

Main Steps For Developping And Implementing A Bioenergy Project In China Through International Joint- Ventures

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INTRODUCTION

The object of my presentation is to briefly summarize the four most important steps that need to be taken when considering developping and implementing a bioenergy project in China:

- The first step for a foreign investor is to determine whether or not the project or the industry concerned is regulated.
- The second step is to identify the main administrative approvals that need to be obtained from the Chinese authorities
- The third step is to structure your investment and choose a legal vehicle that is the most appropriate for implementing and running your bioenergy project
- The fourth step is to identify the means through which you will contribute rights on your technology to the project

First Step :

**DETERMINE WHETHER OR NOT
THE PROJECT OR THE INDUSTRY
CONCERNED IS REGULATED.**

China and WTO

- In December 2001, China became the 143rd member of the World Trade Organisation (WTO).
- Many regulations governing foreign investments in China have therefore been modified since then to take into account the internationally accepted standards.

The Regulations on Foreign Investment Orientation and the Guidance Catalogue for Foreign Investments

- In order to determine whether or not the project or the industry concerned is regulated, two sets of regulations governing foreign investments in China must be consulted:
 - the Regulations on Foreign Investment Orientation as enacted by Decree No. 346 of the State Council on 21 February 2002 (***"the Foreign Investment Regulations"***);
 - the Guidance Catalogue for Foreign Investments, as enacted by the State Development and Planning Commission, the State Economic and Trade Commission and the Ministry of Foreign Trade and Economic Cooperation in 1997 and as amended in March 2002; the revisions entered into force on 1st April 2002 (***"the Foreign Investment Catalogue"***);

The Regulations on Foreign Investment Orientation and the Guidance Catalogue for Foreign Investments

- The Foreign Investment Regulations divide industries into four categories:
 - (i) encouraged
 - (ii) allowed
 - (iii) restricted
 - (iv) prohibited
- Under the Foreign Investment Regulations, *"new technologies, new equipment, energy and raw material saving, integrated utilization of resources and renewable resources, and environmental pollution prevention"* are encouraged foreign investment projects (see, Article 5, 4) of the Foreign Investment Regulations).

The Regulations on Foreign Investment Orientation and the Guidance Catalogue for Foreign Investments

- The foreign invested projects falling within the encouraged category
 - enjoy a tax holiday (customs duties and V.A.T.) for imported equipment
 - might enjoy additional preferential treatment according to relevant laws or administrative bylaws (i.e. preferential treatments granted to Foreign Investment Enterprises)
 - may, upon approval, expand their related business scopes if they are characterized by a huge investment and a long return period, such as construction activities related to energy, transportation, urban infrastructure construction (coal, petroleum, natural gas, electric power, railways, highways, harbours, airports, urban roads, sewage and garbage treatment)(see, Article 9 of the Foreign Investment Regulations)

The Regulations on Foreign Investment Orientation and the Guidance Catalogue for Foreign Investments

- The Foreign Investment Catalogue lists the industries falling within each of these categories other than the allowed category.
- Since April 2002, many areas in which foreign investment was in the past prohibited or severely restricted have listed in the Foreign Investment Catalogue.
- These areas include foreign trade, distribution of goods, financial services, insurance and telecommunication, and liberalization is scheduled to comply with the commitments China made in the WTO accession protocol.
- The Foreign Investment Catalogue also relaxes foreign investment shareholding restrictions for some entities in China in this respect.

The Regulations on Foreign Investment Orientation and the Guidance Catalogue for Foreign Investments

- It should be noted that the Foreign Investment Catalogue does not, unlike for other types of projects, impose that the Chinese party should hold a majority equity whenever the project involves "*construction and operation of power station using new energy such as solar energy, wind energy, magnetic energy, geothermal energy, tidal energy and biomass energy*" (see, item 4, 7) of the encouraged categories under the Foreign Investment Catalogue).

Second Step :

IDENTIFY THE MAIN ADMINISTRATIVE APPROVALS THAT NEED TO BE OBTAINED FROM THE CHINESE AUTHORITIES*

* This part of the presentation is based on the administrative procedure as in force in August 2002

Administrative authorisations **- Approval by the State Council -**

- Certain particularly large-scale projects - such as projects on environmental protection, product safety, technical standards on products, food safety, etc. - need to be approved by the State Council, without prejudice to any other procedure.

Administrative authorisations **- Approval by the SDPC -**

- In November 2001, the State Planning Development Commission (SDPC) announced that it did not any longer have to approve the following projects:
 - (i) Urban infrastructure projects;
 - (ii) Agricultural, forestry, and water conservancy projects that do not need any governmental funding;
 - (iii) Social projects where investments are raised by Chinese individuals or enterprises;
 - (iiii) Construction projects (real estate);
 - (iv) Infrastructure projects for commerce and trade.

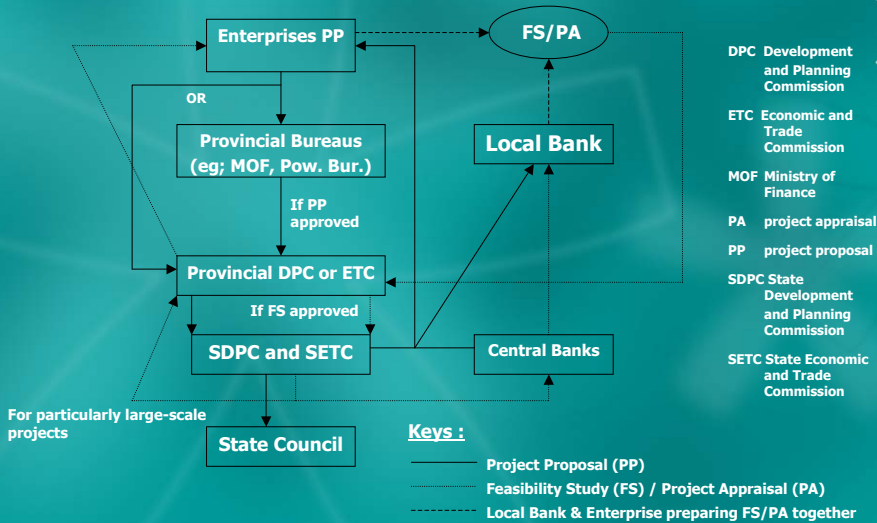
Administrative authorisations - Approval by the SDPC -

- Nevertheless, any project falling within one of the following categories must still be approved by the SDPC:
 - (i) projects that require financing from the central government,
 - (ii) projects that, though using non-governmental financial sources, can concern strategic exploitation and utilization of resources or may cover several water streams or provinces,
 - (iii) projects that affect the regional economic coordinated development, and
 - (iv) projects that the central government considers as strategic for the national industry or that are subject to a limitation under some specific regulation.

Administrative authorisations - Approval by the SDPC -

- **The stage at which the SDPC has to approve a project depends on the type of project:**
 - For projects requiring some financing by the central government, the SDPC has in any event to approve the feasibility study report; if all or most part of the financing is supplied by the central government, the SDPC has also to approve the project proposal and the construction starting report; if governmental financing is required from the Central Banks or if the government is requested to guarantee the reimbursement of a loan granted by foreigner(s), the project should also be approved by the State Economic and Trade Commission (SETC), the Ministry of Finance, and the Central Banks.
 - For projects that, though using non-governmental financial sources, can concern strategic exploitation and utilization of resources or can cover several water streams or provinces, the SDPC has only to approve the project proposal;
 - For projects that affect the regional economic coordinated development or that the central government considers as strategic for the national industry or that are subject to a limitation under some specific regulation, the SDPC must approve the project proposal, the feasibility study report, the primary design and must check the project at the end of project construction.

Administrative authorisations - Approval by the SDPC -



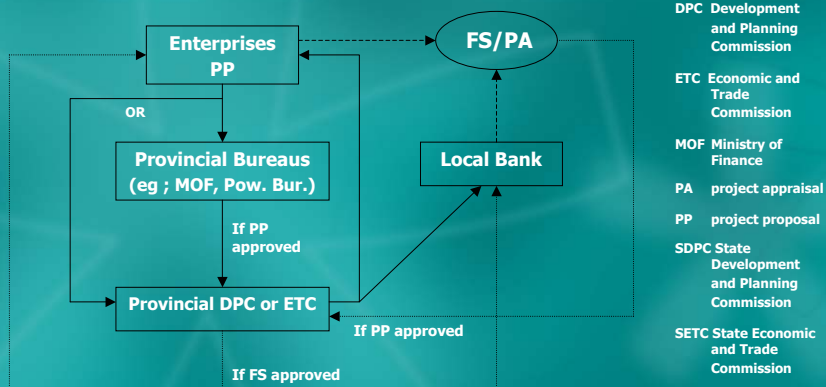
Administrative authorisations - Approval by the SDPC -

The enterprise first prepares its proposal and takes it to either the appropriate power bureau or the provincial branch of the Development Planning Commission (DPC) – for construction projects - or of the Economic and Trade Commission (ETC) – for renovation projects. If the proposal is approved, it is sent to the central branch of the State Development Planning Commission (SDPC) or State Economic and Trade Commission (SETC) for their approval. After the central State Development Planning Commission (SDPC) and State Economic and Trade Commission (SETC) review it with the Central Banks, the proposal is either approved or rejected. If approved, both the local bank and the enterprise will prepare a feasibility study, which needs the approval of the provincial Development Planning Commission (DPC) or Economic and Trade Commission (ETC). After the feasibility study is approved, it is sent to the central State Development Planning Commission (SDPC) and State Economic and Trade Commission (SETC) for authorization. At the same time, the local branch of the Development Planning Commission (DPC) or Economic and Trade Commission (ETC) is notified, and it, in turn, notifies the enterprise. Both the enterprise and the local bank will prepare a project appraisal that goes through the same approval procedure as the feasibility study. Once the project appraisal is approved, the project is ready to be developed. If the project's budget is particularly significant, the State Council must approve the proposal.

Administrative authorisations - Approval by the local DPC or ETC -

- Any other project must be approved by the local Planning Development Commission (DPC) in so far as the project affects only one single province.
- The local Development Planning Commission (DPC) is competent for construction projects, while the local Economic and Trade Commission is competent for renovation projects.
- The total need for foreign capital must be reported to the SDPC in Beijing.

Administrative authorisations - Approval by the local DPC or ETC -



DPC Development and Planning Commission
 ETC Economic and Trade Commission
 MOF Ministry of Finance
 PA project appraisal
 PP project proposal
 SDPC State Development and Planning Commission
 SETC State Economic and Trade Commission

Administrative authorisations **- Approval by the local DPC or ETC -**

- First of all, the enterprise should prepare its proposal and takes it to either the appropriate power bureau and the provincial branch of the DPC or ETC. If the proposal is approved, both the local bank and the enterprise should then prepare a feasibility study, which has to be approved by the provincial DPC or ETC. Once the feasibility study has been approved, the local bank and the enterprise will have to prepare a project appraisal that goes through the same approval procedure as the feasibility study. Once the project appraisal is approved, then the project is ready to be developed.

Administrative authorisations **- Additional approvals -**

- Approval of the joint venture agreement by the MOFTEC. As described above the MOFTEC or its local bureau is responsible for examining the contractual terms of the foreign investment, and will examine and approve the joint venture contract and articles of association; Authority to approve joint ventures is delegated to the provincial municipal and county levels, depending on the project size, its categorization under the Foreign Investment Catalogue and other conditions.
- If the project is partially financed by Chinese funds, it will have to be approved by the Ministry of Finance.
- Even though a biomass project has an agricultural aspect to it, it does not need to be approved by the Ministry of Agriculture.
- Other authorisations might be required based on the specifics of the project

Third Step :

**STRUCTURE YOUR INVESTMENT
AND CHOOSE A LEGAL VEHICLE
THAT IS THE MOST APPROPRIATE
FOR IMPLEMENTING AND
RUNNING YOUR BIOMASS
PROJECT**

Direct investment structures

- Foreign investors may adopt one of a number of structures for direct investment in China:
 - Joint venture
 - Wholly foreign-owned enterprise (WFOE)
 - Branch office
 - Representative office
- A Chinese partner may be of valuable assistance to the enterprise in applying for PRC approvals and licences, clearing equipment import and purchasing raw materials locally. The practical difficulties of operating in China without a local partner is a major reason why foreign investors have historically tended to favour joint ventures

Joint ventures

- Two forms of joint ventures are available to foreign investors:
 - The equity joint venture (EJV)
 - The co-operative joint venture (CJV)
- An EJV must take the form of either:
 - a limited liability company; or
 - a joint stock company.
- A CJV may be either:
 - An Unincorporated CJV, which does not involve the creation of a legal entity separate and distinct from the contracting parties; or
 - A Legal Person CJV, which is a separate legal entity with limited liability

Joint ventures

- To establish a joint venture, the parties should:
 - Sign a letter of intent or heads of agreement and must follow the similar approval procedures prescribed by the EJV Regulations and the CJV Rules.
 - Submit a feasibility study and subsequently the joint venture contract together with its articles of association to the Ministry of Foreign Trade and Economic Co-operation (MOFTEC) or its local branch for approval. A decision should be made within three months of submission of the application for an EJV or 45 days for a CJV.
 - Within one month of obtaining approval, the applicant should register with the industry and commerce administrative authorities and obtain a business licence.

Joint ventures

- As compared with EJVs, CJVs offer
 - a more flexible profit distribution structure
 - earlier recovery of foreign investment in certain circumstances
 - a more flexible operational accounting and auditing procedures
- As a result CJVs are seen by the Chinese authorities as a less certain legal structure and providing the Chinese party less security than EJVs. Consequently CJVs will be under a higher scrutiny from the authorities and it seems that their approval may be more difficult to obtain
- In any case, it must be noted that EJVs are generally preferred to CJVs by the Chinese parties and have become the most popular form of joint venture

Legal background for Chinese-foreign equity joint ventures

- Chinese-foreign equity joint ventures are governed by
 - (i) the Law on Chinese-Foreign Equity Joint Venture adopted by the 2nd Session of the 5th National People's Congress on 1st July 1979, as amended on 4 April 1990 and 15 March 2001 (hereafter the "***Chinese-Foreign EJV Law***"); and
 - (ii) the Regulations on the Implementation of the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures, which was enacted by the State Council on 20 September 1983 and amended by the State Council on 15 January 1986, on 21 December 1987 and on 22 July 2001 (hereafter the "***Chinese-Foreign EJV Regulations***").

Fourth Step :

IDENTIFY THE MEANS THROUGH WHICH YOU WILL CONTRIBUTE RIGHTS ON YOUR TECHNOLOGY TO THE PROJECT

Technology transfers as a contribution in kind to a Chinese-Foreign EJV by the foreign partner

- The Chinese-Foreign EJV Regulations provides, at Article 22, that the parties to a joint venture should determine the value of contributions in kind through joint assessment or by a third party agreed upon.
- Furthermore, the Chinese-Foreign EJV Regulations imposes, at Article 25, two restrictions as to the possibility of contributions in kind by the foreign partner to the joint venture under the form of industrial property rights or special technologies. Said contributions have to be able (i) to remarkably improve the performance and quality of the existing products and production efficiency or (ii) to remarkably save raw materials, fuels and power. Of course, biomass technology meets this requirement.

Technology transfers as a contribution in kind to a Chinese-Foreign EJV by the foreign partner

- The Chinese-Foreign EJV Regulations (see, Article 27) requires that all contributions in kind by the foreign partner should be submitted to the approval of
 - (i) the Ministry of Foreign Trade and Economic Co-operation of the People's Republic of China ("**MOFTEC**") and
 - (ii) the people's governments in the provinces, autonomous regions and municipalities under the direct jurisdiction of the Central Government or the competent authorities under the State Council (altogether the "**Approving Authorities**").

Technology transfers as a contribution in kind to a Chinese-Foreign EJV by the foreign partner

- Moreover, in the case of contributions by the foreign partner under the form of industrial property rights or proprietary technologies, all relevant data concerning said industrial property rights or special technologies - including the copy of patent certificate or trademark registration certificate, the validity status and associated technical specifications – must be submitted to (the approval of) the Approving Authorities (including MOFTEC)(see, Article 26 of The Chinese-Foreign EJV Regulations).
- For the purpose of this submission, the price evaluation agreement jointly signed by the foreign partner and the Chinese partner must be attached to the joint venture contract.

Technology Transfers to a Chinese-Foreign EJV

- Generally, all technology licences, know-how transfer contracts, technical assistance contracts and other types of technology contracts obtained from a third party or the foreign joint venture party shall be separately examined by the relevant division of MOFTEC or its local branch, and then filed for the records (see, Article 43 of the Chinese-Foreign EJV Regulations).
- Similarly, although there are no restrictions affecting the payment of royalties by a Chinese-Foreign EJV to the foreign partner for the use of technology, the terms and conditions for the payment of royalties and methodology for calculation of royalties will be examined closely during the approval process (see, Article 43 of the Chinese-Foreign EJV Regulations).

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