

The changing of Chinese laws regarding milk production

In September this year, the crisis of melamine contaminated milk powder made headlines all over the world. The contamination resulted in tens of thousands of Chinese babies falling ill as well as several deaths. The company Sanlu, formerly China's largest producer of powdered milk, was found to have the highest levels of contamination. Further research has shown that Sanlu was not the only one at fault; the local government in Hebei province delayed in announcing signs of contamination and refused to approve a public recall. There is speculation that the company was waiting until after the Olympics had ended.

Since the full scale of the crisis was revealed in September, Sanlu has financially collapsed, and another dairy company, Sanyuan, which emerged unscathed from the scandal, has made plans to purchase the assets of Sanlu. Moreover, local government ministers responsible for food safety have been removed from office and several people have been jailed.

In response to the public outcry over the scandal, legal workings also followed to help ensure that such a disaster could never recur. The October 2008 law titled "Regulation on the Supervision and Administration of the Quality and Safety of Dairy Products" seeks to enforce tougher regulations on the dairy industry such as more specific rules regarding ingredients, the breeding of dairy cows, and responsibilities of inspection agencies.



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Dear Readers,

The Nov-Dec / 08 edition of our China Green Report contains news and insights on the Chinese environmental and investment climate, and a brief assessment on the progress made. In addition, a new section "Further insight into..." has been created to specifically focus on the CDM market in China.

Feel free to contact us for any questions you may have.

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Citizen Guides to Environmental Education

The Natural Resource Defense Council (NRDC), an international environmental NGO has assisted with the publication of "Citizen Guides"

aimed at increasing public awareness of and participation in environmental issues. Most recently, NRDC has published guides tailored for Xinjiang, but in the past has also assisted in publishing guides for Jiangsu, Gansu, and Xiamen.

The guides not only inform citizens of the types of pollution, outlining them according to type (air, water, indoor, etc), but also inform readers how to go about making change. In China, public participation in legal activities is usually not very involved. Indeed, the idea that there is nothing individuals can do to change things is quite pervasive.

This view is understandable because historically it has been true that the decisions of the government do not heed the desires of local people.

In the post-reform era since 1986, this has developed in the form of collusion between businesses and the government.

The success of such citizen's guides, however, is symbolic of growing public concern over environmental issues. More and more frequently, people being influenced by polluters are speaking up. The Chinese legal system will have to adapt to a more informed public that knows more about its rights, especially regarding the contamination of public resources.

Legal news**The struggle to enforce environmental laws in rural China**

The environmental history of China during the 1990s and early 2000s has not been a picture of responsible industry. While in the books China's environmental laws are strong, in practice they are frequently ignored. Every year there are cases of human-caused ecological disasters.

In the far southeastern region of Sichuan province, for example, mining more magnesium has taken its toll on local communities and the environment. Runoff from the regions hundreds of mining projects has contaminated the water with heavy metals and other mining toxins, killing crops and putting the health of local people at risk.

In another example from September 2008, Yangzonghai Lake in neighboring Yunnan province was found to contain high levels of arsenic in the water. Several companies bordering the lake were found to be responsible, and were fined accordingly. Despite such measures, the continuing occurrence of such cases is an obvious sign that noncompliance is the primary issue in rural environmental protection.

In order to improve rates of compliance, prevent ecological disasters, and protect people's health, Kunming, the capital of Yunnan, has created a specialized law enforcement group tasked with tackling environmental law enforcement in Yunnan province. For Yunnan, China's most biologically and geographically diverse province, the creation of the task group is an investment in the province's natural resources.

However, in the past such local law enforcement agencies have had similar responsibilities and nonetheless failed to enforce environmental laws. Often such local agencies must have the approval of local officials to carry out investigations, and officials in the past have been more than willing to ignore environmental concerns in favor of economic growth and local favoritism. The test will be to see whether this new agency is given a new degree of independence to carry out its charge.

If the issues of favoritism, bribery, and other forms of corruption do not allow the agency to be effective, a national enforcement body with complete independence may be the only real solution.

Progress

The presence of China at the UN Conference

December 13 marked the last day of the United Nations Climate Change Conference held in Poznan, Poland. In regard to developing countries such as China, the conference focused on discussing the transfer of technologies to ameliorate pollution resulting from inefficient technology and stemming the trend of deforestation. The convention was heavily oriented on preparing for next year's meeting in Copenhagen, where parties are to discuss a replacement for the Kyoto protocol, which expires in 2012. Despite widespread recognition of the severity of the climate change problem, the current financial difficulties around the world have taken some of the energy out of discussions relating to finding solutions. According to Britain's Guardian newspaper, fewer world leaders support alternative energy as a way to solve climate change than did 12 months ago.

In October 2008, the Chinese government issued a pronouncement entitled *China's Policies and Actions for Addressing Climate Change*, which outlines the government's stance on climate change and what will be done domestically to reduce emissions. The Chinese government maintains that it will make efforts to reduce emissions through improved efficiency and technology transfer, largely through foreign investment in CDM and similar projects.

While such investment is certainly pivotal in helping China reduce emissions, domestic efforts to regulate industries and improve efficiency are certainly also necessary. Based on the report issued in October, it seems that Chinese government still does not recognize a need for reducing overall emissions, but merely reducing the growth rate of emissions. From one standpoint, such an attitude is understandable. As a developing country, it follows that China should have room to expand its carbon emissions to meet the growing needs of its economy, as Western countries did during their development. However, if one looks at statistics indicating China to be the world's largest polluter, it seems that China's industrialization has proceeded without restriction for too long. The approach that China will take in future international discussions remains vague.

In spite of the potential for waning political support, the market for carbon offsets continues to expand rapidly in China. Just a few days ago, on December 18, the Chinese government issued approval for dozens more Clean Development Mechanism (CDM) projects to begin work. This is good news on many fronts, as CDM projects continue to represent not only a part of the solution to climate change, but also valuable investment opportunities for foreign firms looking to buy carbon offsets.

While international carbon trading and technology transfer alone cannot resolve global warming, it nonetheless proves to be one of the fastest ways to affect environmentally sound development on a broad scale. However, the importance of government support should not be under-emphasized, even the existence of the carbon trading market is contingent on political support and legal enforcement in participating countries.

A time for green investment in China

Even in the depths of what some people are calling America's Great Depression 2.0, there are still those with an eye on future investments. According to reporting from Xinhua News Agency, China's top producer of solar water heaters has secured an investment of over 100 million U.S. dollars from Goldman Sachs.

For the Chinese firm, called Himin Solar Energy Group, this is a huge boost to their business potential. As a result of securing the investment, they will be able to expand their sales domestically and internationally as well as continue to develop new technologies.

Such a large investment in a time of economic crisis carries huge symbolism. By investing in technology that is environmentally friendly, Goldman Sachs is setting an important precedent for the next generation of investors. By investing in a Chinese firm, Goldman Sachs is acknowledging the potential of the Chinese market, a place where environmental technology firms are small, but have enormous prospects.

It is becoming more and more clear that with awareness of climate change on the rise, the next generation of international investment will be focused on green investment in the vast markets of rapidly industrializing China.

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Investment

CERs floor price undermines CDM wind power growth

China is the only Non-Annex 1 country to set a floor price for CERs generated from CDM projects implemented in its territory. Price varies depending on the different types of projects, with the highest prices being those CERs from wind power projects: €12.00.

In a situation in which the price of CERs in the secondary market ("sCERs") continues to fall down from the peak of €24.00 in July reaching around €13.50 in these recent days, investors are losing their interest in purchasing Chinese CERs from wind power projects. Such a slight difference between the price of risky and "virtual" CERs in the primary market and the price of risk-free and "real" CERs in the secondary market is encouraging firms to go shopping on the exchanges. It has to be noted that all the forecasts state that sCERs price will increase again as the current prices collapse is mainly a consequence of the global financial downturn.

China has responded by decreasing the floor price for wind power CERs from €12.50 to the current €12.00 around the middle of November, but this measure seems not to be enough. When will the dream of a Chinese CERs price entirely determined by market forces finally come true?

Further insight into...

China, the Clean Development Mechanism, and the role of law firms

THE "CARBON MARKET"

During the first three quarters of 2008 the so called "global carbon market" – an abstract concept grouping the various carbon markets, which are linked together by varying degrees of interconnection – has increased by 81% in value as of 2007, reaching a total of US\$87 billion. Forecasts say that by the end of 2008, the total value will close at US\$166 billion, representing a correspondent volume of 3,900 Mt of CO₂e, up by 30% from 2007.

THE CDM MARKET IN CHINA

China is the first host country in the Clean Development Mechanism (CDM) market, both for Certified Emission Reductions supplied (CERs - carbon credits generated by CDM projects and acquired either for Kyoto and non-Kyoto compliance purposes or on a voluntary basis) and for the number of projects under development, accounting for over 70% of global CER generation. To date, 325 Chinese projects have been registered at the United Nations Executive Board (EB), with a potential generation of some 126 million CERs per annum. Of these projects, 81 have already obtained CERs issuance from the EB, while almost 1300 are requesting registration at the EB. Around 1700 projects are either being developed or under national approval from the National Development and Reform Commission (NDRC), and hundreds are in the pipeline every month.

THE ROLE OF LAW FIRMS

As a consequence of the exponential growth of the Chinese CDM market, law firms are gaining increasing involvement in CERs transactions and CDM projects implementation. Renowned international firms, usually on the side of foreign investors and CERs buyers, are dealing with local law firms, representing Chinese project owners. Such domestic law firms have now developed a significant expertise in the field and can be counted on to have a deep knowledge and thorough understanding of local realities, and a positive relationships with local communities and authorities.

Law firms are dealing with CDM projects from various perspectives. In most cases a CDM project implies the construction of a new facility. As such – in the case, for example, of a wind farm, a hydro power plant, or a system for the capture of landfill gases – developers need to obtain relevant permits, go through specific administrative procedures, and satisfy environmental standards through an environmental impact assessment. This allows them to obtain necessary environmental permits, in a way not quite different from what happens with regards to any other construction projects of similar dimensions.

Furthermore, CDM projects usually entail large investments, and even if the CDM mechanism allows for the resulting CERs to be purchased before the actual implementation of the project and the consequent issuance from the EB, it often happens that only a percentage of the CERs' value are paid by the foreign party before their actual issuance. As such, a key element in the successful implementation of the project is structuring a proper finance plan, often the responsibility of law firms.

It is common practice to establish a company to run the project cycle, with this company ultimately being the project owner and the recipient of CERs issued by the UN. Where this is the case, law firms assist with the drafting of the various documents to be submitted to the authorities for the approval and registration of the company.

The insurance of intellectual property rights, such as patents for invention and design, trademarks, and commercial secrets, also require legal expertise. This is particularly true in the case of a foreign investor dealing with a domestic entity which is participating in the project either as a JV partner or as a technology and equipment seller/licensor. Furthermore, assistance on taxation issues is relevant as well.

In order to start to implement the project, project owners/developers often have to enter into commercial agreements with contractors, suppliers, leasers, and financial institutions. Law firms will assist in conducting negotiations and in the drafting of related contracts.

The main document around which a CDM deals are centered is the Emission Reduction Purchase Agreement (ERPA), the contract for the sale and purchase of the CERs. Negotiations between the parties in this regard are notably time-consuming and conducted on a clause-to-clause basis. This is primarily due to the Chinese CDM market being young and largely comprised of junior domestic players with insufficient confidence to deal with "massive" and very detailed contracts, such as the ERPA. Such emphasis on written contracts is often in contrast with traditional Chinese cultural and contractual practices.

It is a main interest for both the parties of a CDM deal to discover with whom they are actually engaging in a contractual relationship. As such, law firms help in performing due diligence and similar investigations, both on foreign/domestic entities and on the CDM project itself.

Lehman, Lee & Xu is one of the few Chinese law firms actively involved in CDM projects. The firm has developed a network with various investors from Annex B countries, is able to provide any project with the ideal investor/CERs purchaser, and to assist both foreign and local parties with a full range of legal services in connection with their CDM deals.

The firm is founding member of the auditing firm Lehman Tax & Accounting, and as such is able to assist clients in performing financial due diligence and investigations on potential partners and project companies. Additionally, Lehman, Lee & Xu cooperates with PIN and PDD consultants to be able to provide project developers with a comprehensive service also in the design phase of their projects.