

Public Disclosure Authorized

CONFORMED COPY

LOAN NUMBER 7524-CN

Project Agreement

(Liaoning Third Medium Cities Infrastructure Project)

between

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

and

LIAONING PROVINCE

Dated July 1, 2008

PROJECT AGREEMENT

AGREEMENT dated July 1, 2008, entered into between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (“Bank”) and LIAONING PROVINCE (“Project Implementing Entity”) (“Project Agreement”) in connection with the Loan Agreement (“Loan Agreement”) of same date between PEOPLE’S REPUBLIC OF CHINA (“Borrower”) and the Bank. The Bank and the Project Implementing Entity hereby agree as follows:

ARTICLE I – GENERAL CONDITIONS; DEFINITIONS

- 1.01. The General Conditions (as defined in the Appendix to the Loan Agreement) constitute an integral part of this Agreement.
- 1.02. Unless the context requires otherwise, the capitalized terms used in this Agreement have the meanings ascribed to them in the Loan Agreement or the General Conditions.

ARTICLE II – PROJECT

- 2.01. The Project Implementing Entity declares its commitment to the objective of the Project. To this end, the Project Implementing Entity shall: (a) carry out, and cause the Project Cities and Project Companies to carry out the Project in accordance with the provisions of Article V of the General Conditions; and (b) provide, or cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the Project.
- 2.02. Without limitation upon the provisions of Section 2.01 of this Agreement, and except as the Bank and the Project Implementing Entity shall otherwise agree, the Project Implementing Entity shall carry out, and shall cause the Project Cities and the Project Companies to carry out the Project in accordance with the provisions of the Schedule to this Agreement.

ARTICLE III – REPRESENTATIVE; ADDRESSES

- 3.01. The Project Implementing Entity’s Representative is the Governor or a Vice Governor; or such other person or persons as said Governor or a Vice Governor shall designate in writing, and the Project Implementing Entity shall furnish to the Bank sufficient evidence of the authority and the authenticated specimen signature of each such person.

3.02. The Bank's Address is:

International Bank for Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable:	Telex:	Facsimile:
INTBAFRAD Washington, D.C.	248423(MCI) or 64145(MCI)	1-202-477-6391

3.03. The Project Implementing Entity's Address is:

Liaoning Provincial Department of Finance
103 North Nanjing Street
Heping District
Shenyang
Liaoning Province
People's Republic of China 110002

Facsimile:

86-24-2283-4167

AGREED at Beijing, People's Republic of China, as of the day and year first above written.

INTERNATIONAL BANK FOR
RECONSTRUCITON AND DEVELOPMENT

By /s/ David Dollar
Authorized Representative

LIAONING PROVINCE

By /s/ Xu Weiguo
Authorized Representative

SCHEDULE

Project Execution

Section I. Institutional and Other Arrangements

Project Management

1. (a) The Project Implementing Entity shall maintain, or cause to be maintained, as the case may be, for purposes of carrying out the Project, the following organizations, with terms of reference, staffing and other resources acceptable to the Bank, throughout the period of implementation of the Project:
 - (i) the Project Coordination Group established at the provincial level, chaired by a Vice Governor of Liaoning to be responsible for providing policy guidance for the Project's implementation;
 - (ii) the FFUPO to be responsible for day-to-day Project implementation; and
 - (iii) the Project Management Offices established by Benxi, Yingkou, Liaoyang, and Fushun municipalities to be responsible for day-to-day management of implementation of the Project within their respective jurisdictions.
- (b) The Project Implementing Entity shall assign, for purposes of carrying out the Project, sufficient staff and resources acceptable to the Bank, to the Liaoning Provincial Department of Finance to be responsible for integrated management of the Project, including providing guidance to the FFUPO and monitoring day-to-day Project implementation by the FFUPO.

Financial Arrangements

2. The Project Implementing Entity shall allocate to each Project City an amount of the Loan under arrangements satisfactory to the Bank, which shall include, without limitation, the following principal terms:
 - (a) the Project Implementing Entity shall make available the principal amount which has been allocated to each Project City pursuant to Section IV, paragraph A.2 of Schedule 2 to the Loan Agreement in Dollars on account of its Respective Parts of the Project;

- (b) the Project Implementing Entity shall recover such principal amount so made available including the Front-end Fee paid pursuant to Section 2.03 of the Loan Agreement, over a period of thirty (30) years, inclusive of a grace period of five (5) years; and
- (c) the Project Implementing Entity shall charge interest on such principal amount, withdrawn and outstanding from time to time at a rate equal to the rate of interest applicable from time to time to the Loan pursuant to Section 2.04 of the Loan Agreement.

Subsidiary Loan Agreements

- 3. The Project Implementing Entity shall cause each Project City to relend the portions of the proceeds of the Loan, which was allocated to it pursuant to paragraph 2 of Section I of this Schedule for the purposes of the carrying out of its Respective Project Company's Respective Part of the Project, to its Respective Project Company under a subsidiary loan agreement to be entered into between said Project City and its Respective Project Company: (i) on the principal terms set forth in paragraphs 1 through 3 of Annex A to this Schedule; and (ii) under conditions which shall have been approved by the Bank, and which shall include, without limitation, those set forth in paragraphs 4 through 15 of Annex A to this Schedule.

Resettlement and Environment Protection

- 4. The Project Implementing Entity shall:
 - (a) take, and shall cause each Project City and Project Company to take, all necessary actions to minimize to the extent possible any involuntary loss by persons of shelter, productive assets or access to productive assets or income or means of livelihood, temporarily or permanently in carrying out the Project; and
 - (b) for this purpose:
 - (i) prior to commencement of any civil works under the Project, cause each Project City and Project Company to implement its Respective Resettlement Action Plan, in each case in a manner satisfactory to the Bank; and
 - (ii) whenever implementation of Part B of the Project in Yingkou Municipality would give rise to Displaced Persons, provide, and cause Yingkou Municipality and the Yingkou Gas Company to provide, (before commencing said Part of the Project) to the Bank for its review, a resettlement action plan prepared in

accordance with the principles and procedures set forth in the Resettlement Policy Framework and, thereafter, implement in a manner satisfactory to the Bank such resettlement action plan as shall have been acceptable to the Bank.

5. The Project Implementing Entity shall, and shall cause each Project City and Project Company to:
 - (a) implement its respective Environmental Management Plan in a manner satisfactory to the Bank and designed to ensure that the Project is implemented in accordance with sound environmental standards and practices; and
 - (b) without limitation upon the provisions of sub-paragraph 5(a) above, prior to commencement of any civil works under Part B of the Project and, conduct, and cause Yingkou Municipality to conduct, environmental assessments and prepare and implement an environmental management plan (including an emergency response plan) pursuant thereto during implementation of said Part of the Project, all in a manner satisfactory to the Bank, and designed to ensure that Part B of the Project is implemented in accordance with sound environmental practices and standards.

6. The Project Implementing Entity shall, and shall cause each Project City and Project Company to:
 - (a) maintain policies and procedures adequate to enable it to monitor and evaluate, in accordance with guidelines acceptable to the Bank, the implementation of its respective Environmental Management Plan, its respective Resettlement Action Plan, and the Resettlement Policy Framework, and the achievement of the objectives of said Plans and said Framework, and to this end, engage experienced and qualified independent monitoring agencies acceptable to the Bank;
 - (b) prepare under terms of reference satisfactory to the Bank, and furnish to the Bank by June 30 and December 31 of each year, commencing December 31, 2008, semi-annual reports of the results of such monitoring and evaluation activities, together with any revisions proposed to be introduced into such Plans and Framework in order to achieve their respective objectives; and
 - (c) introduce such revisions into said Plans and Framework as shall have been agreed with the Bank.

Project Implementation

7. With respect to each Project Company's revenue requirements set forth in paragraphs 9, 10, 11, 12, 13 of Annex A to this Schedule, the Project Implementing Entity shall cause each of the concerned Project Cities to take all necessary measures to enable its Respective Project Company to meet said requirements, including without limitation, adjustments of the levels of heat or gas tariffs, as the case may be.

Section II. Project Monitoring, Reporting and Evaluation

A. Project Reports

1. The Project Implementing Entity shall monitor and evaluate the progress of the Project and prepare Project Reports for the Project in accordance with the provisions of Section 5.08(b) of the General Conditions and on the basis of the indicators set forth in Annex B to this Schedule. Each such Project Report shall cover the period of one (1) calendar semester, and shall be furnished to the Bank not later than seventy-five (75) days after the end of the period covered by such report.
2. The Project Implementing Entity shall provide to the Borrower not later than six (6) months after the Closing Date, for incorporation in the report referred to in Section 5.08(c) of the General Conditions all such information as the Borrower or the Bank shall reasonably request for the purposes of that Section.

B. Financial Management, Financial Reports; and Audits

1. The Project Implementing Entity shall and shall also cause each of the Project Cities to maintain a financial management system and prepare financial statements in accordance with consistently applied accounting standards acceptable to the Bank, both in a manner adequate to reflect the operations and financial condition of the Project Implementing Entity and each of the Project Cities, including the operations, resources and expenditures related to its Respective Part of the Project.
2. The Project Implementing Entity shall and shall also cause each of the Project Cities to have its financial statements referred to above audited by independent auditors acceptable to the Bank, in accordance with consistently applied auditing standards acceptable to the Bank. Each audit of these financial statements shall cover the period of one (1) fiscal year of the Project Implementing Entity and each Project City. The Project Implementing Entity shall furnish the audited financial statements for each period after consolidating the audited financial statements provided by each of the Project Cities to the Borrower and the Bank not later than six (6) months after the end of the period.

Section III. Procurement

All goods, works and services required for the Project and to be financed out of the proceeds of the Loan shall be procured in accordance with the provisions of Schedule 2 to the Loan Agreement.

ANNEX A
to
the SCHEDULE

**Principal Terms and Conditions of the
Subsidiary Loan Agreements**

For the purposes of paragraph 3 of Section I of the Schedule to this Agreement: (a) the terms of availability of the Loan proceeds shall be those set forth in paragraphs 1 through 3 of this Annex; and (b) the Subsidiary Loan Agreements shall be entered into on the conditions set forth in paragraphs 4 through 15 of this Annex.

Terms of Availability

1. The principal amount of the Subsidiary Loan made by each of the Project Cities to its Respective Project Company shall be the amount equivalent in Dollars (on the respective dates of withdrawal from the Loan Account) of the value of the currency or currencies so withdrawn on account of its Project Company's Respective Part of the Project.
2. Each Project Company shall repay such principal amount (including the fee paid pursuant to Section 2.03 of the Loan Agreement) over a period of not more than thirty (30) years, inclusive of a grace period of five (5) years.
3. Each Project Company shall pay interest on the principal amount thereof withdrawn and outstanding from time to time at a rate not less than the rate of interest applicable from time to time to the Loan pursuant to Section 2.04 of the Loan Agreement.

Conditions

The Subsidiary Loan Agreements shall include the following principal conditions:

4. Each Project Company shall undertake to: (a) carry out its Respective Part of the Project with due diligence and efficiency and in accordance with appropriate management, financial, engineering and public utility practices and social and environmental standards acceptable to the Bank, and provide, promptly as needed, the funds, facilities and other resources required for the purpose; and (b) without limitation on the foregoing, take all measures necessary to ensure that its Respective Part of the Project shall be implemented in accordance with its respective Resettlement Action Plan, Resettlement Policy Framework, and the Environmental Management Plan (including Yingkou Gas Company's resettlement action plan and environmental management plan, as the case may be, pursuant to the provisions in paragraph B.1(d) Section IV of Schedule 2 to the Loan Agreement).

5. Each Project Company shall undertake to procure the goods, works and consultants' services to be financed out of the proceeds of the Loan in accordance with the provisions of Section III of Schedule 2 to the Loan Agreement, and utilize such goods, works and consultants' services exclusively in the carrying out of its Respective Part of the Project.
6. Each Project Company shall undertake to enable the Bank, the Project Implementing Entity and the Project City concerned to inspect such goods and the sites and works included in its Respective Part of the Project, the operation thereof, and any relevant records and documents.
7. Each Project Company shall undertake to take out and maintain with responsible insurers such insurance, against such risks and in such amounts, as shall be consistent with sound business practice, including, without limitation, such insurance to cover hazards incident to the acquisition, transportation and delivery of goods financed out of the proceeds of the Loan to the place of use or installation, any indemnity thereunder to be made payable in a currency freely usable to replace or repair such goods.
8. Each Project Company shall undertake to:
 - (a) Maintain records and accounts adequate to reflect in accordance with sound accounting practices its operations and financial condition.
 - (b) Have its financial statements (balance sheets, statements of income and expenses and related statements) for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank.
 - (c) Furnish to the Bank, the Project Implementing Entity and the Project City concerned, as soon as available, but in any case not later than six (6) months after the end of each such year: (i) certified copies of said financial statements and accounts for such year as so audited; and (ii) an opinion on such statements by said auditors in such scope and detail as the Bank, the Project Implementing Entity or the Project City concerned shall have reasonably requested.
 - (d) Prepare and furnish to the Bank, the Project Implementing Entity and the Project City concerned, all such other information concerning said records, accounts and financial statements, as well as the audit thereof, as the Bank, Project Implementing Entity, or the Project City concerned shall reasonably request.
 - (e)
 - (i) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with indicators

set forth in Annex B of the Schedule to this Agreement the carrying out of its Respective Part of the Project and the achievement of the objectives thereof;

- (ii) prepare, under terms of reference satisfactory to the Bank, and furnish to the Project Implementing Entity for its review and consolidation in the Project Reports and submission to the Bank, semi-annual reports integrating the results of the monitoring and evaluation activities performed pursuant to clause (i) of this subparagraph (e) on the progress achieved in the carrying out of its Respective Part of the Project during the period preceding the date of each such report; and
- (iii) provide such other information and reports as the Project Implementing Entity may request in order to enable the Project Implementing Entity to fulfill its obligations under the Project Agreement.

9. Except as the Bank shall otherwise agree, each of the Project Companies (except for Dashiqiao Urban Construction Investment Co. Ltd) shall for each Fiscal Year, starting Fiscal Year 2009, undertake to produce:
- (a) total collected revenues, equivalent to not less than the sum of:
 - (i) its total operating expenses; and
 - (ii) the amount by which debt service requirements exceeds the provision for depreciation;
 - (b) review, before March 1 in each year starting Fiscal Year 2009, and on the basis of forecasts prepared by it and satisfactory to the Bank, whether it would meet the requirements set forth in subparagraph (a) hereof, in respect of such year and the next following fiscal year and furnish to the Bank the results of such review upon its completion; and
 - (c) if any such review shows that it would not meet the requirements set forth in subparagraph (a) hereof for the fiscal years covered by such review, promptly take all necessary measures (including, without limitation, adjustments of the structure or levels of its tariffs) in order to meet such requirements.
10. Except as the Bank shall otherwise agree, each of the Project Companies (except for Dashiqiao Urban Construction Investment Co. Ltd) shall for each Fiscal Year, starting Fiscal Year 2012, undertake to produce total revenues not less than total expenses.

11. Except as the Bank shall otherwise agree, each of the Project Companies shall undertake not to incur any debt unless a reasonable forecast of its revenues and expenditures shows that its estimated net revenues for each fiscal year during the term of the debt to be incurred shall be at least 1.3 times its estimated debt service requirements in such year on all of its debt including the debt to be incurred.

12. For purposes of this Schedule:
 - (a) The term “total revenues” means the total operating revenues and net non-operating income.
 - (b) The term “total collected revenues” means the total of the invoiced operating revenues less any invoiced amount not collected plus subsidies and any other operating revenues.
 - (c) The term “total operating revenues” means revenues from all sources related to operations.
 - (d) The term “total operating expenses” means all expenses related to operations, including administration, adequate maintenance, taxes and payments in lieu of taxes, and provision for depreciation on a straight line basis at a rate of not less than 3.3% per annum of the average current gross value of the Project Company’s fixed assets in operation, or other basis acceptable to the Bank, but excluding interest and other charges on debt.
 - (e) The term “total expenses” means the sum of all expenses related to operations including administration, adequate maintenance, taxes and payments in lieu of taxes, provision for depreciation, other non-cash operating charges, and interest and other charges on debt.
 - (f) The average current gross value of the Project Company’s fixed assets in operation shall be calculated as one half of the sum of the gross value of its fixed assets in operation at the beginning and at the end of the fiscal year, as valued from time to time in accordance with sound and consistently maintained methods of valuation satisfactory to the Bank.
 - (g) The term “debt service requirements” means the aggregate amount of repayments (including sinking fund payments, if any) of, and interest and other charges on, debt.

- (h) The term “debt” means any indebtedness of the Project Company maturing by its terms more than one (1) year after the date on which it is originally incurred.
 - (i) Debt shall be deemed to be incurred:
 - (i) 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
 - (ii) under a guarantee agreement, on the date the agreement providing for such guarantee has been entered into.
 - (j) The term “net revenues” means the difference between:
 - (i) the sum of revenues from all sources related to operations and net non-operating income; and
 - (ii) 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.
 - (k) The term “net non-operating income” means the difference between:
 - (i) revenues from all sources other than those related to operations; and
 - (ii) expenses, including taxes and payments in lieu of taxes, incurred in the generation of revenues in (i) above.
 - (l) The term “reasonable forecast” means a forecast prepared by the Project Company not earlier than twelve (12) months prior to the incurrence of the debt in question, which both the Bank and said Project Company accept as reasonable and as to which the Bank has notified said Project Company of its acceptability, provided that no event has occurred since such notification which has, or may reasonably be expected in the future to have, a material adverse effect on the financial condition or future operating results of said Project Company.
13. Whenever, for the purposes of this Schedule, 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 the Bank.

14. Each of the Project Cities shall have the right to suspend or terminate the right of its Respective Project Company to the use of the proceeds of the loan made available under the Subsidiary Loan Agreement with said Project Company upon failure by such Project Company to perform its obligations under the agreement.

Dashiqiao City's Respective Part of the Project

15. In the event that Dashiqiao Urban Construction Investment Co. Ltd intends to transfer the operation and maintenance of the Project assets under its Respective Part of the Project to Dashiqiao Hongyang Heating Company. Ltd., prior to such transfer, Dashiqiao Urban Construction Investment Co. Ltd shall enter into an agreement with Dashiqiao Hongyang Heating Company Ltd., acceptable to the Bank, which sets out, among other matters, the arrangements for the future operation and maintenance of said Project assets and the financial arrangements to enable Dashiqiao Urban Construction Investment Co. Ltd to meet its Subsidiary Loan repayment obligations under its respective Subsidiary Loan Agreement.

ANNEX B to the SCHEDULE

Performance Indicators

PROJECT PERFORMANCE INDICATORS		Benxi II	Benxi Nanfen	Benxi Steel	Fushun	Gongchang-ling	Haicheng	Huludao	Yingkou Dashiqiao	Yingkou EDZ	Northern Yingkou	Project weighted average
start - end of connection to central heating system	FY	YR2-YR6	YR2-YR6	YR2 - YR3	YR2-YR6	YR1-YR5	YR2-YR4	YR2-YR3	YR1-YR5	YR1-YR5	YR3-YR6	YR1 - YR6
<u>Part A of the Project Centralized Heating Infrastructure</u>												
Fuel consumption per connected floor area	kWh/m ²	148.6	155.4	14.4	176.5	145.1	145.4	144.8	156.1	148.1	143.0	138.9
Electricity used for district heating/connected floor area	kWh/m ²	4.1	4.0	4.9	1.2	3.6	3.3	3.1	3.5	1.2	2.3	2.7
Make-up water used /connected floor area	ltr/m ²	34.2	99.0	234.0	148.7	96.6	96.9	84.2	89.4	43.3	96.6	96.7
Total Suspended Particulates (TSP) emissions /connected floor area	kg/m ²	0.008	0.006	0.004	0.064	0.006	0.004	0.004	0.005	0.023	0.023	0.020
SO2 emissions /connected floor area	kg/m ²	0.054	0.042	0.010	0.073	0.040	0.032	0.022	0.042	0.043	0.023	0.040

<u>Part B of the Project Urban Natural Gas Infrastructure</u>	FY	YR3
Reduced gas loss after distribution system is rehabilitated.	Gas loss %	2.8%

