

PUBLIC

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

## **HONDURAS**

### **SUPPORT FOR THE INTEGRATION OF HONDURAS IN THE REGIONAL ELECTRICITY MARKET**

**(HO-L1039)**

## **LOAN PROPOSAL**

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<b>REQUIRED</b>	
1.	Annual work plan <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38029339">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38029339</a>
2.	Monitoring and evaluation plan <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37958693">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=37958693</a>
3.	Environmental and Social Management Report <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38082028">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38082028</a>
4.	Full procurement plan <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38029049">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38029049</a>
<b>OPTIONAL</b>	
1.	Institutional Capacity Assessment System (ICAS) <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38029371">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38029371</a>
2.	Economic analysis report <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38029253">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38029253</a>
3.	Technical engineering report <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38029297">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38029297</a>
4.	Socioenvironmental audit <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38029236">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38029236</a>
5.	Technical annex on regional integration <a href="http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38060222">http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38060222</a>

## ABBREVIATIONS

AOM	Administration, Operation, and Maintenance
AWP	Annual work plan
CNE	National Energy Commission
CRIE	Comisión Regional de Interconexión Eléctrica [Regional Electric Interconnection Commission]
EIRR	Economic internal rate of return
ENEE	Empresa Nacional de Energía Eléctrica [National Electric Power Company]
EOR	Ente Operador Regional [Regional Operator]
EPR	Empresa Propietaria de la Red
ESMR	Environmental and Social Management Report
ESS Program	Energy Sector Support Program
ICAS	Institutional Capacity Assessment System
kV	Kilovolts
LMSE	Ley Marco del Subsector Eléctrico [Electricity Subsector Framework Act]
MER	Mercado Eléctrico Regional [Regional Electricity Market]
MVA	Megavolt ampere
MW	Megawatt
MWh	Megawatt-hour
NPV	Net present value
PCU	Program Coordination Unit
SIEPAC	Sistema de Interconexión Eléctrica de los Países de América Central [Central American Electric Interconnection System]

## PROJECT SUMMARY

### HONDURAS

### SUPPORT FOR THE INTEGRATION OF HONDURAS IN THE REGIONAL ELECTRICITY MARKET (HO-L1039)

Financial Terms and Conditions					
<b>Borrower:</b> Republic of Honduras  <b>Executing agency:</b> Empresa Nacional de Energía Eléctrica [National Electric Power Company] (ENEE)				<b>OC</b>	<b>FSO</b>
			Amortization period:	30 years	40 years
			Disbursement period:	5.5 years	5.5 years
			Grace period:	6 years	40 years
<b>Source</b>	<b>Amount</b>	<b>%</b>	Inspection and supervision fee:	*	N/A
IDB (OC)	US\$16,051,000	70	Interest rate:	SCF-Fixed	0.25%
IDB (FSO)	US\$6,879,000	30	Credit fee:	*	N/A
Total	US\$22,930,000	100	Approval currency:	US\$ from the SCF of the Ordinary Capital	US\$
<p><b>Program objective:</b> The program's objective is to support the start-up of commercial operation of one of the segments of SIEPAC and to improve physical infrastructure conditions in Honduras so as to enable the country to participate effectively in the Regional Electricity Market (MER).</p> <p>The specific objectives are to: (i) reestablish the operating conditions of the only SIEPAC electric interconnection between Guatemala and Honduras, one of SIEPAC's central connections; and (ii) strengthen ENEE's operations and management so as to maximize the benefits of marketing electric power in the MER.</p> <p><b>Special contractual clauses:</b></p> <p><b>Special conditions precedent to the first disbursement:</b> (i) the signing of the subsidiary agreement between ENEE and the Ministry of Finance (paragraph 3.1.1); (ii) the selection of a general program coordinator, a technical coordinator, a monitoring specialist, a financial specialist, a procurement specialist, and an environmental specialist for the PCU (paragraph 3.2); and (iii) the preparation and approval of the program's Operations Manual (paragraph 3.2).</p> <p><b>Special execution conditions:</b> (i) ENEE will fulfill the environmental and social obligations described in detail in the Environmental and Social Management Report (ESMR) and will implement the actions provided in the Environmental and Social Management Plan (ESMP) in accordance with the time frames set forth therein, and comply with the environmental and social regulations in effect in the MER (paragraph 3.6); and (ii) ENEE will present evidence to the Bank that the land has been purchased before the works contract is awarded (paragraph 2.7).</p> <p><b>Exceptions to Bank policies:</b> None</p>					
<b>Project qualifies as:</b> <span style="margin-left: 20px;">SEQ [ ]</span> <span style="margin-left: 20px;">PTI [ ]</span> <span style="margin-left: 20px;">Sector [ ]</span> <span style="margin-left: 20px;">Geographic [ ]</span> <span style="margin-left: 20px;">Headcount [ ]</span>					

\* The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable policies.

## I. DESCRIPTION AND RESULTS MONITORING

### A. Background, problems to be addressed, and rationale

- 1.1 This operation HO-L1039<sup>1</sup> supports the integration of Honduras into the Central American Regional Electricity Market (MER) through the Sistema de Interconexión Eléctrica de los Países de América Central [Central American Electric Interconnection System] (SIEPAC).<sup>2</sup> This loan includes: (i) bringing one of SIEPAC's main corridors, the segment from Panaluya, Guatemala to San Buenaventura, Honduras, on line (paragraph 1.7 to 1.12); (ii) completing works under two Bank operations currently in execution that support the integration of Honduras in the MER (paragraphs 1.13 to 1.18); and (iii) strengthening the Empresa Nacional de Energía Eléctrica [National Electric Power Company] (ENEE) for effective participation in the MER (paragraph 1.19).
- 1.2 The MER was agreed under a framework agreement entered into by six Central American countries: Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica, and Panama, and is designed as a seventh electricity market, in addition to the markets in each country. The MER was made viable by the construction of the SIEPAC project, allowing greater exchanges of electric power between the countries. The benefits of SIEPAC/MER include optimizing energy resources and electricity infrastructure in the Central American region to reduce electric power costs in the region's countries, by capitalizing on economies of scale through investments in regional power generation and creating savings in each country's individual investments in reserve capacity.
- 1.3 Financing for SIEPAC's power infrastructure and technical assistance to create the MER were originally approved by the Inter-American Development Bank (IDB) in 1997. Empresa Propietaria de la Red (EPR) was created for execution purposes, and the six IDB borrowing member countries signed agreements through their respective national power utilities, transferring the financing to EPR. In addition, to make the MER's development possible, the following regional agencies were created: the MER Board of Directors (CDMER), which handles electricity integration policy issues, the Comisión Regional de Interconexión Eléctrica [Regional Electric Interconnection Commission] (CRIE), which acts as regulatory authority; the Ente Operador Regional [Regional Operator] (EOR), which acts as system and market operator.

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<sup>1</sup> Pipeline number HO-L1039 had been reserved for a second loan under the "Energy Sector Support Program II," the first loan for which (loan 2016/BL-HO, project HO-L1019) was approved by the Board of Executive Directors of the Inter-American Development Bank (IDB) on 10 September 2008. However, that second operation never took place and the number was assigned to this operation.

<sup>2</sup> SIEPAC has two principal components: (i) construction and commissioning of the first regional electricity transmission system, which will integrate the power grids of the aforementioned six countries; and (ii) development of the MER, devised as a seventh market superimposed on the six existing national markets, with a regional institutional framework and regulations. Further details on SIEPAC are available through the electronic link [IDBDOCS#37799822](https://www.idbdocs.org/eng/document/IDBDOCS37799822).

- 1.4 Exchanges of electricity in SIEPAC/MER have remained relatively constant in recent years at 368 gigawatt-hours (GWh) in 2009, 336 GWh in 2010, 344 GWh in 2011, and 310 GWh in 2012. However, in June 2013, with the entry into effect of the MER Regulations, the trend has changed and these exchanges have increased significantly to 506 GWh year-on-year through September 2013, and are projected to reach 1,000 GWh in 2014. To provide an idea of what these figures represent, the total demand in the region is about 44,205 GWh<sup>3</sup> and the objective for transactions in the MER would be between 3,000 GWh and 5,000 GWh.
- 1.5 Despite the progress, SIEPAC/MER still faces challenges that need to be overcome for its ultimate consolidation, including the start-up of commercial operations of the complete line. To make this possible, two of the 19 segments must be brought online:
- a. The Parrita – Palmar Norte segment in Costa Rica is under construction and is estimated to go online by the end of 2014; and
  - b. the Panaluya, Guatemala – San Buenaventura, Honduras segment has been built but has not yet been authorized for commercial operation due to the fact that ENEE made a connection on this segment without following the procedure established under the regional regulations, when it connected the San Nicolás mobile substation to resolve a serious supply problem in western Honduras. As a result, the segment between Panaluya, Guatemala and the San Nicolás substations is out of service and the segment from San Buenaventura, Honduras to the San Nicolás substation is being used to power the San Nicolás substation, in other words, as a domestic or national line.<sup>4</sup>
- 1.6 ENEE is a key Honduran stakeholder in the SIEPAC/MER project in its capacity as a partner in Empresa Propietaria de la Red (EPR) and as national grid operator/market operator (OS/OM). ENEE is a vertically integrated, State-owned company operating alone nationwide in the distribution, transmission, and dispatch sectors in Honduras. In 1994, the Electricity Subsector Framework Act (LMSE) was approved, aimed at introducing reforms to encourage private sector participation in power generation and distribution. With the reforms, the private-sector share in power generation has been rising and now accounts for 67% of the country's installed capacity. Recently, the Government of Honduras initiated actions aimed at awarding concessions for electric power distribution, transmission, and marketing.

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<sup>3</sup> Source: electricity subsector production statistics, 2012, from the Economic Commission for Latin America and the Caribbean (ECLAC), published in May 2013.

<sup>4</sup> Resolution CRIE-NP-05-2013. [www.crie.org.gt](http://www.crie.org.gt).

- 1.7 **Problem to be addressed and rationale.** In 2011, ENEE declared an emergency in the provision of electric power services in the western region of Honduras.<sup>5</sup> This became a springboard for developing an action plan to improve energy service in the area. The plan involved using part of the SIEPAC line, in the Panaluya, Guatemala – San Buenaventura, Honduras segment, on a temporary basis and connected a mobile 50 megavolt ampere (MVA) to 230/34.5 kV substation. This created problems with the regional regulator, CRIE, because a connection had been made outside the regional rules and regulations in effect. As a result, CRIE did not approve the connection.
- 1.8 The lack of commercial operation on the Panaluya, Guatemala – San Buenaventura, Honduras segment has hindered power transactions and the reaping of the benefits of the regional electricity market. It also jeopardizes the financial sustainability and proper operations of one of the most significant regional integration operations in Latin America. The lack of a solution to this problem affects both EPR and ENEE.
- 1.9 Specifically, the identified problems are: (i) financial: EPR cannot receive the revenues associated with this segment, and as time goes by without the start-up of commercial operations and without the inflow of revenues, this will end up impacting the sustainability of SIEPAC/MER. In 2013, approximately US\$1.4 million was not received for this segment, according to EPR calculations; (ii) higher costs for ENEE under the MER regulations: if this segment were operating commercially, the associated costs would be assumed by market agents making exchanges through this segment. However, since the line is not operating, these expenses would be assumed by ENEE, aggravating its financial situation; (iii) lack of power transmission capacity: the current lack of conversion capacity in the western region of Honduras hinders the integration of the energy to be generated by various renewable energy projects in that area into SIEPAC/MER; (iv) reduction of potential electricity exchanges: currently this segment cannot be used for international exchanges, which reduces the potential for SIEPAC/MER transactions, harms consumers and power generators/marketers since they cannot leverage the advantages of more competitive prices that would be available if this segment were operational; and (v) inefficient exports: Guatemala—the country with the greatest export capacity in the region—cannot use this segment to export to Honduras, and must do so through El Salvador, which is less efficient and reduces the potential for business in the market.
- 1.10 To solve the problem created by ENEE’s connection to the SIEPAC line in the San Buenaventura, Honduras to Panaluya, Guatemala segment, CRIE and the EOR settled on the need for ENEE to arrive at a final resolution that satisfies regional regulations by replacing the existing mobile substation with a permanent solution.

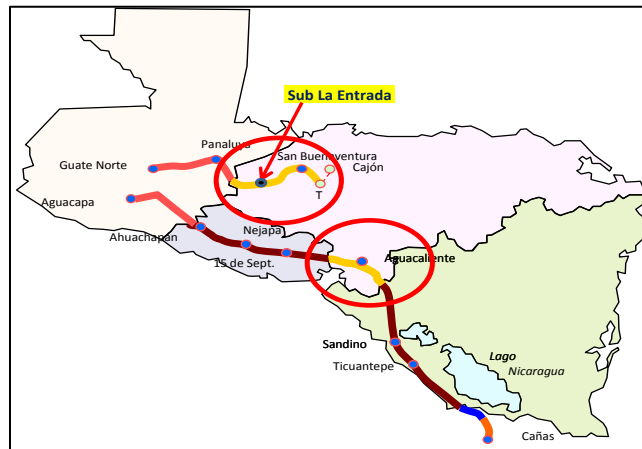
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<sup>5</sup> The western region of Honduras, particularly the municipios of La Entrada, Ruinas de Copán, and Sula-Quimistán, in the departments of Copán and Santa Bárbara, respectively, have poor quality of electric service as evidenced by: (i) low voltage levels of 86% of nominal voltage, when acceptable levels range from 95% to 98%; (ii) high losses of 21%, when energy loss levels in radial systems are around 10%; and (iii) a failure frequency of 6.4 hours/month, when the average nationwide is 2.5 hours/month.



- 1.11 This permanent solution would be the construction of the La Entrada substation,<sup>6</sup> as provided under the program, which will allow the CRIE to authorize the connection to the SIEPAC line at this point and lead to normal commercial operations in this segment of SIEPAC (see Figure 1). The substation design incorporates technical standards that include trade measuring systems on the San Buenaventura, Honduras to Panaluya, Guatemala line to quantify the energy traded between the countries, a connection to the ENEE control center, and an automatic generation control adjustment.<sup>7</sup>

**Figure 1. SIEPAC and the location of the La Entrada substation**



- 1.12 Technically, the entry into operation of this segment would close a power loop between the systems of Guatemala, El Salvador, and Honduras, giving the regional transmission network the robust structure that it needs.<sup>8</sup>
- 1.13 The power interconnection initiative under the Puebla Panama Plan, under which SIEPAC is being executed, aims to promote the efficient use of the region's natural resources for energy production, particularly for the benefit of rural communities that do not have electricity service. In this context, in 2005, the Bank approved "Support for Rural Electrification and the Energy Sector," loan 1584/SF-HO (operation HO-0224), contributing not only with the rural electrification component, but also with the modernization of the dispatch center that will allow ENEE to interact appropriately with the market and participate actively in the MER.

<sup>6</sup> The substation to be established in the municipal of La Entrada is considered and justified in the ENEE's Transmission and Distribution Expansion Plan.

<sup>7</sup> There are studies showing that the interventions provided for in the program will be effective: (i) MER Regulations. Chapter 5. IDBDOCS#38202824. Operational Safety Study; (ii) Review of technical studies regarding the request by the EOR to connect the San Nicolás substation to the regional transmission network (RTR); and (iii) SIEPAC loan (CA-0035) financed by the IDB.

<sup>8</sup> National transmission lines complete the loop and are not shown in Figure 1, which basically shows the SIEPAC line.

- 1.14 In addition, to make effective use of SIEPAC/MER, each country should have a national transmission network with sufficient capacity to accommodate the growing demand for electricity, which could be delivered through regional interconnections. Thus, in 2010, the Bank approved the “Energy Sector Support Program,” loan 2016/BL-HO (project HO-L1019), which sought to build the capacity of the power transmission network for the transport of local energy and that of the regional market needed to address medium-term demand under conditions of reliability.
- 1.15 These two operations, loans 1584/SF-HO and 2016/BL-HO, supporting the integration of Honduras into the MER, currently in execution, are running financial deficits to complete the works planned and contracted under the operations.
- 1.16 The deficit of resources in these project arose when: (i) as part of the commitments undertaken by Honduras for the Multilateral Debt Relief Mechanism (CA-474-2), on 29 January 2008, the Bank approved a downsizing of operation 1584/SF-HO, which was reduced by US\$9.9 million; and (ii) on 29 September 2010, the Bank’s Board approved an increase in supplementary financing for SIEPAC (document PR-3598), redirecting US\$4.5 million from operation 2016/BL-HO.
- 1.17 When the recommendation to reduce the size of loans 1584/SF-HO and 2016/BL-HO was presented, it was believed that the eliminated funds, totaling US\$14.4 million (coming primarily from contingencies), would not be needed to complete the scheduled works. With the passage of time and execution delays related to the failure to obtain rights of way in a timely manner, it became evident that part of those eliminated resources would in fact be needed. Thus, projects 1584/SF-HO and 2016/BL-HO, which finance the expansion and construction of substations and transmission lines and support for ENEE efficiency in the marketing and delivery of electricity,<sup>9</sup> lack the resources required to complete the payments for the works described in paragraph 1.27(b).<sup>10</sup>
- 1.18 In order to achieve full completion of projects 1584/SF-HO and 2016/BL-HO, support is needed to finance the remaining works, by replacing approximately US\$4.8 million (about US\$2.4 million for each operation) of the US\$14.4 million in cuts. Availability of these funds will make it possible to achieve the outcomes planned under these operations. All other works provided for under these loans have been completed. Currently, both loans are being properly executed and have been almost 100% disbursed.
- 1.19 Although ENEE has used resources from the two aforementioned operations to acquire equipment for the National Dispatch Center, there is persistent weakness in

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<sup>9</sup> Primarily by modernizing the National Dispatch Center in order to enhance and expand data acquisition media, control of the power grid, and management of the electricity market (SCADA/EMS), and by investing in telecommunications systems.

<sup>10</sup> Quantification of the financial resources required to complete the works is found in the technical engineering report [IDBDOCS#38029297](#).

managing energy trade with the countries in the region through the MER<sup>11</sup> (paragraphs 1.13 and 1.14). Maximizing the benefits of Honduras' integration into the MER, especially in view of the entry into force of the MER regulations in June 2013, requires continued support for the strengthening of ENEE's commercial management capacity, where needed actions have been identified such as creating an electricity marketing and transactions unit at the ENEE National Dispatch Center and improving ENEE's management for the proper handling of information on commercial transactions in the MER. Both actions, which previously were not needed because the electricity system operated as an isolated monopoly, are now essential in electricity systems that are becoming part of a regional market.

- 1.20 Such is the context framing this operation, "Support for the Integration of Honduras in the Regional Electricity Market" (the program), which will finance priority investments to support regional integration and strengthen ENEE's commercial management. Thus, this operation will provide continuity to the loans currently in execution (1584/SF-HO and 2016/BL-HO) and strengthening ENEE to promote Central American electricity integration (1095/SF-HO and 007/SQ-HO).
- 1.21 **Central American regional strategy in the sector.** The Central American countries' strategy for the development of their electricity sector is set forth in the "Central American Sustainable Energy Strategy 2020,"<sup>12</sup> approved by all of the region's governments in 2008, setting the primary objective of ensuring Central America's energy supply, in the quality, quantity, and diversity of sources needed to guarantee sustainable development, while take into account social equity, economic growth, governance, and compatibility with the environment, in accordance with international environmental commitments. The strategy includes the strengthening of regional energy integration (regional electricity market and customs union) as one of the fundamental means for achieving this objective. In addition, in the Ministerial Declaration on the Progress of Mesoamerican Energy Integration and Trade in Low-carbon Electricity signed at the meeting held at the IDB on 27 and 28 June 2013, the region's Ministers of Energy renewed their commitment to promote Mesoamerican energy integration and complete SIEPAC infrastructure by 2014.
- 1.22 **The Bank's strategy in the Central American electricity sector.** The proposed program is consistent with the Sector Strategy to Support Competitive Global and Regional Integration (document GN-2565-4) adopted in 2011, which considers among the Bank's priority areas of intervention the physical integration of power grids, the regulatory harmonization of energy markets, and the development of regional generation capacity able to contribute to greater efficiency and energy security.

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<sup>11</sup> The Report on Recommendations for Improving Procedures, Staff Profile, and Implementation Plan by Pablo Corredor. See electronic link [IDBDOCS#38174656](#).

<sup>12</sup> Source: Economic Commission for Latin America and the Caribbean (ECLAC) and the Central American Integration System.

- 1.23 **Strategic alignment.** The Program complies with the criteria set forth in the Ninth General Increase in the Resources of the Inter-American Development Bank (document AB-2764): (i) lending to small and vulnerable countries; (ii) lending to support regional cooperation and integration (energy integration); and (iii) lending to support climate change, sustainable energy, and environmental sustainability initiatives. Thus, the activities to be carried out under the program will facilitate the purchase and sale of energy in the regional electricity market. The SIEPAC line, and in particular, the connection to Guatemala through the Panaluya – San Buenaventura link, is very important for efficiently increasing the share of renewable sources without having a negative impact on the security and quality of the supply, and allowing a reduction of thermal generation in Honduras.<sup>13</sup> Moreover, the program is aligned with the IDB Country Strategy with Honduras 2011-2014 (document GN-2645), where regional activities in the energy sector are established as an area of dialogue (paragraph 3.5 of document GN-2645). This program supports the consolidation of SIEPAC with the investments needed for Honduras's integration into the MER. The strategy also indicates that the Bank's support for the Honduran electricity sector through investment loans is subject to progress in the sector's reform (paragraphs 3.18 to 3.21 of document GN-2645). This investment operation presents a program that aims to contribute to the regional integration agenda while the Honduran electricity sector moves forward with the necessary reforms that will allow the Bank to support the sector directly.
- 1.24 **Consistency with policies.** The program is consistent with the objectives set forth in the Energy Policy (Operational Policy OP-733) and the Electric Energy Policy (Operational Policy OP-733-1). The objectives of Operational Policy OP-733 include "to efficiently meet the energy requirements of its member countries derived by the process of socioeconomic development" and "to foster cooperation among member countries with a view to joint development and utilization of their energy resources, through the execution of national, bilateral, and multilateral projects." In particular, Operational Policy OP-733-1 promotes the financing of projects that will increase the availability and reliability of the energy supply.

**B. Objective, components, and cost**

- 1.25 The general objective of the program is to support the start-up of commercial operation of one of the segments of SIEPAC and improve the physical infrastructure conditions in Honduras so as to enable the country to participate effectively in the MER.
- 1.26 The program's specific objectives are to: (i) reestablish the operating conditions of the only SIEPAC electric interconnection between Guatemala and Honduras, one of SIEPAC's central connections; and (ii) strengthen ENEE's operations and management so as to maximize the benefits of marketing electric power in the MER. In order to achieve these objectives, the operation includes the following components:

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<sup>13</sup> See regional integration technical annex [IDBDOCS#3806022](#).

**1.27 Component I: Investment in works related to the integration of Honduras into SIEPAC (US\$ 19.7 million).** Component I is divided into two parts:

- a. **Construction of the La Entrada substation (US\$14.9 million).**<sup>14</sup> This part includes: (i) building a substation with capacity to convert from 50 MVA to 230 kV/34.5 kV, along with its associated outgoing lines, in order to create a link between SIEPAC and the transmission network in Honduras; (ii) installing three towers for the incoming transmission lines; (iii) improving the associated distribution lines; and (iv) purchasing land for construction of the substation.
- b. **Investments in electric transmission infrastructure (US\$4.8 million).** This will make it possible to complete the works and achieve the outcomes planned under loans 1584/SF-HO and 2016/BL-HO. The works to be completed under these loans are: (i) two 69-kV transmission lines: Las Flores–Erandique (62 km) and Danli–Chichicaste (33 km); (ii) one 138-kV transmission line: San Pedro Sula Sur–Naco (23 km); (iii) expansion of the Las Flores and Danli substations (entirely under 1584/SF-HO); and (iv) the Amaratéca substation, with capacity to convert from 150 MVA to 230 kV (2016/BL-HO). These are works considered in the original design of the operations and that are already contracted, but due primarily to issues with rights of way, have experienced delays in their execution.<sup>15</sup>

**1.28 Component II. Strengthening ENEE for energy marketing in the MER (US\$1.7 million).** Component II will help ENEE enhance its management capacity, including: (i) creating an electricity marketing and transactions unit at the ENEE National Dispatch Center so as to enhance the benefits from ENEE’s marketing of energy in the MER; and (ii) improving ENEE’s financial management for the proper handling of information on commercial transactions in the MER.

**1.29 Engineering, administration, audit, and evaluations (US\$1.49 million).** This will support the program’s execution by funding program supervision, including environmental monitoring, audit, and evaluations.

**C. Results Matrix and indicators**

- 1.30** As a result of the regionally oriented investments in transmission, plans call for authorizing commercial operation of the SIEPAC segment from Panaluya to San Buenaventura and enhancing the quality of service and reliability of the Honduran electricity system. The Results Matrix (Annex II) shows impact, outcome, and output indicators that contribute to the program’s evaluation. These indicators have been agreed with, and will be verified by, ENEE.

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<sup>14</sup> This amount includes the items: La Entrada substation and contingencies.

<sup>15</sup> See footnote 10.

## D. Cost and financing

- 1.31 The cost of the Program is US\$22.93 million, to be financed by the Bank through an investment loan.<sup>16</sup>

**Table 1. Costs and financing**

Items		Financing (US\$ millions)	
No	Description	IDB	Total
<b>1</b>	<b>Direct costs</b>	<b>20.04</b>	<b>20.04</b>
1.1	La Entrada substation	13.53	<b>13.53</b>
1.2	Replacement of the 1584/SF-HO and 2016/BL-HO financing	4.79	<b>4.79</b>
<b>1.3</b>	<b>Institutional strengthening</b>	<b>1.73</b>	<b>1.73</b>
<b>2</b>	<b>Contingencies</b>	<b>1.39</b>	<b>1.39</b>
<b>3</b>	<b>Engineering, administration, audit, and evaluations</b>	<b>1.50</b>	<b>1.50</b>
3.1	Engineering, administration, and environment	1.34	<b>1.34</b>
3.2	External audits	0.13	<b>0.13</b>
3.3	Midterm and final evaluations	0.03	<b>0.03</b>
	<b>Program total</b>	<b>22.93</b>	<b>22.93</b>
	<b>Percentage share</b>	<b>100%</b>	<b>100%</b>

## II. FINANCING STRUCTURE AND MAIN RISKS

### A. Financing structure

- 2.1 The program proposes financing the Republic of Honduras through an investment loan.

### B. Main risks and mitigating measures

#### 1. Institutional and fiduciary risk

- 2.2 The program will be executed by ENEE, using its organizational structure and fiduciary management systems. ENEE's institutional and fiduciary risk was analyzed by the project team using the Institutional Capacity Assessment System (ICAS).<sup>17</sup> The analysis indicated that ENEE's fiduciary system poses a medium-level risk.<sup>18</sup>
- 2.3 To mitigate the identified risks and facilitate program execution, there will be a Program Coordination Unit (PCU) inside ENEE. This unit is currently in charge of execution of loans 1584/SF-HO and 2016/BL-HO and has proven experience and ability. Creating a PCU with the required staff is a condition precedent to the first disbursement under the program (paragraph 3.2).

<sup>16</sup> The finance costs will be borne by the borrower.

<sup>17</sup> Conducted pursuant to the Financial Management Policy for IDB-financed Projects (document OP-273-1) and its Operational Guidelines (document OP-274-1).

<sup>18</sup> In addition to the mitigating measures provided for in the program, it is expected that the fiduciary and procurement risks will be partially reduced upon ENEE's implementation of the corporate and commercial management system awarded in 2013 under a World Bank loan.

## **2. Environmental and social risks**

- 2.4 The works contemplated under the program are not in the vicinity of any protected area or sensitive natural habitat, and will not require the resettlement or displacement of any population. Consequently, in accordance with the Bank's Environment and Safeguards Compliance Policy (Operational Policy OP-703), the project has been classified as a category "B" operation.
- 2.5 The Bank commissioned a socioenvironmental audit of the two operations (1584/SF-HO and 2016/BL-HO),<sup>19</sup> as well as an analysis of the socioenvironmental impacts and risks of the construction of the La Entrada substation, in order to identifying socioenvironmental liabilities and impacts and mitigating measures. All of this is summarized in the program's Environmental and Social Management Report (ESMR). The audit identified certain environmental liabilities, such as the absence of: reforestation, bird-safety devices on the transmission lines, and institutional strengthening of ENEE's environmental studies unit. As such, the Environmental and Social Management Plan (ESMP) provides an action plan to remedy such noncompliance. ENEE will be responsible for complying with the ESMP within the agreed-upon timeframes and budget. If necessary during the course of program execution, the ESMP may be modified on the basis of information derived from the inspection and monitoring programs. In addition, ENEE will comply with the MER Environmental Management Plan for both the construction phase and the operational phase and for such purposes will coordinate with the national EPR office in Honduras.
- 2.6 With regard to the analysis of the La Entrada substation, given the nature of the proposed works, the primary adverse socioenvironmental impacts and risks will arise during the construction stage. These impacts and risks will be moderate, low-magnitude, localized, and temporary (noise, dust and debris generation, accident risk, oil spills, and traffic interruption) and can be mitigated through the relevant environmental management plans that will be part of the bidding documents for the works.
- 2.7 One or two properties (private estates) will be impacted prior to the award of the works contract. Furthermore, given the wealth of archaeological resources in the area, the Bank engaged an expert to carry out an archaeological survey<sup>20</sup> at the location at which construction of the works will take place. The survey did not identify any cultural vestiges either on the surface or in subsoil samples. While this significantly reduces the possibility of an impact on archeological sites or remains, monitoring should be continuously conducted during the excavation stage of the works, and the action plan set forth in the ESMP should be followed in the event of an unexpected archeological discovery.

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<sup>19</sup> In compliance with Directive B.5 of Operational Policy OP-703.

<sup>20</sup> In compliance with Directive B.9 of Operational Policy OP-703.

### **3. Construction risk**

- 2.8 ENEE has 56 years of experience in electric power generation, transmission, distribution, and marketing in Honduras and, through its Engineering Division, has been responsible for the construction and oversight of works similar to those contemplated under the program. It will also have the support of EPR, in its capacity as the party responsible for the construction, operation, and maintenance of SIEPAC's power infrastructure. The works under loans 1584/SF-HO and 2016/BL-HO do not pose any risk since these are ongoing contracts and are scheduled to be completed by 2014.
- 2.9 The La Entrada substation will be built on land to be purchased by ENEE. Construction of works under the program, including detailed engineering of the La Entrada substation, associated outgoing lines, and equipment supply, will be carried out on a turnkey basis pursuant to fixed time frames and amounts. This arrangement transfers to the contractor any additional costs arising from delays or other issues not provided for in the bid. ENEE will engage a supervisory firm to ensure compliance with technical specifications and with the agreed-upon work quality, construction time, and budget.
- 2.10 Program investment costs have been calculated by the Engineering Division of ENEE based on experience with works of similar scope, and have been reviewed and adjusted, including the work timetable, by the Bank's independent engineer to reflect more conservative assumptions, including 10% for contingencies, which is considered appropriate for the proposed works.
- 2.11 In view of the foregoing, the construction risk is considered low, since: (i) the works have been developed considering the technical and financial analysis presented by ENEE's Planning and Development Office; (ii) the works will be built under good design and construction practices and in accordance with international standards of quality, and have been approved by the MER operator; (iii) ENEE has a great deal of experience in the sector and in building similar and more complex works, in addition to having EPR's support; (iv) the equipment to be provided is standard; (v) the budgeted costs are consistent with market costs; and (vi) the proposed timetable is compatible with the volume of works.

### **4. Operating and maintenance risk**

- 2.12 With the start-up of commercial operation of the Panaluya, Guatemala to San Buenaventura, Honduras segment under MER regulations, the operating and maintenance costs (among other costs) will be assumed by market agents, ensuring the sustainability of the SIEPAC works. At the same time, ENEE will be responsible for the operation and maintenance of the transmission (substations and transmission lines) and distribution works contemplated under the program, and ENEE has a budget for operating and maintenance expenses.



**C. Economic, financial, and technical viability**

- 2.13 **Economic viability.** The economic evaluation was conducted using the cost-benefit method with and without the program.<sup>21</sup> When using the cost of energy determined as a system linked to the MER, the program's economic evaluation yields an economic internal rate of return (EIRR) of 23.5% and a net present value (NPV) of benefits of US\$16 million (discounted at 12%).
- 2.14 The sensitivity of results to changes in the principal parameters used (costs, willingness to pay, loss reduction, reliability) shows that the associated risk of a significant adverse impact on the EIRR and NPV is very low. The EIRR would exceed 12%.
- 2.15 **Financial viability.** The program's financial evaluation shows an internal rate of return (IRR) of 8% and an NPV of US\$3.5 million (discounted at 12%), demonstrating the program's soundness.
- 2.16 The start-up of commercial operation of the Panaluya – San Buenaventura segment will allow EPR to be able to receive the annual allocation for administration, operation, and maintenance and the return related to this segment. At the same time, it will allow ENEE to sell energy in the MER at marginal costs below the scenario without the MER, improving the cost reduction for electricity, with a positive impact on ENEE's operating margins, which, along with its cash flow, were negative in 2012.<sup>22</sup>
- 2.17 In a regional electricity market, the technical and financial strength of the participating enterprises (agents) is a fundamental requirement for ensuring the market's sustainability and maximizing the benefits for each of the countries. In this context, the Honduran government has begun a reform process in the electricity sector, aimed at separating the activities of distribution, transmission, and dispatch, as well as public lighting.<sup>23</sup> The separation of activities as business units, with separate accounting, is necessary in order to improve corporate governance at ENEE and enhance the financial benefits of Honduran integration in the MER.
- 2.18 **Technical viability.** The principal works provided under the program do not pose any specific construction or operating challenges. The independent engineer engaged by the Bank reviewed the program and confirmed that, in terms of costs, quality, and execution timetable, the program can ensure that the works are carried out within the scheduled timeframe and in accordance with the required technical

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<sup>21</sup> See economic analysis report [IDBDOCS#38029253](#).

<sup>22</sup> See the ENEE Financial Plan Report, December 2012, in electronic link [IDBDOCS#38029553](#).

<sup>23</sup> The sector reform process is framed within the project "Loss Recovery in the Services Provided by ENEE," and the Honduran government has formed three trusts, approved under law, with three national banks. In addition to managing and administering the financial flows, each trust is charged with granting concessions for these activities under a public-private participation structure, in which the necessary studies, reform proposals, and preparation of concession contracts are being supported by the World Bank's International Finance Corporation (IFC) and its respective consultants.

specifications. The independent engineer also highlighted the importance of the supervisory firm to be contracted under the program in ensuring successful implementation and monitoring of the works.

### III. IMPLEMENTATION AND MANAGEMENT PLAN

#### A. Execution arrangements

- 3.1 The borrower will be the Republic of Honduras, and ENEE will be the program's executing agency in its capacity as EPR partner and primary Honduran agent for the MER. **As a special condition precedent to the first disbursement, a subsidiary agreement will be signed between ENEE and the Ministry of Finance,** including the following provisions: (i) how the loan proceeds will be transferred; (ii) ENEE's commitment to execute the program's activities in accordance with the terms and conditions of the loan contract; and (iii) a commitment to use the loan proceeds for purposes of the program.
- 3.2 **Organization.** ENEE will be responsible for program execution, administration, monitoring, and evaluation, with the support of a PCU and in coordination with the EPR given the regional nature of the program. The PCU will include a general program coordinator, a technical coordinator, a monitoring specialist, a financial specialist, a procurement specialist, and an environmental specialist (paragraph 2.3). **As a special condition precedent to the first disbursement: (i) the PCU will have all the aforementioned technical experts in place; and (ii) the program's Operating Manual will have been prepared and approved.**<sup>24</sup>
- 3.3 In its capacity as executing agency, ENEE will be responsible for implementing and supervising the program, preparing and approving the annual work plans (AWPs), providing the information needed for the Bank to monitor and evaluate the program's impacts, coordinating and managing the disbursements, and keeping accounting and financial records, including the annual financial statements required by the Bank.
- 3.4 **Monitoring and evaluation.** The program will include the following instruments, to be produced by the executing agency: (i) AWPs; (ii) semiannual reports describing progress made on the AWPs and outcomes of the execution of activities; and (iii) an action plan for the following six-month period with respect to areas that require corrective action with a view to improving the overall performance of the program.
- 3.5 The evaluation system will be aimed at verifying fulfillment of the targets agreed upon in the Results Matrix. Plans call for semiannual monitoring reports and a final evaluation six months following the conclusion of the execution period.<sup>25</sup>

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<sup>24</sup> Lessons learned in earlier operations were taken into account when preparing the program.

<sup>25</sup> See electronic link: monitoring and evaluation [IDBDOCS#37958693](#).

- 3.6 **Special execution conditions.** The following are special execution conditions: (i) ENEE will fulfill the environmental and social obligations established in the ESMR and implement the actions provided in the ESMP within the time frames set forth therein, and will comply with the environmental and social regulations in effect in the MER; and (ii) ENEE will present evidence to the Bank that the land has been purchased before the works contract is awarded.

**B. Management**

- 3.7 **Procurement of works, goods, and services.** The procurement of works, goods, and services and the contracting of consulting services financed by the IDB will be carried out in accordance with IDB procurement policies (documents GN-2349-9 and GN-2350-9, respectively). Program procurement will be reviewed as provided in the procurement plan.
- 3.8 **Fiduciary considerations.** The program's fiduciary considerations are set forth in Chapter IV of Annex III.
- 3.9 **Payments for the completion of works under loans 1584/SF-HO and 2016/BL-HO.** The operation calls for financing expenditures incurred by the executing agency with respect to works procured under loan contracts 1584/SF-HO and 2016/BL-HO. These works were procured in accordance with the Bank's policies for the procurement of works and goods pursuant to the aforementioned loan contracts. A reallocation of resources from the above-indicated operations led to cuts in the original budget for these works. As provided in paragraph 1.27(b), an amount of up to US\$4.8 million of the financing being presented for approval as additional financing may be used to pay for such expenditures.
- 3.10 **Financial planning and disbursements.** The financial plan to accompany each disbursement request must be updated semiannually or as otherwise required by the Bank, based on the actual cash needs of the program. Disbursements will be made over a period of six years.
- 3.11 **External audits.** The borrower will submit the program's annual consolidated financial statements to the Bank within 120 days following the end of the relevant fiscal year throughout the program's execution period. The audits will be performed by an independent audit firm acceptable to the Bank. This firm will be selected and contracted in accordance with the procedures set forth in the external audit bidding document approved by the Bank (AF-200). External audit services will also be required in order to properly complete projects 1584/SF-HO and 2016/BL-HO. The audit costs will be financed using program resources.

Development Effectiveness Matrix			
Summary			
I. Strategic Alignment			
1. IDB Strategic Development Objectives		Aligned	
Lending Program	i) Lending to small and vulnerable countries, ii) Lending to support climate change initiatives, renewable energy and environmental sustainability, and iii) Lending to support regional cooperation and integration.		
Regional Development Goals			
Bank Output Contribution (as defined in Results Framework of IDB-9)	i) Km of electricity transmission and distribution lines installed or upgraded, ii) Regional and sub-regional integration agreements and cooperation initiatives supported, and iii) Number of cross border and transnational projects supported (infrastructure and customs, etc).		
2. Country Strategy Development Objectives		Aligned	
Country Strategy Results Matrix	GN-2645	i) Increase the share of renewable sources in the electric power grid, and ii) Improve the operational and commercial efficiency of the electricity sector.	
Country Program Results Matrix	GN-2696	The intervention is included in the 2013 Country Program Document.	
Relevance of this project to country development challenges (If not aligned to country strategy or country program)			
II. Development Outcomes - Evaluability		Highly Evaluable	Weight
		8.9	10
3. Evidence-based Assessment & Solution	9.7	33.33%	1
4. Ex ante Economic Analysis	10.0	33.33%	1
5. Monitoring and Evaluation	7.1	33.33%	1
III. Risks & Mitigation Monitoring Matrix			
Overall risks rate = magnitude of risks*likelihood		Low	
Identified risks have been rated for magnitude and likelihood		Yes	
Mitigation measures have been identified for major risks		Yes	
Mitigation measures have indicators for tracking their implementation		Yes	
Environmental & social risk classification		B	
IV. IDB's Role - Additionality			
The project relies on the use of country systems (VPC/PDP criteria)	Yes	Financial Management: i) Budget, ii) Treasury, and iii) Accounting and Reporting. Procurement: Information System.	
The project uses another country system different from the ones above for implementing the program			
The IDB's involvement promotes improvements of the intended beneficiaries and/or public sector entity in the following dimensions:			
Gender Equality			
Labor			
Environment			
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project			
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan			

The Electrical Interconnection System for Central American Countries (SIEPAC) seeks to put in service the first regional electric transmission system that will integrate power grids of the six Central American countries and develop the Regional Electricity Market (MER), becoming a seventh market overlapped with the six national markets. SIEPAC/MER exchanges remained relatively constant until mid-2013, when MER's Regulations were enacted. From that date on they have increased and are expected to reach 1,000 GWh in 2014, nearly three times those registered in June 2013, and targeting of transactions in the 3,000-5,000 GWh range.

SIEPAC/MER faces several challenges to achieve these milestones, one of them being the integration of the Panaluya -Guatemala (GU) - San Buenaventura - Honduras (HO) tranche. In this section, due to local power supply emergency issues, connections have been made outside the regional rules - by installing a mobile sub-station - which prevents regional commercial operation of the section Panaluya (GU)-San Buenaventura (HO). This situation also affects the financial sustainability and the good functioning of electric regional integration in Central America.

The solution to the problem of connecting the National Electricity Company of Honduras (ENEE) to the SIEPAC line in this section replacing existing the mobile substation, with a new substation called La Entrada, which would normalize the operation of this section of SIEPAC, closing a "ring" among the systems in Guatemala, El Salvador and Honduras. The projects that are currently funding activities towards regional electrical integration, no longer have sufficient resources for completion. The diagnosis is presented articulately, with enough empirical evidence.

In connection with the diagnosis, it is proposed to finance investments in order to integrate Honduras to SIEPAC - which mainly includes funding for substation La Entrada, additional funding to ongoing investments and funding to strengthen commercial management. This substation is considered vital to close the link between the SIEPAC and the Honduras transmission network, normalizing electricity related commercial transactions between Guatemala and Honduras, including electricity transactions with the rest of the countries of Central America.

The construction of the proposed works will result in operational and sustainability improvements which are expressed in the results indicators, and these operational improvements will effectively integrate Honduras - in its north-western section - to the SIEPAC. The documentation contains a full economic analysis. The monitoring and evaluation plan proposes the implementation of an ex-post cost-benefit analysis.

## RESULTS MATRIX

<b>Program objective</b>	<p>The program's objective is to support the start-up of commercial operation of one of the segments of SIEPAC and to improve physical infrastructure conditions in Honduras so as to enable the country to participate effectively in the Regional Electricity Market (MER). The specific objectives are to: (i) reestablish the operating conditions of the only SIEPAC electric interconnection between Guatemala and Honduras, one of SIEPAC's central connections; and (ii) strengthen ENEE's operations and management so as to maximize the benefits of marketing electric power in the MER.</p>
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<b>Impact indicator</b>	<b>Baseline 2012</b>	<b>Target level 2017</b>	<b>Source of information</b>	<b>Verification frequency</b>
Final activation of commercial operation of the San Buenaventura, Honduras – Panaluya, Guatemala SIEPAC segment	NO	YES	Regional Electric Interconnection Commission (CRIE)	Annual
<b>Outcome indicators</b>	<b>Baseline 2012</b>	<b>Target level 2017</b>	<b>Source of information</b>	<b>Source of information</b>
Marketing of electricity in the MER (GWh)	310	1,000 or more	ENEE/ Operations Division	Annual
Installed capacity using renewable sources in the western region (MW)	22.5	84	ENEE/ Operations Division	Annual
Equivalent interruption time in the western region (hours/year)	77	25	ENEE/ Operations Division	Annual
Average overload at substations in the western region (%)	97	60	ENEE/ Operations Division	Annual
Staff making up ENEE's Electricity Marketing/Transactions Unit	0	4	ENEE/Management	Annual

<b>Output indicators</b>	<b>Baseline 2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>Total</b>	<b>Source of information</b>
<b>Component I. Investment in works related to the integration of Honduras into SIEPAC</b>								
La Entrada substation completed	-	-	-	-	-	50 MVA	50 MVA	Supervisory firm report/ENEE
Rehabilitation of distribution lines completed (km)	-	-	-	9	9	-	18	Supervisory firm report/ENEE
New distribution lines completed (km)	-	-	-	3	3	6	12	Supervisory firm report/ENEE
<b>Component II. Strengthening ENEE for energy marketing in the MER</b>								
ENEE electricity marketing/ transactions unit created	0	0	0	1	1	1	1	ENEE Management

## FIDUCIARY AGREEMENTS AND REQUIREMENTS

<b>Country:</b>	Honduras
<b>Project number:</b>	HO-L1039
<b>Name:</b>	Support for the Integration of Honduras in the Regional Electricity Market
<b>Executing agency:</b>	Empresa Nacional de Energía Eléctrica [National Electric Power Company] (ENEE)
<b>Fiduciary team:</b>	Kelvin Suero (Financial Management FMP/CHO); Juan Carlos Martell (Procurement FMP/CHO)

### I. EXECUTIVE SUMMARY

- 1.1 There are risk factors, related to the institutional capacity of the Honduran public sector, in the execution of projects to be financed during the course of the Bank's current strategy with the country. To mitigate this risk, the Bank continues to implement technical support and public sector strengthening actions in various areas.
- 1.2 Regarding the fiduciary management systems, the most recent diagnostic assessments in Honduras reflect significant progress toward international good practices and standards, primarily in terms of modernizing the institutional framework and integrating the government budget, cash management, and accounting systems. The Bank supported the development and implementation of the SIAFI/UEPEX module and currently supports its strengthening. The government's internal and external control systems are not used in executing the Bank's portfolio; external auditing services for Bank-financed operations are employed instead. Nevertheless, coordination activities are currently being carried out to strengthen the Sistema Nacional de Control de los Recursos Públicos [National Public Resources Control System] (SINACORP). With regard to the **public procurement system**, the country has strengths that were identified in the MAPS/OECD diagnostic assessment in 2010, particularly a legal framework in line with most international best practices. However, there are challenges in achieving the standards that can allow the Bank to use the country system in Bank-financed operations.

### II. FIDUCIARY CONTEXT OF THE EXECUTING AGENCY

- 2.1 The executing agency for the operation is Empresa Nacional de Energía Eléctrica [National Electric Power Company] (ENEE). At present, ENEE has implemented the Sistema Integrado de Administración Financiera [Integrated Financial

Administration System] (SIAFI), along with its budget, accounting, and cash management subsystems and the UEPEX module for issuing reports on operations with external financing. This system is being used for the financial and accounting management of Bank-financed operations in the Honduran public sector. With regard to procurement, despite the fact that the use of the country system in Bank-financed operations is not provided for in the case of Honduras, it is common practice to use HONDUCOMPRAS to announce State procurement opportunities. In addition, standard national competitive bidding documents and shopping documents are used for the procurement of works and goods.

### III. FIDUCIARY RISK EVALUATION AND MITIGATION MEASURES

- 3.1 On the basis of available information, the fiduciary team determined that the program risk associated with financial and procurement management is **MEDIUM**. This conclusion is basically related to the executing agency's operating capacity and knowledge of Bank policies. For fiduciary management, the executing agency will rely on the Program Coordination Unit (PCU) currently in charge of Bank-financed operations in this sector. Specifically with regard to financial and accounting management, the executing agency already has prior experience and proven ability, as evidenced by its execution of Bank-financed operations (1584/SF-HO and 2016/BL-HO) using the SIAFI/UEPEX system and all national controls derived from such use. With regard to procurement, the identified risks will be mitigated by engaging staff specialized in procurement under IDB procedures as part of the PCU for this new operation. A monitoring system will be implemented, encompassing the planning of the procurement required for the program through a procurement plan execution system agreed upon with the Bank. In addition, the proposed fiduciary supervision arrangements include annual auditing services with semiannual preliminary reports, which will help to mitigate the fiduciary risk. The principal fiduciary risks and their respective mitigation measures are identified in the risk evaluation matrix presented as an electronic link in the loan document. A risk matrix update will be performed at the start of the program. In the event that greater capacity is required, the possibility has been considered of contracting the necessary support.

### IV. CONSIDERATIONS FOR THE SPECIAL CONDITIONS OF THE CONTRACT

- 4.1 Below are agreements and requirements that should be considered in the special conditions of the loan contract:
- a. **Conditions precedent to the first disbursement:** (i) the signing of the subsidiary agreement between ENEE and the Ministry of Finance; (ii) the creation of the Program Coordination Unit (PCU), including appointment of the required technical experts; and (iii) the preparation and approval of the program's Operating Manual.
  - b. **Special execution conditions:** (i) ENEE will fulfill the environmental and social obligations described in detail in the Environmental and Social



Management Report (ESMR) and implement the actions provided in the Environmental and Health and Safety Action Plan (EHSAP); (ii) ENEE will implement the financial recovery plan and show an improvement in its main financial indicators.

- c. **Exchange rate agreed upon with the executing agency/borrower for rendering accounts:** For purposes of Section 3.06(b) of the General Conditions of this contract, the parties agree that the applicable exchange rate will be as indicated in Section 3.06(b)(ii). In this case, the applicable exchange rate will be the rate in effect on the date on which the beneficiary, the executing agency, or any other individual or legal entity that has been delegated the power to incur expenses makes the relevant payment to the contractor or supplier. The Ministry of Finance (SEFIN) is currently reviewing this option; thus, should a change in this respect be considered, it should be coordinated with the Bank in timely fashion.
- d. **Financial statements and other audited reports:** The borrower undertakes to present the following reports either directly or through the executing agency: the program's audited financial statements, duly reviewed by independent auditors acceptable to the Bank, within a period of one hundred twenty (120) days following the end of every fiscal year of the executing agency (which runs from 1 January to 31 December) and during the established loan disbursement period. The final set of such statements will be presented within one hundred twenty (120) days following the date provided for the last disbursement of loan proceeds. The Bank may require the presentation of preliminary reports semiannually or otherwise, based on the evolution of the fiduciary risk.

## V. AGREEMENTS AND REQUIREMENTS FOR PROCUREMENT EXECUTION

- 5.1 The procurement-related fiduciary agreements and requirements establish the applicable provisions when executing any procurement under the program.

### 1. Procurement execution

- 5.2 ENEE, acting through the PCU, will be responsible for conducting the selection, bidding, contracting, supervision, and receipt of program procurement. The aforementioned procurement execution processes will be carried out in accordance with the Bank procurement policies set forth in documents GN-2349-9 and GN-2350-9 and the provisions of the operation's procurement plan, which indicates: (i) the works, goods, and consulting services contracts required to implement the program; (ii) the proposed methods for procurement of goods and selection of consultants; and (iii) the procedures used by the Bank to review each procurement process. For procurement planning, the executing agency will review the procurement plan, either annually or according to the program's needs, using a procurement plan execution and monitoring system to be determined by the Bank both to plan and to report advances. Any modification of the procurement plan must

- be submitted to the Bank for approval. The PCU will agree with the Bank on a procurement plan for the first 18 months of execution.
- 5.3 **Procurement of works, goods, and nonconsulting services:** Procurement for works, goods, and nonconsulting services<sup>1</sup> generated under the program and subject to international competitive bidding (ICB) will be executed using the standard bidding documents (SBD) issued by the Bank. Procurement subject to national competitive bidding (NCB) will be executed using domestic bidding documents agreed upon with the Bank and published on the website of the Oficina Normativa de Contratación y Adquisiciones del Estado [State Procurement Agency] (ONCAE), [www.honducopras.hn](http://www.honducopras.hn).
- 5.4 **Selection and contracting of consultants:** Consulting services generated under the program will be executed using Standard Requests for Proposals (SRFP) issued or agreed upon by the Bank.
- Selection of individual consultants:** At the discretion of the executing agency, local or international announcements may be placed in order to advertise the contracting of individual consultants with a view to creating a shortlist of qualified individuals. Consultants contracted to assist the executing agency during the operation's execution period may be contracted under single-source selection on a continuity of services basis by reason of services rendered in operations HO0224 and HO-L1019 executed by ENEE.
- 5.5 **Advance procurement:** The operation calls for financing expenditures incurred by the executing agency for works procured in the framework of loan contracts 1584/SF-HO and 2016/BL-HO. These works are expected to be completed in the first half of 2014. They were procured in accordance with the Bank's policies for the procurement of goods and works pursuant to the aforementioned loan contracts, and a reallocation of resources from the above-indicated operations led to cuts in the original budget for these works. An amount of up to US\$4.8 million from the financing being presented for approval as additional financing may be set aside to pay for such expenditures.
- 5.6 **National preference:** National preference will not be considered.
- 5.7 **Others:** The Operating Regulations will contain details regarding the program execution arrangements and instruments, as well as internal processing and approval flows at ENEE for purposes of conducting timely monitoring of the processes.

## **2. Threshold amounts (US\$ thousands)**

- 5.8 The thresholds determining the use of ICB and creation of a shortlist with international consultants will be made available to the executing agency on the website [www.iadb.org/procurement](http://www.iadb.org/procurement). Below these thresholds, the selection method will be determined on the basis of the complexity and characteristics of the

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<sup>1</sup> Policies for the procurement of goods and works financed by the Inter-American Development Bank (GN-2349-9), paragraph 1.1: Nonconsulting services are treated as goods.

procurement in question, and this will be reflected in the procurement plan approved by the Bank.

### 3. Main procurement processes

- 5.9 The executing agency will be responsible for preparing the procurement plan,<sup>2 3</sup> and the procurement specialist will provide assistance to ensure that the procedures are appropriate and follow the Bank's procurement policies. The main procurement processes planned for this operation are as follows:

**Main Procurement Processes**

Activity	Type of bidding	Estimated date	Estimated amount US\$
<b>Works</b>			
La Entrada substation construction	ICB	Q1 2014	13,234,000
<b>Consulting services</b>			
Coordinator	SSS	Q2 2014	165,600
Financial specialist	SSS	Q2 2014	149,040
Procurement specialist	SSS	Q2 2014	75,900
<b>Consulting firms<sup>4</sup></b>			
Substation construction supervision	QCBS	Q1 2014	675,000
Consulting assignment for management and implementation of the change	QCBS	Q1 2014	170,000

\* To access the 18-month procurement plan,<sup>18</sup> click here.<sup>5</sup>

### 4. Procurement supervision

- 5.10 Pursuant to the analysis of procurement-related fiduciary risk, the supervision method will be a combination of ex post and ex ante as provided in the procurement plan.
- 5.11 All single-source selection of consulting services to be performed by firms or individuals, as well as all procurement of nonconsulting services, goods, or works, will be supervised by the Bank on an ex ante basis without regard to the contract amount.

### 5. Special provisions

- 5.12 **Measures aimed at reducing the likelihood of corruption:** Address the provisions of GN-2349-9 and GN-2350-9 regarding prohibited practices (lists of ineligible legal entities and individuals drawn up by multilateral agencies).

<sup>2</sup> Policies [GN-2349-9](#), paragraph 1.16. and [GN-2350-9](#), paragraph 1.23.: Borrower shall prepare and, before loan negotiations, furnish to the Bank for its approval, a Procurement Plan acceptable to the Bank... [for] an initial period of at least 18 months.

<sup>3</sup> See [Guidelines for preparing and using a Procurement Plan](#)<sup>18</sup>

<sup>4</sup> In consulting services, it means populating the shortlist with firms of various nationalities. See Policy [GN-2350-9](#), paragraph 2.6.

<sup>5</sup> To create the link, right click on edit Hyperlink and include the IDBDocs number at the end of the link.

- 5.13 **Other special procedures:** The Bank may at its sole discretion change the procurement supervision arrangements based on execution experience and adjustments made to institutional capacity or on fiduciary visits conducted.

## **6. Records and files**

- 5.14 The PCU will be responsible for keeping files and support documents regarding any procurement processes carried out using program resources, as well as for keeping records using established procedures. The internal work flows and separation of functions will be documented in the Operating Regulations.

# **VI. FINANCIAL MANAGEMENT AGREEMENTS AND REQUIREMENTS**

## **1. Programming and budget**

- 6.1 The most recent diagnostic assessments of public finance management systems in Honduras show significant progress. Implementation of the Sistema Integrado de Administración Financiera [Integrated Financial Administration System] (SIAFI) and the Cuenta Única del Tesoro [General Treasury Account] (CUT) has led to more prudent and disciplined management of cash resources and greater decentralization of the treasury function. For certain purposes, legislative approval is not required to reallocate and expand budgets for projects with external financing. It is enough to have an agreement and modification of the relevant quarterly installment, which is approved by SEFIN subject to budgetary availability. The Bank's financial parameters for the country allow the financing of an entire project or program.

## **2. Accounting and information systems**

- 6.2 The SIAFI/UEPEX module is used for financial reporting and rendering of accounts in Bank-financed projects. The program's financial and accounting transactions will rely on the practices of the country system. Accounting records are kept on a cash basis. There is continued progress toward implementation of the International Public Sector Accounting Standards (IPSAS), based on Article 96, Item 1 of the Organic Budget Law, which provides that accounting charts and manuals must be consistent with International Public Sector Accounting Standards.

## **3. Disbursements and cash flow**

- 6.3 For purposes of advances of funds, the executing agency will open a special account in the name of the program at Banco Central de Honduras (BCH), to be used for funds disbursements. The maximum amount of each advance of funds will be determined by the Bank on the basis of the cash flow analysis submitted by the executing agency.

## **4. Internal control and internal audits**

- 6.4 Despite confirmed advances in the country's internal control system, there is still room for improvement. In this particular case, the executing agency will perform its fiduciary duties with the support of the Program Coordination Unit (PCU) created for such purposes in the framework of Bank-financed operations in this sector.

These operations are ongoing as of the date of preparation of this document. At present, the Bank and the Oficina Nacional de Desarrollo Integral del Control Interno [National Office for Integrated Development of Internal Control] (ONADICI) are coordinating efforts to improve the internal control environment at the institutions responsible for Bank-financed operations in Honduras.

## **5. External control and reports**

- 6.5 The Tribunal Superior de Cuentas [Superior Audit Court] (TSC) is the institution responsible for the external control of public funds in Honduras. Due to the TSC's current technical and financial limitations, the external audit function for the operation will be performed by an independent auditing firm acceptable to the Bank and will be financed using loan proceeds. Support and coordination work is currently being carried out with the TSC, and it is expected that a strategic alliance can be developed in the future so that a TSC role may be considered in Bank-financed operations in Honduras. Based on the foregoing, the following financial agreements and arrangements have been determined:
- a. Having annual external financial auditing services available for the program, including the presentation of semiannual preliminary reports.
  - b. On the part of the Bank, the rules to be used in this operation are the Financial Management Policy for IDB-financed Projects (document OP-273-1) and the Financial Management Operational Guidelines for IDB-financed Projects (document OP-274-1).
  - c. The total estimated cost of the auditing services is US\$130,000.00, to be financed using loan proceeds. The independent auditing firm will be selected and contracted on the basis of document AF-200, in accordance with the established guidelines.

## **6. Financial supervision plan**

- 6.6 The Bank will supervise the financial management of the program, monitoring actions taken by the executing agency or the borrower, as the case may be, to remedy any observations or findings identified in the course of the external audits. In addition, the Bank will conduct visits and meetings to monitor the implementation of measures intended to mitigate risks identified during the operation. Supervision will be performed by the financial management specialist assigned to the operation with the support of external auditing services and consultants and in coordination with the Project Team Leader, the other members of the project team, the Country Office authorities, and VPC/FMP.

## **7. Execution arrangements**

- 6.7 The program will be executed by ENEE, acting through the PCU. The PCU will include at least a general program coordinator, a technical coordinator, a monitoring specialist, a financial specialist, and a procurement specialist. This execution unit will coordinate with the administrative and technical areas of ENEE responsible for the various components. The general coordinator will be responsible for technical,

administrative, and financial coordination with the various authorities, and will take the necessary action to ensure that the program is executed within the scheduled timeframes, under the agreed-upon budget, and in compliance with the contractual terms and conditions. The details of the execution arrangements will be set forth in the program's Operating Manual.

#### **8. Other financial management agreements and requirements**

- 6.8 There will be periodic monitoring of actions aimed at mitigating the fiduciary risks identified in the risk matrix. In addition, strengthening actions will be proposed as needed to reasonably ensure proper and efficient use of the resources, and if necessary, the fiduciary arrangements will be modified to achieve this objective.