

Summary of International Investment Attraction Project for Partial Equity Transfer Of Shanghai Municipal Waterworks Pudong Co., Ltd.

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Introduction

Partial equity transfer of Shanghai Municipal Waterworks Pudong Co., Ltd. (hereinafter referred to as “Waterworks Pudong Company”) through international investment attraction and Sino-foreign joint operation was a major strategic move in Shanghai to deepen the reform and speed up the development of the water supply and drainage industry. It would play an active role in and create deep and significant influence on introducing the technology, management and capital, further promoting the industrial structure and system innovation of the municipal waterworks industry as well as raising the enterprise management performance and the total quality. Under the leadership of Shanghai Water Authority, Shanghai Water Assets Operation and Development Co., Ltd. (hereinafter referred to as “Water Assets Company”) cooperated with multiple companies including the Waterworks Pudong Company to work on international investment attraction for partial equity transfer of Waterworks Pudong Company. As market competition mechanism was introduced to the investment attraction in accordance with international practices, the whole campaign achieved

significant success and meanwhile embodied the principles of “openness, fairness and justice”.

Three internationally well-known water groups, such as France’s General Water Company, performed an open, fair and very fierce competition with the same rule and at the same starting line. After nearly one-year efforts and operation, the international tendering project for transfer of partial equity of Waterworks Pudong Company was announced to complete on May 23, 2002. The Water Assets Company signed a contract for transfer of 50% equity of Waterworks Pudong Company with France’s General Water Company which was transferred the equity with 2.66 times premium of net assets. The Chinese party and the French party established the first joint venture in the national municipality industry with joint investment, joint operation, joint adventure and equity proceeds by both Chinese and foreign parties without fixed returns. The business scope of this joint venture included water manufacturing, sales and service.

The summary of the International Tendering Project for Transfer of Partial Equity of the Waterworks Pudong Company is as follows.

Purpose of Partial Equity Transfer by the Waterworks Pudong Company

Shanghai Water Industry actively promoted the reform of corporate structure and transformation of operation mechanism to improve the entire quality and market competitiveness of enterprises and explore the new ways of investment and financing system so as to suit the general needs of the new turn great development of Shanghai Municipal Construction. According to the actual situation of Waterworks Pudong Company, it was determined to establish a joint venture of waterworks by transferring partial equity of Waterworks Pudong Company through international tendering. The main purpose was:

1. Grasp the development opportunity, actively promote the innovation of investment and financing system and explore ways to form a new investment and financing mode featured by the unique characteristics of "Input - Recovery - Re-input" of Shanghai Water Industry.

Since the establishment of the country, our water supply and drainage industry implemented monopoly management system by the government. The government organized and established the enterprises, funded the investment, determined the prices and assumed all the profit and loss, so the enterprises had no management adventure at all. The resource allocation method formed by the long-term planned economic system and the full investment method by the country to the urban infrastructure were more and more difficult to suit the needs for development of market economy, so it was urgent to further strengthen the efforts of and accelerate the pace of reform, and promote the innovation of investment and financing system.

The investment projects of the water industry were featured with large fund needs and long investment recovery period, so it was rather difficult to be financed domestically. To attract foreign funds through asset sales, equity transfer,

direct investment, BOT etc., to attract, drive the foreign funds and other social resources by minor state-owned capital, so as to liquidate capital stock and broaden the fund source of municipal infrastructure construction had strategic significance to promotion of the continuous development of Shanghai Water Industry.

2. Diversifying the investment entities and promoting the construction of modern corporate system of water supply and drainage enterprises

After China's access into WTO, faced with the competition from so many international water groups, water supply and drainage enterprises in Shanghai would possibly lose their competitive advantage and developing opportunities and finally lose their market if they kept the state-wholly-owned, conservative and out-of-date system and monopoly pattern. Therefore, it was an urgent task to accelerate the structural reform and innovation of waterworks industry in Shanghai. Through the adjustment of ownership structure, the monolithic state-owned structure will be turned into the fully-structured modern corporate system featured by diversified investment entities and corporate governance to invigorate the enterprise and deepen the structural reform of water enterprises.

3. Import from abroad the advanced technologies as well as management philosophy and management approaches to enhance our service quality and management level and strengthen the core competitiveness of the enterprise

Through cooperation with an international advanced water company by establishing a joint venture, we could import foreign capital with the internationally advanced water-manufacturing technology and management philosophy, management approaches and management methods, so as to reduce the gap between Shanghai waterworks industry and international advanced level, improve the quality and market competitiveness of waterworks enterprises in Shanghai and upgrade the technology, management and operation of Shanghai waterworks industry.

4. Relying on the operation of Sino-foreign joint ventures, explore the experience in the prioritized development of major business and the separation of major business and sidelines of water supply and drainage enterprises

The separation of major business and sideline was crucial for state-owned enterprises to survive and develop in the market-oriented economy. Due to historical reasons, Shanghai water supply and drainage enterprises used to be entangled in mixed operating costs of major business and sideline and the reliance of sidelines upon the major business. This is a major obstacle preventing the water supply and drainage enterprises from increasing their operation and management level. On the pilot basis of the establishment of joint venture between Waterworks Pudong Company and the foreign partner, the separation of major business and sidelines would be carried out thoroughly, which not only helped to attract foreign investment and facilitate the establishment of joint ventures, but also could accumulate the experience in the separation of major business and sidelines by Shanghai water supply and drainage enterprises.

5. Establish the new mode of enterprise operation and force competition among waterworks companies from various regions

In 1999, the former Shanghai Waterworks Company were separated into four regional waterworks companies, which had played an active role in reducing the operation and accounting unit, enhancing the operation and management level and reversing the unfavorable economic benefit of the industry. However, with the same investment mode and similar technological level and management approaches, these four waterworks companies lacked necessary competition, which hindered the intensive operation and management of enterprises. Through the establishment of Sino-foreign joint venture waterworks companies, different operation modes could be imported to help form the beneficial market competition mechanism and market operation

mode in a bid to further deepen the structural reform of waterworks enterprises and increase their management level.

Major Practices

1. Planning

The equity transfer of Waterworks Pudong Company to establish a Sino-foreign joint venture was a difficult and demanding project involving various aspects. To smoothly implement this project, Water Assets Company, adhering to the principle of “active and prudent, develop and innovate”, carried out an over-half-a-year first-phase survey according to the intentions and requirements of bureau cadres and the actual situation of Waterworks Pudong Company, learned about the experience of foreign capital operation, referred to both domestic and foreign cases and materials, paid great attention to the information of foreign capital operation and analyzed quite a few foreign-invested projects in China, which were the important and basic materials for the project plan. They prepared several proposals and made repeated revisions. The investment attraction plan for this project was determined according to the guideline of “moderate packaging, market competition and complying with the international practices”. Based on the international competitive tendering, the overall plan would ensure the providing of investment attraction materials to all foreign applicants according to the practices of international investment attraction.

(1) Key points of the plan

Through the international investment attraction, 50% of the equity of Waterworks Pudong Company would be transferred to establish a Sino-foreign joint venture. Based on the principle of market-oriented operations, Chinese and foreign partners jointly operated and jointly gained the proceeds and jointly shared the risks, with no fixed returns guaranteed. This set the first example in the municipality industry nationwide.

(2) Adopt the internationally accepted market valuation method to maximize cash inflow Different from the joint venture mode in which the Chinese partner invests in land and plant while the foreign partner invests in fund, equipment and technology, Waterworks Pudong Company transferred partial equity to establish a new joint venture. The proceeds from equity transfer were recovered by Water Assets Company to invest in the construction of Shanghai water industry.

(3) Set up preconditions

According to the requirements of China's industrial policies and characteristics of water supply enterprises, we required the foreign partner to accept the equity transfer in a lump sum with its self-owned funds and to invest in cash. The foreign partner should meet a dozen of preconditions for cooperation, e.g., the partner must have the internationally advanced technology and management experience in respect of a water-manufacturing enterprise.

2. Preparations

On September 24, 2001, the work group for the project of partial equity transfer of Waterworks Pudong Company was set up, consisting of professionals from Water Assets Company, Shanghai Ownership Exchange, Shanghai Orient International Tendering Co., Ltd., Shanghai Runhe Law Firm and Waterworks Pudong Company.

3. Pre-qualifications

In order to select an ideal investor and carry out the whole investment attraction project according to the principle of "openness, fairness and impartiality", the project of partial equity transfer of Waterworks Pudong Company was listed on the website of Shanghai Property Exchange.

In order to select the "best partner", we adopted the method of "mark line", e.g. the pre-qualifications for tenders. To facilitate the first-round selecting of the potential investors, the project work group prepared pre-qualification documents such as "announcement of pre-qualifications" and "instructions for pre-qualification", and sent these pre-qualification

documents on November 14, 2001 to 7 companies, namely France's Ondeo Water Company, France's General Water Company, Britain's Thames Water Company, Global Engineering Company subordinate to US Tank Company, Italy's Impregilo Company, ABB company and Hong Kong China Power Company.

4. Application for investment attraction

It was an important and lasting phase in the whole process of the equity transfer project. In this phase, the project work group prepared the investment attraction documents in a shorter period of time, including the "Instructions for Investment Attraction", "Draft for the Contract on Equity Transfer", "Draft for the Joint-venture Contract" and "Draft for the Articles of Association of the Joint Venture". The investment attraction documents acted as important basis guiding the next-phase of work and the establishment of the joint venture.

On December 21, 2001, three applicants who passed the pre-qualifications received the investment attraction documents. When preparing the application documents on investment attraction, foreign investors made further request to clarify the investment attraction documents and the materials provided in the first-phase promotion period. In response to their questions, the project work group compiled two batches of "Question & Answer Memo" on the basis of selection, and sent them to the applicants for reference.

On February 5, 2002, Seuz Ondeo-New World United Entity, France's General Water Company and Britain's Thames Water Company respectively submitted their application documents on investment attraction, which were important basis determining the final investor.

5. Clean-up of application documents on investment attraction

The project work group made a preliminary inspection of the application documents on investment attraction submitted by the three foreign investors and concluded that they all

complied with the requirements stated on the “Instructions for Investment Attraction”. From February 6, 2002 to February 20, 2002, the members of project work group and the related personnel from Waterworks Pudong Company secretly and confidentially carried out a comprehensive sorting and clean-up of the application documents on investment attraction submitted by the three foreign investors, according to the purpose of joint venture and the requirements of review. Four documents were finalized, i.e., “Simplified Version of Application Documents on Investment Attraction of Three Foreign Investors”, “Check List of the Documents”, “Main Points of Negotiation”, and the “List of Issue Clarification” in response to the request by the three applicants in their application documents on investment attraction. The first two documents were used for experts’ review, while the last two for negotiation in the clarification phase.

6. Clarification negotiation

The clarification negotiation was divided into two phases. In the first phase, from March 4, 2002 to March 6, 2002, the foreign parties were requested to clarify and explain the cooperation principles and preconditions put forward by the Chinese party in the documents but not expressly guaranteed in their application documents on investment attraction. With regard to questions raised by our Chinese party, foreign parties clarified and explained from different prospective, and fully guaranteed, or partially guaranteed, or conditionally guaranteed, or provided no guarantee but with explanations. After the negotiation, the “Memo on Clarification Negotiation” was formed and signed by the negotiation representatives of both Chinese and foreign parties to be the basis for the negotiation of equity transfer contract, joint venture contract and articles of association. The second phase of clarification negotiation, from March 11, 2002 to March 16, 2002, was to require the foreign investors to explain and interpret the unclear and implicit points in their application documents on investment attraction.

7. Expert review

Expert review was a major phase for determining the bid winner and signing the contract on equity transfer. According to the actual situation of the project, the following steps were taken: the first was to invite the notary office. On April 16, 2002, the expert lot-drawing rules and the procedures of the review committee were submitted to Shanghai Public Notary Office together with related documents and a formal contract was signed to entrust the notary office to notarize the whole process by the review committee. The second step was to determine the name list of experts. On April 16, 2002, Shanghai Orient International Tendering Co., Ltd., Shanghai Urban Construction Investment and Development General Company, Shanghai Ownership Exchange and Shanghai Water Authority respectively recommended the name list of experts. Under the supervision of the notary office, the lot was drawn on the morning of April 18, 2002 to determine the rank of the experts. The third step was to notify the experts. After the ranking of experts by lot drawing, the project work group sent the invitation for review to the first 10 experts of each professional group, stating in the letter of invitation that they were required to send written confirmation before 17:00 of April 20, 2002. The fourth step was to determine the reviewing experts. On April 22, 2002, the project group finalized the name list of the experts for this review according to the replies and ranking of experts through lot drawing, and this name list was sealed by the project owner for confirmation and then kept with the notary office on file. The fifth step concerned the expert review procedures. The experts discussed in groups about the tendering documents and scored according to the appraisal form and put forward the expert review comments. The caller of each group summarized the scores given by experts of the group and provided the written summary of the group. The sixth step was to strengthen the confidentiality measures. As this equity transfer project was of great significance, we took several confidentiality measures to ensure the fairness and impartiality of the whole review process. We in advance announced the confidentiality rules to

the participating experts and signed with each review expert the confidentiality agreements drafted by a lawyer. During the review period, experts were not allowed to arbitrarily leave the place of review, and they were refrained from contacting the outside in the 3-day review period. To prevent the loss of the review materials, each expert group had two working staff, whose duty was to provide the experts with the explanations on investment attraction, investment attraction documents, enterprise introduction materials and the memos of the two rounds of clarification negotiations as well as to supervise the confidentiality. In order to ensure the fairness and impartiality of the expert review, the review materials were handled with no names recorded.

8. Submission of review result

According to the review scope and weight as stipulated in the investment attraction documents, the review experts gave marks to five aspects including the transfer price, financial plan, technical plan, service plan and organization and personnel plan put forward by the applicants in their investment attraction documents, each weighing 20%. The whole review process and review result was notarized by Shanghai Public Notary Office.

According to the expert review result, France General Water Company became the optimal partner for the project of partial equity transfer of Waterworks Pudong Company. This result reflected the principles of “openness, fairness and impartiality” and standard, and the investment attraction was free from outside interference.

9. Signing of the contract on equity transfer

At 3:00 pm, May 23, 2002, the ceremony for signing of the contract on the partial equity transfer of Waterworks Pudong Company was held in Shangri-la (Shanghai) Hotel. Representative from Water Assets Company and France’s General Water Company signed the contract on equity transfer of Waterworks Pudong Company, which marked the successful completion of the international investment attraction of the partial equity transfer of Waterworks Pudong Company.

10. Coordination and implementation of some policies concerning the project investment attraction

With the support from the departments and sections of the bureau, Water Assets Company actively coordinated with the competent authority of the municipal government about some policy issues and agreed with Shanghai House and Land Resources Administration on the land use method and exemption and reduction of taxes and fees of the joint venture, and submitted these issues to the municipal government for approval. It agreed with the State Administration of Foreign Exchange Shanghai Branch, Municipal State-owned Assets Office, Municipal Administration for Industry and Commerce on the establishment of foreign exchange accounts, transfer of capital ownership and industrial and commercial registration, so as to timely handle the supporting policies and the related legal procedures concerning the establishment and operation of the joint venture.

Key Experience and Gains

The international investment attraction project for the transfer of partial equity of Waterworks Pudong Company was an innovative task, and was successfully concluded despite its wide involvement, great difficulty and tight schedule, mainly due to the following reasons:

1. The Municipal Party Commission and Municipal Government formulated the right guidelines for investment and financing reform of municipality construction.
2. The reform of the management structure of Shanghai water industry provides conditions for the implementation of the investment attraction project.
3. Water Assets Company designed and operated in a refined and standardized way, ensuring the success of the project.
4. Water Assets Company and Waterworks Pudong Company well cooperated and the cadres at all levels actively participated to stimulate the efforts from both inside and outside.

5. The departments and commissions under the Municipal Government, governments at all levels and the Municipal Urban Investment Company offered energetic support.

“Water is source of life”. The development of water industry was not only important to the city’s modernization construction but also closely associated with people’s lives. Water Assets Company, Shanghai Oriental International Tendering Company, Shanghai Runhe Law Firm and Shanghai Ownership Exchange made great contributions to this project. All their cadres and staff discussed and solved the problems regarding each step, even every detail of the project, cautiously and conscientiously to ensure the project was dealt with in a refined and thorough way. Regardless of their own losses and gains, quite a few personnel overworked on holidays such as the National Day and Spring Festival and made painstaking efforts for the investment attraction project.

Reflecting upon the international investment attraction project of partial equity transfer of Waterworks Pudong Company, we deeply felt that only by carrying out the ideals of “three representatives”, by carrying forward the spirit of growing with times and by adhering to the work principles of down-to-earth, meticulousity, and by pursuing improvement, could we increase our abilities to tackle complex issues, hold the job in our own control, carry out the work in a creative way and fulfill all tasks. ■

