methodology would measure the difference between the actual income of Beneficiaries and the estimated value of what their income would have been without the Program.

Compact Goal Increased Economic Growth and Reduced Poverty							
Indicator	Year 1	Year 2	Year 3	Year 4	Year 5	Year 20	PV ¹
Increase in income of Beneficiaries (annual US\$ millions) (disaggregated by income level, gender and age, where appropriate.)	\$1.9	\$5.9	\$12.9	\$43.5	\$69.0	\$158.4	\$538.3
Measured by							
Benefits of Highway CA-5 upgrade: ² <i>Beneficiaries: Users of Highway CA-5 and employees of business that use road.</i>	\$1.9	\$5.5	\$4.7	\$15.3	\$19.4	\$30.0	\$133.9
Benefits of secondary road paving: ³ <i>Beneficiaries: Users of paved secondary roads and employees of business that use those roads.</i>	\$0.0	\$0.0	\$1.5	\$4.0	\$6.6	\$14.8	\$55.4
Increase in farm income resulting from Rural Development Project: ⁴ <i>Beneficiaries: Program Farmers</i>	\$0.0	\$0.2	\$2.5	\$10.2	\$18.5	\$60.1	\$172.9
Increase in employment income resulting from Rural Development Project: ⁵ <i>Beneficiaries: Employees of Program Farmers</i>	\$0.0	\$0.2	\$2.1	\$8.8	\$16.0	\$51.9	\$149.4
Benefit of Farm to Market Roads: ⁶ <i>Beneficiaries: Communities surrounding Farm to Market Roads.</i>	\$0.0	\$0.0	\$1.7	\$4.1	\$7.1	\$0.1	\$18.0
Benefits of Agricultural Public Goods Grant Facility: ⁷ <i>Beneficiaries: Users of public goods</i>	\$0.0	\$0.0	\$0.5	\$1.0	\$1.4	\$1.4	\$8.7

Notes to Compact Goal Table:

- 1) PV: Present Value of Benefit Streams calculated for 20 year period with 10% discount rate.
- 2) For the Highway CA-5, the Benefit Stream includes wages to local labor, savings due to reduced vehicle operating costs and travel time.
- 3) For secondary road paving, the Benefit Stream includes savings due to reduced vehicle operating costs and travel time.
- 4) For increase in farm income, the Benefit Stream is calculated as net profits per hectare of a typical horticulture crop (US\$ 1203) minus the net profits per hectare of basic grain production (US\$500) * number of hectares harvesting this typical horticulture crop. A typical horticulture crop is defined as the 25th percentile, in terms of costs and net profits, of a basket of 15 horticulture crops suitable for Honduras.
- 5) For increase in employment income, the Benefit Stream is calculated as the labor costs per hectare associated with a typical horticulture crop (US \$ 608) * number of hectares harvesting this typical horticulture crop.
- 6) For Farm to Market Roads, the Benefit Stream is calculated based on the costs accrued in each year and the imputed value of benefits (assuming 25% depreciation per year) necessary to guarantee a 15% rate of return. Only roads that yield at least this rate of return will be funded.
- 7) For Agricultural Public Goods Fund, the Benefit Stream is calculated based on the costs accrued in each year and the imputed value of benefits necessary to guarantee a 15% rate of return. Only projects that yield at least this rate of return will be funded.

Outcome and Objective Indicators. The M&E Plan shall contain the Objective and Outcome Indicators listed in the table below. MCA-Honduras, with prior approval from MCC, may only add Objective and Outcome Indicators or refine the Targets of existing Objective and Outcome Indicators prior to the disbursement of funds for any Project Activity that may influence that Indicator.

Agricultural Objective						
Objective Level Indicators	Baseline ¹	Year 1	Year 2	Year 3	Year 4	Year 5
# of Program Farmers harvesting high-value horticulture crops at year end	0	--	625	3,499	7,340	8,255
# of hectares harvesting high-value horticulture crops at year end	0	--	950	5,410	11,830	14,400
Outcome Level Indicators	Baseline	Year 1	Year 2	Year 3	Year 4	Year 5
# of business plans prepared by Program Farmers with assistance of T.A. provider (total for year)	0	170	1340	3980	3310	0
Value of loans to Program Farmers ² (year end US\$ mil.)	TBD ³	1.9	10.8	23.7	28.8	31.8
% of MCA-Honduras loan portfolio at risk ⁴	0	4-6%	4-6%	4-6%	4-6%	4-6%
# Liens registered	0	0	TBD	TBD	TBD	TBD

Notes to Agricultural Objective Table:

- 1) Baseline data for each Indicator will be verified prior to undertaking any activity that affects the value of such Indicator.
- 2) Data should be disaggregated by type of collateral (if any), documentation required and tenor of loan.
- 3) There were \$148 million in loans outstanding to the agricultural sector in Honduras in Sept 2004.
- 4) This indicator will be calculated as an average of the previous four quarters.

Transportation Objective							
Objective Level Indicators		Baseline		Year 5		Year 10	
Freight shipment cost from Tegucigalpa to Puerto Cortes ¹		\$6.37 /ton		\$ 5.78/ton		\$ 5.78/ton	
Farm gate price of goods		TBD ²		TBD		TBD	
Average daily traffic volume ³		T1.	8,374	T1.	9,447	T1.	11,550
		T2.	5,411	T2.	6,104	T2.	7,462
		T3	6,732	T3	7,594	T3	9,284
		Secondary Roads	676	Secondary Roads	887	Secondary Roads	1,115
		Rural Roads: TBD ⁴		Rural Roads: TBD		Rural Roads: TBD	
Outcome Level Indicators		Baseline		Year 5		Year 10	
Cost per journey (Travel time) ⁵				25% reduction from baseline			
Cost per journey (International roughness index) ⁶		T1.	4.7	T1.	1.9	T1.	2.2
		T2.	4.4	T2.	2.0	T2.	2.4
		T3	4.0	T3	2.0	T3	2.4
		Secondary Roads	13.6	Secondary Roads	2.5	Secondary Roads	2.8
Proportion of overweight vehicles on main highway network		23%		7%			

Notes to Transportation Objective Table:

- 1) Baseline Freight shipment cost is from the Inter-American Development Bank, (HO-0207 Table III-2). Costs and prices will be reported in constant U.S. Dollars.
- 2) Farm-gate prices will depend on type of crop grown and will be confirmed by implementing entity(ies) as part of reporting requirements.
- 3) T1, T2, and T3 represent different sections of the highway being upgraded.
- 4) This information will be a requirement of the Rural Roads proposals submitted to the Program. Information will be verified as part of the Rural Roads selection process, prior to disbursement of Project funds.
- 5) Rural Roads.
- 6) Highway and Secondary Roads.

(ii) **Activity Indicators.** Prior to the disbursement of MCC Funding for any Project Activity, the Implementing Entity of that Project Activity must propose a set of Activity Indicators that is approved by its Project Manager, MCA-Honduras and MCC. The M&E Plan shall be amended to reflect the addition of such Indicators. The table below shows a notional list of Activity Indicators that the M&E Plan may contain.

Rural Development Project						
Activity Level Indicators	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Farmer Training and Development						
Hours of technical assistance delivered to Program Farmers (thousands)	10	80	330	420	170	1,010
Farmer Access to Credit						
Funds lent by MCA-Honduras to financial institutions (\$US mil.) ¹		\$6		-\$1	-\$5	\$0
Hours of technical assistance to financial institutions ²		4,800	4,800	4,800		14,400
Lien Registry equipment installed		yes				
Farm to Market Roads						
Kilometers of Farm to Market Road upgraded		300	500	700		1,500
Agricultural Public Goods Grant Facility³						

Transportation Project			
Activity Level Indicators	Year 3	Year 4	Total
Highway CA-5			
Kilometers of highway upgraded	61	48	109
Secondary Roads			
Kilometers of secondary road upgraded	38	53	91
Vehicle Weight Control			
Number of weight stations built	3	5	8

Notes to Activity Indicator Table:

1) Negative sign indicates funds repaid to MCA-Honduras Program Account.

2) Hours of banking technical assistance to financial institutions assumes: 3 staff * 8 hours/day * 200 days/year.

3) Activity Indicators will be determined by grant recipients.

(b) **Data Collection and Reporting.** The M&E Plan shall establish guidelines for data collection and a reporting framework, including a schedule of Project Activities and responsible parties. Prior to any Re-Disbursements with respect to a Project Activity, the baseline data or report, as applicable and as specified in the Disbursement Agreement, with respect to such Project Activity must be completed in form and substance satisfactory to MCC. With respect to any data or reports received by MCA-Honduras, MCA-Honduras shall promptly deliver such reports to MCC along with any other related documents, as specified in this Annex III or as may be requested from time to time by MCC.

(c) **Performance Assessments.** The PMU shall conduct regular Performance Assessments to inform MCA-Honduras, Project Managers and the MCC of progress under the Program and to alert these parties to any problems. These assessments will report the actual results compared to the Targets on the Indicators referenced in the Monitoring Component,

explain deviations between these actual results and Targets, and in general, serve as a management tool for implementation of the Program.

(d) **Data Quality Reviews.** From time to time, as determined in the M&E Plan or as otherwise requested by MCC, the quality of the data gathered through the M&E Plan shall be reviewed to ensure that data reported are as valid, reliable, and timely as resources will allow. The objective of any data quality review will be to verify the quality and the consistency of performance data across different implementation units and reporting institutions. Such data quality reviews also will serve to identify where those levels of quality are not possible given the realities of data collection.

3. Evaluation Component.

The Program shall be evaluated on the extent to which the interventions contributed to the Compact Goal. The Evaluation Component shall contain a process and timeline for analyzing data in order to assess planned, ongoing, or completed Project Activities to determine their efficiency, effectiveness, impact and sustainability. The Evaluation Component shall contain two types of reports, a Final Evaluation and Ad Hoc Evaluations and be finalized before any MCC Disbursement or Re-Disbursement for specific Project Activities.

(a) **Final Evaluation.** MCA-Honduras, with the prior approval of MCC, shall engage an independent evaluator to conduct an evaluation at the completion of the Program ("**Final Evaluation**"). The Final Evaluation must at a minimum (i) evaluate the efficiency and effectiveness of the Project Activities, (ii) estimate, in a statistically valid way, the casual relationship between the Projects and the Compact Goal, (iii) analyze the reasons why the Compact Goal was or was not achieved, (iv) identify positive and negative unintended results of the Program, (v) provide lessons learned that may be applied to similar projects, and (vi) assess the likelihood that results will be sustained over time.

(b) **Ad Hoc Evaluations.** Either MCC or MCA-Honduras may request ad hoc evaluations of Projects, Project Activities or the Program as a whole prior to the expiration of the Compact. If MCA-Honduras engages an evaluator, the evaluator will be an externally contracted independent source selected by MCA-Honduras, subject to the approval of MCC, following a tender in accordance with the Procurement Guidelines, and otherwise in accordance with any relevant Implementation Letter or Supplemental Agreement. The cost of an independent evaluation may be paid from MCC Funding. If MCA-Honduras requires an interim independent evaluation at the request of the Government for any reason, including for the purpose of contesting an MCC determination with respect to a Project or to seek funding from other donors, no MCC Funding or MCA-Honduras resources may be applied to such evaluation, without MCC's prior written approval.

4. Other Components of the M&E Plan.

In addition to the Monitoring and Evaluation Components, the M&E Plan shall include the following components for the Program and each Project and Project Activity, including, where appropriate, roles and responsibilities of the relevant parties and Providers:

(a) **Costs.** A detailed cost estimate for all components of the M&E Plan shall be set forth in the M&E Plan.

(b) **Assumptions and Risks.** The M&E Plan shall identify any assumptions and risks external to the Program that underlie the accomplishment of the Objectives and Outcomes; provided, however, such assumptions and risks shall not excuse performance of the Parties, unless otherwise expressly agreed to in writing by the Parties.

(c) **Modifications.** Notwithstanding anything to the contrary in the Compact, including the requirements of this M&E Annex, the Parties may modify or amend the M&E Plan or any component thereof, including those elements described herein, without amending the Compact; provided, any such modification or amendment of the M&E Plan has been approved by MCC and is otherwise consistent with the requirements of this Compact and any relevant Supplemental Agreement between the Parties.

ANNEX III-6