
LOAN NUMBER 2237-PRC

PROJECT AGREEMENT
(Shandong Hai River Basin Pollution Control Project)

between

ASIAN DEVELOPMENT BANK

and

SHANDONG PROVINCIAL GOVERNMENT

DATED 15 NOVEMBER 2006

PAL: PRC 36505

PROJECT AGREEMENT

PROJECT AGREEMENT dated 15 November 2006 between ASIAN DEVELOPMENT BANK (hereinafter called ADB) and SHANDONG PROVINCIAL GOVERNMENT (hereinafter called SPG).

WHEREAS

(A) by a Loan Agreement of even date herewith between the People's Republic of China (hereinafter called the Borrower) and ADB, ADB has agreed to make to the Borrower a loan of Eighty Million Dollars (\$80,000,000) on the terms and conditions set forth in the Loan Agreement, but only on condition that the proceeds of the Loan be made available to SPG and that SPG agrees to (i) make the proceeds of the Loan available to the IAs in accordance with the terms and conditions of the Onlending Agreements and (ii) undertake certain obligations towards ADB as hereinafter in this Project Agreement set forth; and

(B) SPG, in consideration of ADB entering into the Loan Agreement with the Borrower, has agreed to undertake the obligations hereinafter set forth;

NOW THEREFORE the parties hereto agree as follows:

ARTICLE I

Definitions

Section 1.01. Wherever used in this Project Agreement, unless the context otherwise requires, the several terms defined in the Loan Agreement and in the Loan Regulations (as so defined) have the respective meanings therein set forth.

ARTICLE II

Particular Covenants

Section 2.01. (a) SPG shall carry out the Project with due diligence and efficiency, and in conformity with sound administrative, financial, engineering, environmental and IWM, MWM and SWM practices.

(b) In the carrying out of the Project and operation of the Project facilities, SPG shall perform all obligations set forth in the Loan Agreement to the extent that they are applicable to SPG and all obligations set forth in the Schedule to this Project Agreement.

Section 2.02. SPG shall make available, promptly as needed, the funds, facilities, services, equipment, land and other resources which are required, in addition to the proceeds of the Loan, for the carrying out of the Project.

Section 2.03. (a) In the carrying out of the Project, SPG shall employ competent and qualified consultants and contractors, acceptable to ADB, to an extent and upon terms and conditions satisfactory to ADB.

(b) Except as ADB may otherwise agree, all goods and services to be financed out of the proceeds of the Loan shall be procured in accordance with the provisions of Schedule 4 to the Loan Agreement. ADB may refuse to finance a contract where goods or services have not been procured under procedures substantially in accordance with those agreed between the Borrower and ADB or where the terms and conditions of the contract are not satisfactory to ADB.

Section 2.04. SPG shall carry out the Project in accordance with plans, design standards, specifications, work schedules and construction methods acceptable to ADB. SPG shall furnish, or cause to be furnished, to ADB, promptly after their preparation, such plans, design standards, specifications and work schedules, and any material modifications subsequently made therein, in such detail as ADB shall reasonably request.

Section 2.05. (a) SPG shall take out and maintain with responsible insurers, or make other arrangements satisfactory to ADB for, insurance of the Project facilities to such extent and against such risks and in such amounts as shall be consistent with sound practice.

(b) Without limiting the generality of the foregoing, SPG undertakes to insure, or cause to be insured, the goods to be imported for the Project and to be financed out of the proceeds of the Loan against hazards incident to the acquisition, transportation and delivery thereof to the place of use or installation, and for such insurance any indemnity shall be payable in a currency freely usable to replace or repair such goods.

Section 2.06. SPG shall maintain, or cause to be maintained, records and accounts adequate to identify the goods and services and other items of expenditure financed out of the proceeds of the Loan, to disclose the use thereof in the Project, to record the progress of the Project (including the cost thereof) and to reflect, in accordance with consistently maintained sound accounting principles, its operations and financial condition.

Section 2.07. (a) ADB and SPG shall cooperate fully to ensure that the purposes of the Loan will be accomplished.

(b) SPG shall promptly inform ADB of any condition which interferes with, or threatens to interfere with, (a) the progress of the Project, (b) the performance of its obligations under this Project Agreement, the SPG Onlending Agreement or any Municipal Government Onlending Agreement, (c) the performance of the obligations of any other party to any of the Municipal Government Onlending Agreements, City Government Onlending Agreements, County Government Onlending Agreements or IA Onlending Agreements, or (d) the accomplishment of the purposes of the Loan.

(c) ADB and SPG shall from time to time, at the request of either party, exchange views through their representatives with regard to any matters relating to the Project, SPG, the IAs and the Loan.

Section 2.08. (a) SPG shall furnish to ADB all such reports and information as ADB shall reasonably request concerning (i) the Loan and the expenditure of the proceeds thereof; (ii) the goods and services and other items of expenditure financed out of such proceeds; (iii) the Project; (iv) the administration, operations and financial condition of SPG and/or the IAs; and (v) any other matters relating to the purposes of the Loan.

(b) Without limiting the generality of the foregoing, SPG shall furnish to ADB semi-annual and annual reports on the execution of the Project and on the operation and management of the Project facilities. Such reports shall be consolidated to incorporate all Subprojects and shall be submitted in such form and in such detail and within such a period as ADB shall reasonably request, and shall indicate, among other things, progress made and problems encountered during the six months and year under review, steps taken or proposed to be taken to remedy these problems, and proposed program of activities and expected progress during the following six months or year, as applicable.

(c) Promptly after physical completion of the Project, but in any event not later than three (3) months thereafter or such later date as ADB may agree for this purpose, SPG shall prepare and furnish to ADB a report, in such form and in such detail as ADB shall reasonably request, on the execution and initial operation of the Project, including its cost, the performance by SPG of its obligations under this Project Agreement and the accomplishment of the purposes of the Loan.

Section 2.09. (a) SPG shall (i) maintain separate accounts for the Project and for its overall operations; (ii) have such accounts and related financial statements balance sheet, statement of income and expenses, and related statements audited annually, in accordance with appropriate auditing standards consistently applied, by independent auditors whose qualifications, experience and terms of reference are acceptable to ADB; and (iii) furnish to ADB, promptly after their preparation but in any event not later than six months after the close of the fiscal year to which they relate, certified copies of such audited accounts and financial statements and the report of the auditors relating thereto (including the auditors' opinion on the use of the Loan proceeds and compliance with the covenants of the Loan Agreement as well as on the use of the procedures for imprest account/statement of expenditures), all in the English language. SPG shall furnish to ADB such further information concerning such accounts and financial statements and the audit thereof as ADB shall from time to time reasonably request.

(b) In addition to annual audited financial statements referred to in paragraph (a) of this Section, SPG shall ensure that the IAs (i) maintain separate accounts for the Project and its overall operations, (ii) have such accounts and related financial statements balance sheet, statement of income and expenses, and related statements audited annually, in accordance with appropriate auditing standards consistently applied, by independent auditors whose qualifications, experience and terms of reference are acceptable to ADB; and (iii) furnish to ADB, promptly after their preparation but in any event not later than six months after the close of the fiscal year to which they relate, certified copies of such audited accounts and financial statements and the report of the auditors relating thereto, all in the English language. SPG shall furnish to ADB such further information concerning such accounts and financial statements and the audit thereof as ADB shall from time to time reasonably request.

(c) SPG shall enable ADB, upon ADB's request, to discuss SPG's and the IAs' financial statements and financial affairs from time to time with the auditors appointed by

SPG pursuant to Section 2.09(a) hereabove, and shall authorize and require any representative of such auditors to participate in any such discussions requested by ADB, provided that any such discussion shall be conducted only in the presence of an authorized officer of SPG unless SPG shall otherwise agree.

Section 2.10. SPG shall enable ADB's representatives to inspect the Project, the goods financed out of the proceeds of the Loan and, to the extent relevant to the Project, all other plants, sites, works, properties and equipment of the SPG and of the IAs, and any related relevant records and documents.

Section 2.11. (a) SPG shall, promptly as required, take all action within its powers to maintain its corporate existence, to carry on its operations, and to acquire, maintain and renew all rights, properties, powers, privileges and franchises which are necessary in the carrying out of the Project or in the conduct of its business.

(b) SPG shall at all times conduct its operations and activities, and shall ensure that the IAs conduct their respective operations and activities, in accordance with sound administrative, financial, environmental, IWM, MWM, SWM, practices, and under the supervision of competent and experienced management and personnel.

(c) SPG shall, and shall ensure that the IAs, at all times operate and maintain their respective plants, equipment and other property, and from time to time, promptly as needed, make all necessary repairs and renewals thereof, all in accordance with sound administrative, financial, engineering, environmental, IWM, MWM, SWM, and maintenance and operational practices.

Section 2.12. Except as ADB may otherwise agree, SPG shall not, and shall not permit any IA to, sell, lease or otherwise dispose of any of their respective assets which shall be required for the efficient carrying on of their respective operations or the disposal of which may prejudice SPG's ability to perform satisfactorily any of its obligations under this Project Agreement.

Section 2.13. Except as ADB may otherwise agree, SPG shall, and shall ensure that the IAs, apply the proceeds of the Loan to the financing of expenditures on the Project in accordance with the provisions of the Loan Agreement and this Project Agreement, and shall ensure that all goods and services financed out of such proceeds are used exclusively in the carrying out of the Project.

Section 2.14. Except as ADB may otherwise agree, SPG shall (a) duly perform all its obligations under the SPG Onlending Agreement and each Municipal Government Onlending Agreement, (b) ensure the other parties to the Municipal Government, County Government and City Government Onlending Agreements comply with their respective obligations under such Onlending Agreements, and (c) not take, or concur in, any action which would have the effect of assigning, amending, abrogating or waiving any rights or obligations of the parties under any Onlending Agreement.

Section 2.15. SPG shall promptly notify ADB of any proposal to amend, suspend or repeal any provision of the business license or constitutive documents of any IA and shall afford ADB an adequate opportunity to comment on such proposal prior to taking any action thereon.

ARTICLE III

Effective Date; Termination

Section 3.01. This Project Agreement shall come into force and effect on the date on which the Loan Agreement shall come into force and effect. ADB shall promptly notify SPG of such date.

Section 3.02. All the provisions of this Project Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the Loan Agreement.

ARTICLE IV

Miscellaneous

Section 4.01. Any notice or request required or permitted to be given or made under this Project Agreement and any agreement between the parties contemplated by this Project Agreement shall be in writing. Such notice or request shall be deemed to have been duly given or made when it shall be delivered by hand or by mail, telegram, cable, telex, facsimile or radiogram to the party to which it is required or permitted to be given or made at its address hereinafter specified, or at such other address as such party shall have designated by notice to the party giving such notice or making such request. The addresses so specified are:

For ADB

Asian Development Bank
P.O. Box 789
0980 Manila, Philippines

Cable Address:

ASIANBANK
MANILA

Facsimile Numbers:

(632) 636-2444
(632) 636-2407.

For SPG

Shandong Provincial Government
Finance Bureau
3 Jida Rd., Jinan, Shandong Province
People's Republic of China

Facsimile Number:

+86-531-82920751.

Section 4.02. (a) Any action required or permitted to be taken, and any documents required or permitted to be executed, under this Project Agreement by or on behalf of SPG may be taken or executed by its Governor or by such other person or persons as she or he shall so designate in writing notified to ADB.

(b) SPG shall furnish to ADB sufficient evidence of the authority of each person who will act under paragraph (a) of this Section, together with the authenticated specimen signature of such person.


Section 4.03. No delay in exercising, or omission to exercise, any right, power or remedy accruing to either party under this Project Agreement upon any default shall impair any such right, power or remedy or be construed to be a waiver thereof or an acquiescence in such default; nor shall the action of such party in respect of any default, or any acquiescence in any default, affect or impair any right, power or remedy of such party in respect of any other or subsequent default.

IN WITNESS WHEREOF the parties hereto, acting through their representatives thereunto duly authorized, have caused this Project Agreement to be signed in their respective names and to be delivered at the principal office of ADB, as of the day and year first above written.

ASIAN DEVELOPMENT BANK

By 
HARUHIKO KURODA
President

SHANDONG PROVINCIAL GOVERNMENT

By 
LI JINJUN
Ambassador Extraordinary
and Plenipotentiary of the
People's Republic of China
to the Republic of the Philippines

SCHEDULE

Execution of Project; Institutional Development Plans; Tariff and Regulatory Reform; Financial Matters; Other Matters

Implementation Arrangements

1. SPG, as the Project Executing Agency for the Project, shall be responsible for overall Project implementation. To ensure coordination at the central level, the Project Executing Agency shall be assisted by the Shandong Project Leading Group (SPLG) and the Shandong Provincial Government Project Management Office (SPMO). To ensure coordination at the local level, the Project Executing Agency shall be assisted by the Local PLGs. The SPLG shall be responsible for overall policy oversight and guidance for the Project and the Local PLGs shall be responsible for policy matters at the local levels in the Project Areas. The SPMO shall be responsible for (a) guiding the strategic direction of the Project, (b) coordinating uniform policy reform among all Project components and Subprojects in each of the Project Areas, (c) coordinating communication and interaction between the IAs and ADB, (d) leading all committees for procurement and consulting services, (e) monitoring and reviewing Project implementation, (f) representing the interests of the SWM IAs in CDM matters, and (g) providing necessary guidance as appropriate. The SPLG shall meet on a yearly basis, or more frequently as required for Project implementation. Each of the SPLG and the SPMO shall be maintained until Project completion.

2. Each LPMO shall oversee the Project preparation and implementation activities for the Subprojects in their respective Project Areas, as applicable. The LPMOs are comprised of local governmental representatives, including those from the relevant construction bureau, development and reform commission, finance bureau, price bureau, and environmental protection bureau, among others. The LPMOs shall be responsible for (a) coordinating with the SPMO until Project completion, (b) monitoring and reviewing Project implementation in their respective Project Areas, (c) participating in all committees for procurement and consulting services, (d) overseeing the formation and institutional development of the MWM and SWM IAs, and (e) monitoring the activities of the MWM and SWM IAs. Each City and County Government, as applicable, shall allocate additional key staff, particularly in the areas of finance and engineering, to participate in the LPMO activities for the MWM and SWM Subprojects as required for Project implementation. The LPMOs shall (a) meet on a monthly basis, or more frequently as required for Project implementation and (b) be maintained until Project completion.

3. Each IA shall be responsible for (a) implementing the Subprojects in their respective Project Areas, as applicable, (b) operating and managing the Project facilities and (c) in the case of the MWM and SWM Subprojects, providing the MWM or SWM services, as applicable. In particular, the IAs shall be responsible for (a) direct day-to-day Project management, (b) construction supervision, (c) preparing semi-annual progress reports for submission to the LPMOs and (d) planning the strategic direction of the MWM and SWM services and operations as well as the opportunities for institutional reform and development among each of the IAs.

Technical Aspects of Project Facilities

A. SWM Component

4. SPG shall ensure that the Linqing City Government, in accordance with the requirements specified in “Technical Specifications for Municipal Waste Landfill Sites” (CJJ17-2004), permanently closes its existing solid waste landfill site by 31 December 2007.

5. SPG shall ensure that the Linyi County Government, in accordance with the requirements specified in “Technical Specifications for Municipal Waste Landfill Sites” (CJJ17-2004), permanently closes its existing solid waste landfill site within 12 months from the date operations commence under the Linyi SWM Subproject.

6. SPG shall ensure that the Zouping County Government, in accordance with the requirements specified in Chinese National Standard GB 16889-1997, “Pollution Control Standards for Domestic Waste Landfill Sites,” permanently closes its existing solid waste landfill site within 18 months from the date the operations commence under the Zouping SWM Subproject.

B. IWM Component

7. SPG shall ensure that (a) Changyuan IWM IA, within six months from the date operations commence under the Changyuan IWM Subproject, permanently closes its existing black-liquor lagoon and (b) Quanlin IWM IA, within six months from the date operations commence under the Quanlin IWM Subproject, permanently closes its existing lignin lagoon, each in accordance with the requirements specified in Shandong Provincial Standard DB 37/336-2003 “Pollution Control Standards for the Paper Mill Industry.”

Financial Support

8. SPG shall ensure that the Linqing City Government provides all funds required to close the existing solid waste landfill site in Linqing City in accordance with paragraph 4 of this Schedule.

9. SPG shall ensure that the Linyi County Government provides all funds required for closing the existing solid waste landfill site in Linyi County in accordance with paragraph 5 of this Schedule.

10. SPG shall ensure that each of the City and County Governments provide adequate financial resources and/or financial subsidies to each of the MWM and SWM IAs as required for such IAs to satisfy their respective operation and maintenance costs, debt service coverage requirements and current depreciation costs during the period where full cost recovery tariffs are being implemented in accordance with paragraph 26 of this Schedule. Such financial resources and/or subsidies shall be phased out in a gradual manner so as to ensure that there is no negative impact on the financial sustainability of the MWM or SWM IAs.

11. SPG shall ensure that each of the Binzhou City Government, Gaotang County Government, Linqing City Government and Shanghe County Government, for the existing municipal sewerage networks that are associated with the Project facilities related to the MWM Subprojects in their respective Cities or Counties, maintain adequately funded

operation and maintenance programs so that such sewerage networks are maintained in good repair and experience minimal leakage.

Construction, Operation and Maintenance of Project Facilities

12. SPG shall ensure that all Project facilities are designed, installed, operated and maintained in accordance with the PRC's national standards as well as the relevant international standards and related regulations.

Institutional Strengthening and Development

A. Corporate Structuring and Human Resources Development Plan for MWM and SWM IAs

13. In order to facilitate the institutional development of the MWM and SWM IAs, SPG shall ensure that each of the MWM and SWM IAs, in close coordination with the MWM and SWM LPMOs, devises an individual corporate structuring and human resources development plan that identifies the organizational structure and staffing requirements of, as well as the operational procedures and systems required for, each such IA (Corporate Structuring and Human Resources Development Plan). The Corporate Structuring and Human Resources Development Plan shall include, among others (a) a strategy and procedures for recruiting and retaining qualified staff during the construction and operational phases of the Project, (b) operational best practices, (c) advanced corporate governance procedures, including provisions governing the establishment and operation of (i) a Board of Directors, (ii) an independent audit committee within the Board of Directors and (iii) an internal audit department, (d) a training plan and a program of workshops to be given to future MWM and SWM IA employees, (e) efficient and organized lines of reporting among staff, (f) operational procedures and systems required to implement strong and effective financial and accounting systems, including management information systems, and (g) restrictions on the ability of the IAs to engage in activities not related to the core business of the MWM and SWM Subprojects, including, without limitation, the operation of schools and child care facilities.

14. Each Corporate Structuring and Human Resources Development Plan shall (a) evaluate various options and propose recommendations for adoption and implementation, (b) be developed within two years of the Effective Date, (c) be acceptable to ADB, (d) include time bound action plans and be structured so that the plan is fully implemented within five years of the Effective Date, and (e) be implemented in accordance with its terms. SPG shall ensure that (a) each MWM and SWM IA provides ADB a period of six months to review and agree the terms of the Corporate Structuring and Human Resources Development Plan prior to finalizing such plan and (b) no MWM or SWM IA increases its staffing outside of the framework provided under the Corporate Structuring and Human Resources Development Plan.

B. Sector and Asset Integration Plan for MWM and SWM IAs

15. In order to develop economies of scale and the scope of operations for the MWM and SWM Subprojects, SPG shall ensure that each of the MWM and SWM IAs, in close coordination with the MWM and SWM LPMOs, devises an individual sector and asset integration plan that explores options for and a means of integrating (a) the existing municipal sewage networks associated with the Project facilities related to the MWM

Subprojects into the MWM IAs, (b) the comprehensive SWM process, encompassing collection to treatment, into each of the SWM IAs, and (c) the MWM IAs within the local water supply companies (Sector and Asset Integration Plan).

16. Each Sector and Asset Integration Plan shall (a) evaluate various options and propose recommendations for adoption and implementation, including, without limitation the possibility of establishing a holding company structure for all Project facilities associated with the MWM and SWM Subprojects, (b) be developed within two years of the Effective Date, (c) be acceptable to ADB, (d) include time bound action plans and be structured so that implementation of agreed options commences within five years of the Effective Date, and (e) be implemented in accordance with its terms. SPG shall ensure that each MWM and SWM IA provides ADB a period of six months to review and agree the terms of the Sector and Asset Integration Plan prior to finalizing such plan. Any integration of assets in accordance with the Sector and Asset Integration Plan shall be carried out in a transparent manner and shall not affect repayment of the Loan made under the Loan Agreement.

C. Private Sector Participation Action Plan

17. Each IA shall actively explore opportunities for attracting private sector participation in the Subprojects. In order to facilitate an analysis of the viability of and potential for private sector participation in the Subprojects, SPG shall ensure that each IA, in close coordination with the LPMOs, devises an individual private sector participation action plan that assesses options for and a means of attracting private sector participation in the Subprojects, including, among others, through strategic investments, joint venture arrangements and capital markets listings (Private Sector Participation Action Plan).

18. Each Private Sector Participation Action Plan shall (a) propose recommendations for the best means of attracting private sector participation, (b) be acceptable to ADB, (c) include time bound action plans, (d) in the case of the Gaotang MWM IA, Linqing MWM IA, Shanghe MWM IA and SWM IAs, (i) be developed within two years of the Effective Date and (ii) be structured so that implementation of agreed options commences within five years of the Effective Date, (e) in the case of the Binzhou MWM IA and IMW IAs, (i) be developed within 18 months of the Effective Date and (ii) be structured so implementation of agreed options commences within three years of the Effective Date, and (f) be implemented in accordance with its terms. SPG shall ensure that each IA provides ADB a period of six months to review and agree the terms of the Private Sector Participation Action Plan prior to finalizing such plan.

D. Ownership of Linqing MWM IA

19. SPG shall ensure that (a) the Linqing MWM IA is 100% owned by the Linqing City Government, (b) the Linqing MWM IA and the Yinhe Paper Mill operate on an arm's-length basis, and (c) the Yinhe Paper Mill pays for all MWM services provided by the Linqing MWM Subproject in accordance with prevailing tariff rates.

Change in Ownership Structure

20. SPG shall, on behalf of the relevant IA, obtain the prior written consent of ADB in the event that any such IA plans to (a) change the ownership structure of any of the Project facilities, (b) sell, transfer or assign any of its shares, or (c) otherwise make any material organizational change, either financial or operational, where such change may have an

adverse effect on such IA's ability to perform its obligations in respect of the relevant Subproject, the Project Agreement or any IA Lending Agreement. In the event any such change is approved by ADB, SPG shall, through the relevant IA, ensure that the change in ownership structure is carried out in a transparent manner and does not affect repayment of the Loan made under the Loan Agreement. Depending on the nature of the approved change in ownership structure, ADB shall have the right to modify the repayment terms of the Loan.

Tariff and Regulatory Reform and Cost Recovery

A. Tariff and Regulatory Reform

21. SPG shall ensure that the MWM and SWM IAs review the relevant regulations on MWM and SWM tariff regimes prior to the mid-term review. Such review shall cover, among others, (a) a recalculation of minimum cost recovery tariffs based on the actual Project costs, (b) affordability and willingness to pay surveys, (c) financial and economic benefits and (d) extension of price escalation mechanisms to household and commercial consumers and other potential fees and charges to encourage water conservation and sound environmental practices (Tariff Structure Study). SPG shall report the findings of the Tariff Structure Study to ADB at the mid-term review.

22. In an effort to formalize and streamline the tariff setting process and collection mechanisms, SPG shall ensure that each of the City and County Governments devises an individual tariff and regulatory reform plan that (a) establishes clear and transparent policies, guidelines and criteria for setting tariff rates, including, without limitation, procedures for the MWM and SWM IAs to file periodic tariff adjustment applications, (b) assesses the options for direct tariff collection mechanisms to be implemented between the MWM and SWM IAs and the appropriate end users, with guidelines for such tariffs to be retained by the MWM and SWM IAs, and (c) considers the feasibility of direct agreements to be entered into between the MWM IAs and the relevant water suppliers in the Project Areas whereby the MWM IAs directly receive from and retain the MWM tariffs collected by such water supply companies on behalf of the MWM IAs from end users (Tariff and Regulatory Reform Plan). The terms of each Tariff and Regulatory Reform Plan shall be in accordance with the relevant PRC laws and regulations.

23. Each Tariff and Regulatory Reform Plan shall (a) be developed within two years of the Effective Date, (b) be acceptable to ADB and SPG, (c) include time bound action plans and be structured so that (i) the activities set forth in clause (a) of paragraph 22 above are fully implemented within five years of the Effective Date and (ii) implementation of agreed options for other activities to take place under the plan commences within five years of the Effective Date, and (d) be implemented in accordance with its terms. SPG shall ensure that each MWM and SWM IA provides ADB and SPG a period of six months to review and agree the terms of the Tariff and Regulatory Reform Plan prior to finalizing such plan.

24. As an integral component of the Tariff and Regulatory Reform Plans, prior to 31 December 2008, SPG shall ensure that each of the City and County Governments establishes integrated regulatory systems that incorporate the relevant local pricing bureau, finance bureau, public utilities bureau and other relevant agencies in such City or County, as the case may be, to institute clear and transparent guidelines and procedures for (a) regulating and monitoring MWM and SWM IA performance, (b) setting, reviewing and approving proposed MWM and SWM tariff increases and adjustments, and (c) entering into

performance based contracts between the MWM and SWM IAs and the related City or County Government, as the case may be.

B. Tariff Rates

25. SPG shall ensure that public consultations are conducted on tariff adjustments with key stakeholders, including representatives of the poor, and public support for tariff reforms are cultivated through public information and participation programs including presentations at public meetings and news releases.

C. Cost Recovery

26. SPG shall ensure that each of the City and County Governments, by 1 January 2011, establishes, implements and enforces tariffs for (a) in the case of the MWM Subprojects, wastewater treatment and (b) in the case of the SWM Subprojects, solid waste disposal, in each case, at full cost recovery levels. Such tariffs shall (a) be phased-in in a gradual manner, (b) be set at levels sufficient to cover operation and maintenance, depreciation, and debt service obligations, as well as provide a reasonable profit margin for the MWM and SWM IAs, (c) in the case of MWM Subprojects, be set at levels sufficient to cover integrated MWM operations, including collection, transfer and treatment, (d) in the case of SWM Subprojects, be set at levels sufficient to cover integrated SWM operations, including collection, transfer, disposal and treatment, and (e) be collected in accordance with the tariff collection mechanisms devised and implemented under the relevant Tariff and Regulatory Reform Plans.

D. Minimum Living Social Standards

27. SPG shall ensure that each City and County Government (a) continues to provide the existing solid waste disposal and wastewater tariff waiver in accordance with the minimum living social standards so as not to have an adverse effect on the living standard of the poor, (b) reviews the impact of increased wastewater and solid waste tariffs on the poor to ensure that the poor are provided the same level of service as other members of the community, and (c) provides the required water and wastewater rebates to households qualifying for social assistance.

CDM Representation Agreement

28. SPG shall ensure that, within three months of the Effective Date, SPMO and the SWM IAs enter into a legally binding agreement pursuant to which the parties agree that SPMO shall have the exclusive right to represent the interests of each of the SWM IAs in the negotiations with potential purchasers of carbon emissions from the SWM Subprojects (CDM Representation Agreement). The CDM Representation Agreement shall be in accordance with the prevailing PRC laws and regulations and in form and substance satisfactory to ADB.

Financial Ratios

29. The financial ratios contained in paragraphs 30 to 32 below shall be applicable (a) in the case of the IWM IAs, from the Effective Date and (b) in the case of the MWM and SWM IAs, from the commencement of the third full year of commercial operations under the MWM and SWM Subprojects, as applicable.

30. (a) SPG shall ensure that except as ADB shall otherwise agree, no IA incurs any debt unless a reasonable forecast of the revenues and expenditures of such IA shows that the estimated net revenues of the relevant IA for each fiscal year during the term of the debt to be incurred shall be at least 1.2 times the estimated debt service requirements of such IA in such year on all debt of the relevant IA including the debt to be incurred and no event has occurred since the date of the forecast which has, or may reasonably be expected in the future to have, a material adverse effect on the financial condition of future operating results of the IA.

(b) For the purposes of this paragraph:

- i. The term "debt" means any indebtedness of the IA maturing by its terms more than one year after the date on which it is originally incurred.
- ii. Debt shall be deemed to be incurred: (a) under a loan contract or agreement or other instrument providing for such debt or for the modification of its terms of payment on the date of such contract, agreement or instrument; and (b) under a guarantee agreement, on the date the agreement providing for such guarantee has been entered into.
- iii. The term "net revenues" means the difference between:
 - A. the sum of revenues from all sources related to operations and net non-operating income, after making adequate provisions for uncollectible debts; and
 - B. the sum of all expenses related to operations including administration, adequate maintenance, taxes and payments in lieu of taxes, but excluding provision for depreciation, other non-cash operating charges and interest and other charges on debt. Lease payments under finance leases must also be included.
- iv. The term "net non-operating income" means the difference between:
 - A. revenues from all sources other than those related to operations, and
 - B. expenses, including taxes and payments in lieu of taxes, incurred in the generation of revenues in (iv)(A) above.
- v. The term "debt service requirements" means the aggregate amount of repayments of, and interest and other charges on debt.
- vi. The term "reasonable forecast" means a forecast prepared by SPG, through the IA, not earlier than nine months prior to the incurrence of the debt in question, which both ADB and the SPG accept as reasonable and as to which ADB has notified SPG of its acceptability.

31. (a) SPG shall ensure that except as ADB may otherwise agree, no IA incurs any debt if after the incurrence of such debt the ratio of debt to equity shall be greater than 70:30.

- (b) For the purposes of this paragraph:
- i. The term "debt" means any indebtedness of the IA maturing by its terms more than one year after the date on which it is originally incurred.
 - ii. Debt shall be deemed to be incurred: (a) under a loan contract or agreement or other instrument providing for such debt or for the modification of its terms of payment on the date of such contract, agreement or instrument; and (b) under a guarantee agreement, on the date the agreement providing for such guarantee has been entered into.
 - iii. The term "equity" means the sum of the total unimpaired paid-up capital, retained earnings and reserves of the IA not allocated to cover specific liabilities.

32. (a) SPG shall ensure that except as ADB may otherwise agree, each IA maintains a ratio of current assets to current liabilities of not less than 1.2:1.

- (b) For the purposes of this paragraph:
- i. The term "current assets" means all cash, all assets, which could in the ordinary course of business be converted into cash within 12 months, including accounts receivable, marketable securities, inventories and prepaid expenses properly chargeable to operating expenses within the next fiscal year.
 - ii. The term "current liabilities" means all liabilities, which will become due and payable or could under circumstances then existing be called for payment within 12 months, including accounts payable, customer advances, debt service requirements, taxes and payments in lieu of taxes.
 - iii. The term "debt service requirements" means the aggregate amount of repayments of, and interest and other charges on, debt.

33. For purposes of the assurances contained in paragraphs 30 through 32 above, whenever it shall be necessary to value, in terms of the currency of the Borrower, debt payable in another currency, such valuation shall be made on the basis of the prevailing lawful rate of exchange at which such other currency is at the time of such valuation obtainable for the purposes of servicing such debt, or, in the absence of such rate, on the basis of a rate of exchange acceptable to ADB.

Environment

34. SPG shall ensure that each IA (a) constructs, operates, maintains and monitors the Project facilities in accordance with (i) all applicable PRC environmental laws and regulations, (ii) ADB's *Environment Policy* (2002), and (iii) the EIA, SEIA and EMP, (b) minimizes any adverse environmental impacts arising from the Project by implementing the environmental mitigation measures recommended in the EIA, SEIA and EMP, (c) provides ADB justification for any proposed changes to the mitigation measures required during the detailed design, construction, and operation and maintenance of the Project facilities, and (d)

ensures civil work contracts entered into with contractors include obligations of contractors relating to environment including mitigation and monitoring measures as specified in the SEIA and EIAs.

35. SPG shall ensure that each IA provides semi-annual environmental monitoring reports to the SPMO. The SPMO shall, in turn, provide to ADB consolidated semi-annual environmental monitoring reports, in form and substance acceptable to ADB. Such reports shall be provided to ADB from the commencement of Project implementation until Project completion and shall include (a) progress made on mitigation measures and monitoring, (b) restoration, condition, and return of lands temporarily acquired during construction, (c) problems encountered, (d) data collected, (e) results of the independent monitoring of resettlement activities, (vi) any research results, and (f) a corrective action plan if any violation of the PRC's environmental standards, rules, regulations, or laws has occurred.

Land Acquisition and Resettlement

36. SPG, through the MWM and SWM IAs, shall ensure that (a) all land and rights-of-way required by the Project are made available in a timely manner, (b) each RP is implemented promptly and efficiently in accordance with its terms and in accordance with all applicable national and local laws and regulations and ADB's *Policy on Involuntary Resettlement*, (c) all counterpart funds required for land acquisition and resettlement are provided in timely manner, and (d) any obligations in excess of budget estimates necessary to meet the objectives of any RP are met in a timely manner.

37. SPG, through the MWM and SWM IAs, shall ensure that all affected persons (APs) under the Project are (a) given adequate opportunity to participate in resettlement planning and implementation activities, (b) compensated in accordance with the terms of each RP such that, in each case, APs are at least as well off as they would have been in the absence of the Project, and (c) given priority in consideration for employment opportunities relating to the Project.

38. SPG, through the MWM and SWM IAs, shall ensure that (a) in the event there is any significant change in the design of any Subproject covered by a RP or any substantial changes in resettlement impacts, the relevant RP is (i) updated based on a detailed measurement survey, (ii) disclosed to APs and (iii) subsequently provided to ADB for its concurrence prior to commencement of related civil works, (b) civil works contractors' specifications include requirements to comply with each RP, as applicable, and (c) civil works contractors are supervised to ensure compliance with the requirements of each RP, including restoration of land temporarily used during construction, applicable national and local laws and regulations and ADB's *Policy on Involuntary Resettlement*.

39. SPG, through the MWM and SWM IAs, shall (a) establish project resettlement units and ensure that adequate staff and resources are committed to supervising and monitoring the implementation of each RP to ensure compliance with their respective terms, (b) prepare and provide to ADB semi-annual reports on the progress of implementing the RPs for each MWM and SWM Subproject (such reports can be incorporated into the regular SPMO semi-annual reports), and (c) upon the completion of resettlement activities for any RP, prepare and provide to ADB a resettlement completion report for each such Subproject.

40. SPG shall ensure that SPMO engages an independent agency, acceptable to ADB (Independent Monitoring Agency), to (a) carry out monitoring of land acquisition and

resettlement activities under the RPs, including data disaggregated by gender where applicable, and prepare and submit reports to ADB semi-annually during the implementation of resettlement activities, (b) on an annual basis until two years after the completion of land acquisition and resettlement activities for the Project, conduct follow-up surveys and prepare and submit to ADB an annual evaluation report of such land acquisition and resettlement activities, and (c) until such time as all payments required to be made under all RPs have been made, provide to ADB a summary of annual resettlement disbursements and expenditures. All reports provided to ADB by the Independent Monitoring Agency shall be in form and substance satisfactory to ADB, in both hard copy and electronic format to facilitate website uploading.

Health, Labor and Gender

41. SPG shall ensure that each IA, in coordination with the appropriate agencies identified by SPG, causes the contractors to disseminate information on the risks of socially and sexually transmitted diseases, including HIV/AIDS, to their employees during Project implementation.

42. SPG, through the IAs, shall ensure that all civil works contractors engaged under the Project (a) comply with all applicable labor laws, (b) provide timely payment of wages and safe working conditions to all workers (with such requirements being included in civil works contracts and monitored by construction supervision consultant), (c) provide employment opportunities for women, where appropriate, and ensure that there is no differentiation in wages between men and women for work of equal value, (d) use local unskilled labor, when feasible, and (e) not employ child labor in Project activities as prohibited in the relevant PRC laws and regulations.

Anticorruption

43. SPG shall comply with and shall cause each IA to comply with ADB's Anticorruption Policy. SPG agrees (a) that ADB reserves the right to investigate, directly or through its agents, any alleged corrupt, fraudulent, collusive or coercive practices relating to the Project and (b) to cooperate fully with and to cause each IA to cooperate fully with any such investigation and to extend all necessary assistance, including providing access to all relevant books and records, as may be necessary for the satisfactory completion of any such investigation. In particular, SPG shall (a) conduct periodic inspections on the contractors' activities related to fund withdrawals and settlements and (b) ensure that all contracts financed by ADB in connection with the Project include provisions specifying the right of ADB to audit and examine the records and accounts of SPMO, each IA, and all contractors, suppliers, consultants and other service providers as they relate to the Project.

Project Monitoring and Review and Reporting

44. SPG shall ensure that SPMO, within six months of the inception mission for the Project, finalizes and adopts a comprehensive PPMS framework, acceptable to ADB, based upon the PPMS indicators agreed upon between SPMO and ADB. The agreed PPMS indicators include data to allow valuation and monitoring of environmental, socio-economic and health benefits, including, without limitation, service levels, treated wastewater quality, measures for operational performance, percentages of wastewater collected and treated, user satisfaction with the urban environment, and relevant economic and health data. The PPMS framework shall include comprehensive procedures for generating data required to

monitor the PPMS indicators and methodologies for collecting and reporting the PPMS indicators. SPG shall ensure that SPMO (a) monitors the PPMS indicators, through the PPMS framework, on a semi-annual basis to determine the efficiency and effectiveness of the Project and its impacts, (b) provides to ADB bi-annual PPMS monitoring reports, in form and substance acceptable to ADB, from the commencement of Project implementation until Project completion and, (c) thereafter, SPMO or its assignee, as the case may be, shall provide such reports to ADB on an annual basis for the first five years after Project completion.

45. SPG, the City and County Governments, the IAs, and ADB shall jointly undertake an annual review of the Project throughout the Project implementation period. The annual reviews will assess the Project's achievements and progress in implementing the Project objectives and component matters against the PPMS indicators and the Project implementation schedule in order to identify any difficulties or constraints being encountered in implementing the Project and to make adjustments, if necessary, for the remaining Project implementation period. In particular, the annual reviews will address, among others, institutional arrangements, progress in implementing the Institutional Development Plans, results of the Tariff Structure Study, design quality, construction standards, Project scope, overall implementation progress, resettlement and status of compliance with loan covenants.

46. The Borrower, SPG, the City and County Governments, the IAs, and ADB shall, during the third year of Project implementation, jointly undertake a comprehensive mid-term review of the Project. The mid-term review will cover the items to be addressed during the annual reviews as well as (a) undertake a comprehensive and detailed discussion on the progress of the institutional development component of the Project, including progress made under each of the Institutional Development Plans, (b) discuss the results of the Tariff Structure Study, and (c) undertake a comprehensive review of potential loan savings, identify areas for reallocation of loan proceeds, and change disbursement percentages, as appropriate.