

CONFORMED COPY

LOAN NUMBER 4237 CHA

Project Agreement

(Shandong Environment Project)

between

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

and

SHANDONG PROVINCE

Dated February 4, 1998

LOAN NUMBER 4237 CHA

PROJECT AGREEMENT

AGREEMENT, dated February 4 1998, between INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) and SHANDONG PROVINCE (Shandong).

WHEREAS (A) by the Loan Agreement of even date herewith between People's Republic of China (the Borrower), the Bank has agreed to make available to the Borrower an amount of ninety five million dollars (\$95,000,000), on the terms and conditions set forth in the Loan Agreement, but only on condition that Shandong agree to undertake such obligations toward the Bank as are set forth in this Agreement; and

WHEREAS Shandong, in consideration of the Bank's entering into the Loan Agreement with the Borrower, has agreed to undertake the obligations set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

Definitions

Section 1.01. Unless the context otherwise requires, the several terms defined in the Loan Agreement and in the General Conditions (as so defined) have the respective meanings therein set forth.

ARTICLE II

Execution of the Project

Section 2.01. (a) Shandong declares its commitment to the objectives of the Project as set forth in Schedule 2 to the Loan Agreement, and, to this end, shall:

- (i) carry out, or cause to be carried out, Parts D, E.1 (e) and (f), and E.2 of the Project;
- (ii) cause Jinan to carry out Part A of the Project, of which Parts A.1 and E.1 (a) shall be carried out through the Jinan Water Company, and Parts A.2 and E.1 (b) through the Jinan Drainage Company;
- (iii) cause Weihai to carry out Parts B and E.1 (c) of the Project through the Weihai Company; and
- (iv) cause Yantai to carry out Parts C and E.1 (d) of the Project, through the Yantai Company;

all with due diligence and efficiency and in conformity with appropriate administrative, financial, engineering, public utility and environmental standards and practices, and Shandong shall provide, or cause to be provided, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Bank and Shandong shall otherwise agree, Shandong shall carry out the Project, or cause the Project to be carried out, in accordance with the Implementation Program set forth in Schedule 2 to this Agreement.

Section 2.02. Except as the Bank shall otherwise agree, procurement of the goods, works and consultants' services required for the Project and to be financed out of the proceeds of the Loan shall be governed by the provisions of Schedule 1 to this Agreement.

Section 2.03. (a) Shandong shall carry out the obligations set forth in Sections 9.04, 9.05, 9.06, 9.07, 9.08 and 9.09 of the General Conditions (relating to insurance, use of goods and services, plans and schedules, records and reports, maintenance and land acquisition, respectively) in respect of the Project Agreement.

(b) For the purposes of Section 9.08 of the General Conditions, and without limitation thereto, Shandong shall:

- (i) prepare, on the basis of guidelines acceptable to the Bank, and furnish to the Bank not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Bank, a plan for the future operation of the Project; and
- (ii) afford the Bank a reasonable opportunity to exchange views with the Borrower on said plan.

Section 2.04. (a) Shandong shall, at the request of the Bank, exchange views with the Bank with regard to the progress of the Project, the performance of its obligations under this Agreement and other matters relating to the purposes of the Loan.

(b) Shandong shall promptly inform the Bank of any condition which interferes or threatens to interfere with the progress of the Project, the accomplishment of the purposes of the Loan, or the performance by Shandong of its obligations under this Agreement.

ARTICLE III

Financial Covenants

Section 3.01. (a) Shandong shall maintain or cause to be maintained records and accounts adequate to reflect in accordance with sound accounting practices the operations, resources and expenditures in respect of the Project of the departments or agencies of Shandong as well as the Project Municipalities responsible for carrying out the Project or any part thereof.

(b) Shandong shall:

(i) have the records and accounts referred to in paragraph (a) of this Section for each fiscal year audited, in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank;

(ii) furnish to the Bank as soon as available, but in any case not later than six months after the end of each such year, the report of such audit by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and

(iii) furnish to the Bank such other information concerning said records and accounts and the audit thereof as the Bank shall from time to time reasonably request.

ARTICLE IV

Effective Date; Termination; Cancellation and Suspension

Section 4.01. This Agreement shall come into force and effect on the date upon which the Loan Agreement becomes effective.

Section 4.02. (a) This Agreement and all obligations of the Bank and of Shandong thereunder shall terminate on the earlier of the following two dates:

(i) the date on which the Loan Agreement shall terminate in accordance with its terms; or

(ii) the date twenty years after the date of this Agreement.

(b) If the Loan Agreement terminates in accordance with its terms before the date specified in paragraph (a) (ii) of this Section, the Bank shall promptly notify Shandong of this event.

Section 4.03. All the provisions of this Agreement shall continue in full force and effect notwithstanding any cancellation or suspension under the General Conditions.

ARTICLE V

Miscellaneous Provisions

Section 5.01. Any notice or request required or permitted to be given or made under this Agreement and any agreement between the parties contemplated by this 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 or radiogram to the party to which it is required or permitted to be given or made at such party's 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 the Bank:

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

Cable address:

INTBAFRAD
Washington, D.C.

Telex:

248423 (MCI), or
64145 (MCI)

For Shandong:

Shandong Project Management Office
46 Jingwu Xiaoweisi Road
Jinan, China 250001

Cable address:

4102
JINANCHA

Section 5.02. Any action required or permitted to be taken, and any document required or permitted to be executed, under this Agreement on behalf of Shandong may be taken or executed by the Vice-Governor responsible for the environment or such other person or persons as said Vice-Governor shall designate in writing, and Shandong shall furnish to the Bank sufficient evidence of the authority and the authenticated specimen signature of each such person.

Section 5.03. This Agreement may be executed in several counterparts, each of which shall be an original, and all collectively but one instrument.

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in the District of Columbia, United States of America, as of the day and year first above written.

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Yukon Huang

Acting Regional Vice President
East Asia and Pacific

SHANDONG PROVINCE

By /s/ Zhou Wenzhong

Authorized Representative

SCHEDULE 1

Procurement and Consultants' Services

Section I. Procurement of Goods and Works

Part A: General

Goods and works shall be procured in accordance with the provisions of Section I of the "Guidelines for Procurement under IBRD Loans and IDA Credits" published by the Bank in January 1995 and revised in January and August 1996 (the Guidelines) and the following, provisions of Section I of this Schedule.

Part B: International Competitive Bidding

1. Except as otherwise provided in Part C of this Section, goods and works shall be procured under contracts awarded in accordance with the provisions of Section II of the Guidelines and paragraph 5 of Appendix 1 thereto.

2. The following provisions shall apply to goods and works to be procured under contracts awarded in accordance with the provisions of paragraph 1 of this Part B.

(a) Grouping of contracts

To the extent practicable, contracts for civil works shall be grouped into bid packages estimated to cost the equivalent of \$6,000,000 or more each, and contracts for goods shall be grouped into bid packages estimated to cost the equivalent of \$250,000 or more each.

(b) Preference for domestically manufactured goods and domestic contractors

The provisions of paragraphs 2.54 and 2.55 of the Guidelines and Appendix 2 thereto shall apply to goods manufactured in the territory of the Borrower and works to be carried out by domestic contractors.

(c) Notification and Advertising

The invitation to prequalify or bid for each contract estimated to cost \$10,000,000 equivalent or more shall be advertised in accordance with the procedures applicable to large contracts under paragraph 2.8 of the Guidelines.

Part C: Other Procurement Procedures

1. National Competitive Bidding

Works estimated to cost less than \$6,000,000 equivalent per contract, up to an aggregate amount not to exceed \$38,100,000 equivalent, and goods (other than goods required for a Sub-project) estimated to cost \$50,000 or more but less than \$250,000 equivalent per contract, up to an aggregate amount not to exceed \$1,500,000, may be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines.

2. National Shopping

(a) Goods (other than goods required for a Sub-project), estimated to cost less than \$50,000 equivalent per contract, up to an aggregate amount not to exceed \$1,000,000 equivalent, may be procured under contracts awarded on the basis of national shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

(b) Goods required for a Sub-project may be procured under contracts awarded on the basis of national shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

Part D: Review by the Bank of Procurement Decisions

1. Procurement Planning

Prior to the issuance of any invitations to prequalify for bidding or to bid for contracts, the proposed procurement plan for the Project shall be furnished to the Bank for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Guidelines. Procurement of all goods and works shall be undertaken in accordance with such procurement plan as shall have been approved by the Bank, and with the provisions of said paragraph 1.

2. Prior Review

With respect to each contract for works estimated to cost the equivalent of \$2,500,000 or more, and each contract for goods estimated to cost the equivalent of \$500,000 or more, the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Guidelines shall apply.

Section II. Employment of Consultants

Part A: General

Consultants' services shall be procured in accordance with the provisions of the Introduction and Section IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" published by the Bank in January 1997 (the Consultant Guidelines) and the following provisions of Section II of this Schedule.

Part B: Quality- and Cost-based Selection

1. Except as otherwise provided in Part C of this Section, consultants' services shall be procured under contracts awarded in accordance with the provisions of Section II of the Consultant Guidelines, paragraph 3 of Appendix 1 thereto, Appendix 2 thereto, and the provisions of paragraphs 3.13 through 3.18 thereof applicable to quality- and cost-based selection of consultants.

2. The following provisions shall apply to consultants' services to be procured under contracts awarded in accordance with the provisions of the preceding paragraph. The short list of consultants for services to be provided under the Project estimated to cost less than \$200,000 equivalent per contract, may comprise entirely national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Part C: Other Procedures for the Selection of Consultants

1. Single Source Selection

Services under Part E of the Project which are estimated to cost less than \$100,000 equivalent per contract, may, with the Bank's prior agreement, be procured in accordance with the provisions of paragraphs 3.8 through 3.11 of the Consultant Guidelines.

2. Individual Consultants

Services under Part E of the Project for tasks that meet the requirements set forth in paragraph 5.1 of the Consultant Guidelines shall be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.1 through 5.3 of the Consultant Guidelines.

Part D: Review by the Bank of the Selection of Consultants

1. Selection Planning

Prior to the issuance to consultants of any requests for proposals, the proposed plan for the selection of consultants under the Project shall be furnished to the Bank for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Consultant Guidelines. Selection of all consultants' services shall be undertaken in accordance with such selection plan as shall have been approved by the Bank, and with the provisions of said paragraph 1.

2. Prior Review

(a) With respect to each contract for the employment of consulting firms estimated to cost the equivalent of \$200,000 or more, the procedures set forth in paragraphs 1, 2 (other than the third subparagraph of paragraph 2 (a)) and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(b) With respect to each contract for the employment of consulting firms estimated to cost the equivalent of \$100,000 or more, but less than the equivalent of \$200,000, the procedures set forth in paragraphs 1, 2 (other than the second subparagraph of paragraph 2(a)) and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(c) With respect to each contract for the employment of individual consultants estimated to cost the equivalent of \$50,000 or more, the qualifications, experience, terms of reference and terms of employment of the consultants shall be furnished to the Bank for its prior review and approval. The contract shall be awarded only after said approval shall have been given.

3. Post Review

With respect to each contract not governed by paragraph 1 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Consultant Guidelines shall apply.

SCHEDULE 2

Implementation Program

For the purposes of Section 2.01(b) of this Agreement, the Implementation Program shall consist of the provisions set forth or referred to below.

A. Project Management

1. Shandong shall continue to maintain a provincial project office (PPO), with functions satisfactory to the Bank, staffed by qualified staff in adequate numbers, to be responsible for the overall coordination and supervision of Project execution, the supervision of the procurement of goods and services thereunder, the overall assessment of quality and impact of the Project and the preparation and furnishing to the Bank of reports and other information thereon.

2. Shandong shall ensure that each of the Project Municipalities shall continue to maintain its municipal project office with functions satisfactory to the Bank, staffed by qualified staff in adequate numbers, to be responsible for: the coordination and supervision of the execution of its and its Utility Company's Respective Part of the Project; the supervision of the procurement of goods and services under its and its Utility Company's Respective Part of the Project; and the preparation and furnishing to PPO of reports and other information thereon.

B. Resettlement and Environmental Action Plans

1. Shandong shall take, and shall cause the Project Municipalities, each Utility Company and Participating Enterprise to take, all measures necessary to ensure that the Project shall be carried out in accordance with the Resettlement Action Plans and the Environmental Action Plans.

2. Shandong shall carry out, or cause to be carried out the Xiaoqing Environmental Action Plan and the Main Polluter EAPs.

3. Shandong shall ensure that any proposed revision of the Resettlement Action Plans or the Environmental Action Plans (except for the Xiaoqing Environmental Action Plan) shall be furnished to the Bank for prior approval.

C. Financial Arrangements

Shandong shall allocate to each Project Municipality an amount out of the proceeds of the Loan under arrangements satisfactory to the Bank, which shall include, without limitation, the following principal terms:

(a) the principal amount so made available to each Project Municipality shall be the amount 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 said Project Municipality's Utility Company's Respective Part of the Project;

(b) Each Project Municipality shall repay such principal amount over a period of seventeen (17) years, inclusive of a grace period of five (5) years;

(c) Shandong 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 2.05 of the Loan Agreement, plus a spread of not less than one-half percent (0.5%) per annum; and

(d) Shandong shall charge a commitment charge on such principal amount, not withdrawn from time to time at a rate equal to three-fourths of one percent (3/4 of 1%) per annum.

D. Subsidiary Loan Agreements

1. Shandong shall cause each Project Municipality to relend the portion of the proceeds of the Loan allocated to it pursuant to Part C of this Schedule for the purpose of carrying out its Utility Company's Respective Part of the Project, to its Utility Company, under a subsidiary loan agreement to be entered into between said Project Municipality and its Utility Company, under terms and conditions which shall have been approved by the Bank, and which shall include, without limitation, those set forth in Schedule 3 to this Agreement.

2. (a) Shandong shall ensure that each Project Municipality shall cause its Utility Company to:

(i) perform, in accordance with the provisions of the Subsidiary Loan Agreement to which said Utility Company is a party, all of the obligations of said Utility Company therein set forth;

(ii) take or cause to be taken all action, including the provision of funds, facilities, services and other resources, necessary or appropriate to enable said Utility Company to perform such obligations; and

(iii) not take or permit to be taken any action which would prevent or interfere with such performance; and

(b) Shandong shall, and shall cause each Project Municipality to exercise its rights under each Subsidiary Loan Agreement to which it is a party in such manner as to protect the interests of the Borrower, the Bank, Shandong and said Project Municipality and to accomplish the purposes of the Loan, and except as the Bank shall otherwise agree, not assign, amend, abrogate or waive any Subsidiary Loan Agreement to which Shandong or said Project Municipality is a party or any provision thereof.

E. Institutional Development and Training

1. Shandong shall carry out Part E of the Project in accordance with a program acceptable to the Bank, and shall ensure that each of the Project Municipalities fully cooperates in the carrying out of said Part of the Project. Any proposed revision to the aforementioned program shall be furnished to the Bank for its prior approval.

2. Without prejudice to Part E.1 above, Shandong shall: (i) carry out the update referred to in Part E.2 of the Project in accordance with terms of reference acceptable to the Bank not later than June 30, 1998; and (ii) review the recommendations resulting from the update with the Bank.

F. Sub-loans under Part D of the Project

1. Shandong shall make Sub-loans on the terms and conditions set forth or referred to in Schedule 4 to this Agreement.

2. Shandong shall:

(a) adopt a manual (the Operational Regulations) governing the implementation of Part D of the Project and acceptable to the Bank; and

(b) implement Part D of the Project in accordance with the said manual.

3. Shandong shall:

(a) appraise Sub-projects and supervise, monitor and report on the carrying out of Sub-projects, in accordance with the Operational Regulations;

(b) to this end, enter into an agreement (the Financial Agency Agreement) with a financial institution acceptable to the Bank, on terms and conditions acceptable to the Bank, whereby said financial institution shall act as agent for Shandong for the purposes of carrying out of the financial and technical appraisal of Sub-projects and for the disbursement of the proceeds of Sub-loans as well as the collection of amounts thereunder;

(c) utilize all amounts repaid on Sub-loans, to the extent they are not yet required to meet Shandong's repayment obligations to the Borrower, to finance additional Sub-projects consistent with the Operational Regulations;

(d) exercise its rights in relation to each Sub-project in such manner as to protect the interests of the Bank and the Borrower and achieve the purposes of the Project;

(e) not assign, amend, abrogate or waive any of its agreements providing for Sub-loans, or any provision thereof, without the prior approval of the Bank; and

(f) furnish any proposed amendment to the Financial Agency Agreement or the Operational Regulations to the Bank for its prior approval.

4. Shandong shall, under arrangements satisfactory to the Bank, make available for the purpose of funding Sub-projects under Part D of the Project, at least the following amounts:

(a) Renminbi 16,500,000 not later than June 30, 1997;

(b) Renminbi 12,500,000 not later than June 30, 1998; and

(c) Renminbi 12,500,000 not later than June 30, 1999.

G. Monitoring and Reporting

1. Monitoring

Shandong shall maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with indicators acceptable to the Bank, the carrying out of the Project, including the Resettlement Action Plans and the Environmental Action Plans, as well as the achievement of the objectives thereof.

2. Reporting

Shandong shall prepare, under terms of reference acceptable to the Bank, and furnish to the Bank, the following reports: (a) reports not later than February 28, April 30, July 31 and October 31 in each year, integrating the results of the monitoring and evaluation activities performed pursuant to paragraph 1 above and based on quarterly progress reports prepared by the municipal project offices referred to in Part A.2 of this Schedule, on the progress achieved in the carrying out of the Project during the immediately preceding calendar year quarter and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the then current calendar quarter, the February 28 report shall include the latest Project cost estimate and financial plan (including a draft budget for local counterpart funds) for the following calendar year; and (b) a mid-term report not later than September 30, 2000, integrating the results of the monitoring and reporting activities performed pursuant to paragraphs 1 and 2 (a) above, on the progress achieved in the carrying out of the Project during the period preceding the date of said report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof.

3. Consultation

After furnishing each report referred to in paragraph 2 above, Shandong shall review said report with the Bank, and promptly take all measures required to ensure the efficient completion of the Project (including, when applicable, the carrying out of the Resettlement Action Plans and the Environmental Action Plans) and the achievement of the objectives thereof, based on the conclusions and recommendations of said report and the Bank's views on the matter.

SCHEDULE 3

Principal Terms and Conditions of the Subsidiary Loan Agreements

The principal terms and conditions set forth or referred to in this Schedule 3 shall apply for the purposes of Part D.1 of Schedule 2 to this Agreement.

A. Terms

1. The principal amount of each Subsidiary Loan made by a Project Municipality to its Utility Company, shall be the amount 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 said Utility Company's Respective Part of the Project.
2. Each Utility Company shall repay such principal amount over a period of fifteen (15) years, inclusive of a grace period of five (5) years.
3. Each Subsidiary Loan shall bear interest on the principal amount thereof 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 2.05 of the Loan Agreement, plus, a spread of not less than one percent (1.0%), per annum.
4. The Project Municipality concerned shall charge a commitment charge on such principal amount, not withdrawn from time to time at a rate equal to three-fourths of one percent (3/4 of 1%) per annum.

B. Conditions

The Subsidiary Loan Agreements shall include the following principal conditions.

1. Each Utility Company shall undertake to:
 - (a) carry out its Respective Part of the Project with due diligence and efficiency and in accordance with:
 - (i) appropriate technical, financial, engineering and public utility practices; and
 - (ii) appropriate health, safety 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 RAP and the Shandong Environmental Assessment.
2. Each Utility Company shall undertake to procure the goods and services to be financed out of the proceeds of the Loan in accordance with the provisions of Schedule 1 to this Agreement, and utilize such goods and services exclusively in the carrying out of its Respective Part of the Project.
3. Each Utility Company shall undertake to enable the Bank, Shandong and the Project Municipality 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.
4. Each Utility 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 by the Utility Company to replace or repair such goods.
5. Each Utility Company shall undertake to:
 - (a) maintain records and accounts adequate to reflect in accordance with consistently maintained 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 and the Project Municipality concerned;

(c) furnish to Shandong, the Project Municipality concerned, and to the Bank, as soon as available, but in any case not later than six 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) the report of such audit by said auditors in such scope and detail as Shandong, the Bank and/or said Project Municipality shall have reasonably requested; and

(d) prepare and furnish to the Bank, Shandong, and the Project Municipality concerned all such other information concerning said records, accounts and financial statements, as well as the audit thereof, as the Bank, Shandong, and/or said Project Municipality shall reasonably request.

6. The Jinan Drainage Company, Jinan Water Company and Yantai Company shall for each fiscal year as of 1997, and the Weihai Company shall for each fiscal year as of 1998, undertake to produce:

(a) total revenues, equivalent to not less than the sum of:

(i) its total operating expenses;

(ii) for Jinan Drainage Company, Weihai Company and Yantai Company only, the amount by which debt service requirements exceeds the provision for depreciation; and

(iii) for Jinan Water Company only, increases in working capital other than cash, debt service requirements and 20% of the annual average of its capital expenditures incurred, or expected to be incurred, for the current year, the previous fiscal year and the next following fiscal year;

(b) review, before September 30 in each fiscal year as of fiscal 1998, 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.

7. Each Utility Company 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.

8. For the Jinan Subsidiary Loan Agreement only, Jinan Water Company shall, by not later than December 31, 2000, strengthen its distribution system to handle an increased supply of about 400,000 cubic meters of fully treated water to Jinan.

9. Each Project Municipality shall have the right to suspend or terminate the right of each Utility Company to which it has made a Subsidiary Loan to the use of the proceeds of such Subsidiary Loan upon failure by said Utility Company to perform its obligations under its respective Subsidiary Loan Agreement.

C. Definitions

1. For purposes of this Schedule:

(a) The term "total revenues" means the terms of total operating revenues and net non-operating income.

(b) The term "total operating revenues" means revenues from all sources related to operations.

(c) The term "total operating expenses" means all expenses related to operations, including administration, adequate maintenance, taxes and payments in lieu of taxes, and (except for Jinan Water Company) 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 Utility Company's fixed assets in operation, or other basis acceptable to the Bank, but excluding interest and other charges on debt.

(d) The average current gross value of the Utility 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.

(e) 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.

(f) The term "debt" means any indebtedness of the Utility Company maturing by its terms more than one year after the date on which it is originally incurred.

(g) 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.

(h) 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.

(i) The term "reasonable forecast" means a forecast prepared by the Utility Company not earlier than twelve months prior to the incurrence of the debt in question, which both the Bank and said Utility Company accept as reasonable and as to which the Bank has notified said Utility 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 Utility Company.

(j) The term "working capital other than cash" means the difference between current assets excluding cash and current liabilities at the end of each fiscal year.

(k) The term "current assets excluding cash" means all assets other than cash which could in the ordinary course of business be converted into cash within twelve months, including accounts receivable, marketable securities, inventories and pre-paid expenses properly chargeable to operating expenses within the next fiscal year.

(l) The term "current liabilities" means all liabilities which will become due and payable or could under circumstances then existing be called for payment within twelve months, including accounts payable, customer advances, debt service requirements, taxes and payments in lieu of taxes, and dividends.

(m) The term "capital expenditures" means all expenditures on account of

fixed assets, including interest charged to construction, related to operations. 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.

2. 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.

SCHEDULE 4

Sub-loans

A. Terms

1. The principal amount of each Sub-loan financed:

(a) shall be the amount in Dollars (determined as of the date, or respective dates, of withdrawal from the Loan Account) of the value of the currency or currencies so withdrawn on account of the Sub-project for which said Sub-loan has been made; and

(b) shall be repaid within a period not exceeding 5 years, inclusive of a grace period not exceeding 2 years.

2. Each Sub-loan shall:

(a) bear interest, on the principal amount thereof withdrawn and outstanding from time to time, at a rate equal to the rate applicable from time to time to the Loan pursuant to Section 2.05 of the Loan Agreement, plus a spread of not less than one and one-half percent (1.5%), per annum;

(b) carry a commitment fee on the principal amount of said loan not withdrawn from time to time at a rate equal to three fourths of one percent (3/4 of 1%) per annum;

3. The total estimated cost of each Sub-project (excluding the cost of land) shall not exceed \$1,000,000. The aggregate amount of all Sub-loans made to any one Participating Enterprise shall not exceed the equivalent of \$500,000. The amount of any one Sub-loan and the aggregate amount of all Sub-loans made for any one Sub-project shall not exceed 50% of the total estimated cost (excluding the cost of land) of such Sub-project.

B. Eligibility and Appraisal

1. Each Sub-loan shall be made only to a Participating Enterprise which:

(a) is an enterprise legal person duly established and operating under the laws of the Borrower; and

(b) shall have established on the basis of guidelines satisfactory to the Bank, that it is creditworthy and has a sound financial structure and the organization, management, staff and other resources required for the efficient carrying out of its operations, including the Sub-project.

2. Sub-projects shall be appraised and selected on the basis of technical, financial, environmental and resettlement criteria acceptable to the Bank. Such criteria shall include, without limitation:

(a) Financial: the Participating Enterprise needs to demonstrate that it can maintain a debt service coverage ratio (as defined in Parts B.7 and C of Schedule 3 to this Agreement) of not less than 1.4 times after the proposed Sub-project has reached full production capacity;

(b) Technical: Sub-projects shall be technically viable based on an assessment of:

- (i) the Sub-project's impact on the ambient environment;
- (ii) the Sub-project's investment and operating cost per unit pollution load reduction;
- (iii) the efforts made by the Participating Enterprise on pollution prevention;
- (iv) the Participating Enterprise's record regarding compliance with environmental regulations and standards; and
- (v) the Sub-project's technical feasibility and least-cost option.

(c) Environmental: for each Sub-project the Participating Enterprise shall prepare an environmental action plan satisfactory to the Bank, including an assessment of the Participating Enterprise's and the Sub-project's adverse impact on the environment and appropriate mitigation measures to be carried out to remedy such impact.

(d) Resettlement: for each Sub-project involving the involuntary resettlement of any persons in connection therewith, the Participating Enterprise shall prepare, on the basis of procedures and principles acceptable to the Bank, a resettlement action plan satisfactory to the Bank. Resettlement action plans shall be prepared in consultation with the affected persons on the basis of policies, planning principles and institutional arrangements designed to improve the living standards of the said persons, together with satisfactory operational procedures adequate to enable the monitoring and evaluation of the implementation of the said resettlement plan.

C. Utilization of Sub-loan proceeds

The proceeds of Sub-loans shall be withdrawn only to finance expenditures for materials, equipment and services, required for a Sub-project, net of taxes.

D. Other conditions

1. No expenditures for goods or services required for a Sub-project shall be eligible for financing out of the proceeds of the Loan unless:

(a) the Sub-loan shall have been approved by the Bank and such expenditures shall have been made not earlier than 90 days prior to the date on which the Bank shall have received the application and information required under Section (a) of this Part in respect of such Sub-loan; or

(b) the Sub-loan shall have been a free-limit Sub-loan for which the Bank has authorized withdrawals from the Loan Account and such expenditures shall have been made not earlier than 90 days prior to the date on which the Bank shall have received the request and information required under Section 2 (b) of this Part in respect of such free-limit Sub-loan. For the purposes of this Schedule, a free-limit Sub-loan shall be a Sub-loan (other than the first three (3) Sub-loans made) in an amount to be financed out of the proceeds of the Loan which shall not exceed the sum of \$300,000 equivalent, when added to any other outstanding amounts financed or proposed to be financed out of the proceeds of the Loan or of any other loan, provided for in any outstanding agreement between the Borrower and the Bank, the proceeds of which have been or are being used for financing goods and services directly and materially related to such Sub-project, the foregoing amounts being subject to change from time to time as determined by the Bank.

2. (a) Each application for approval by the Bank of a Sub-loan (other than a free-limit Sub-loan) shall be in form satisfactory to the Bank, and shall include:

(i) a description of the Participating Enterprise and an appraisal of the Sub-project, including a description of the expenditures

proposed to be financed out of the proceeds of the Loan;

(ii) the proposed terms and conditions of the Sub-loan, including the schedule of amortization thereof; and

(iii) such other information as the Bank shall reasonably request.

(b) Each request for authorization to make withdrawals from the Loan Account in respect of a free-limit Sub-loan shall contain:

(i) a summary description of the Participating Enterprise and the Sub-project, including a description of the expenditures proposed to be financed out of the proceeds of the Loan; and

(ii) the terms and conditions of the Sub-loan, including the schedule of amortization thereof.

3. Each Sub-loan shall be made on further conditions whereby Shandong shall obtain, by written contract with the Participating Enterprise, rights adequate to protect the interests of the Bank and Shandong, including:

(a) that the Participating Enterprise shall undertake to:

(i) carry out and operate the Sub-project (including completion of abatement measures, the Sub-project EAP and, if applicable, the Sub-project RAP), with due diligence and efficiency and in accordance with sound technical, financial and managerial standards and appropriate safety, health and environmental standards satisfactory to the Bank, maintain adequate records and provide, promptly as needed, the funds, facilities and other resources required for the purpose;

(ii) procure the goods and services required for the Sub-project in accordance with the provisions of Schedule 1 to this Agreement, and utilize such goods and services exclusively in the carrying out of its Sub-project;

(iii) enable the Bank and Shandong to inspect such goods and the sites and works included in its Sub-project the operation thereof, and any relevant records and documents;

(iv) 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 required for the Sub-project to the place of use or on, any indemnity thereunder to be made payable in a currency freely usable by the Participating Enterprise to replace or repair such goods; and

(v) prepare and furnish to Shandong, as the case may be, for forwarding to the Bank, if it shall so request, all such information as the Bank or Shandong shall reasonably request relating to the foregoing and to the administration, operations and financial condition of the Participating Enterprise and to the benefits to be derived from the Sub-project; and

(b) provisions to ensure the right of Shandong to suspend or terminate the right of the Participating Enterprise to the use of the proceeds of the Loan upon failure by such Participating Enterprise to perform its obligations under its contract providing for the Sub-loan.

