
PRC REGULATORY OVERVIEW

APPLICABLE LAWS, RULES AND REGULATIONS TO OUR PRODUCTION, OPERATIONS AND BUSINESS IN THE PRC

Our principal place of business is in the PRC and therefore we are subject to the PRC laws and regulations. This section summarizes the principal PRC laws and regulations relating to our production, operation and business which include, but not limited to, Regulations of the PRC on the Administration of Production Licence for Industrial Products (中華人民共和國工業產品生產許可證管理條例), Regulations on the Safety Administration of Hazardous Chemicals (危險化學品安全管理條例), Regulations on Work Safety Licences (安全生產許可證條例), Environmental Protection Law of the PRC (中華人民共和國環境保護法), Prevention and Control of Atmospheric Pollution Law of the PRC (中華人民共和國大氣污染防治法) and Prevention and Control of Water Pollution Law of the PRC (中華人民共和國水污染防治法). Certain important provisions of the above laws and regulations relating to the chemical industry and environmental protection are set out below.

Apart from the abovementioned laws and regulations in relation to our production operations and business in the PRC, the PRC government has introduced several preferential policies directly for the benefit of fertiliser producers, which are to ensure the sufficient domestic supplies of fertilisers and to stabilise the prices of fertilisers.

Regulations of the PRC on the Administration of Production Licence for Industrial Products (中華人民共和國工業產品生產許可證管理條例) and Measures for the Implementation of Regulations of the PRC on the Administration of Production Licence for Industrial Products (中華人民共和國工業產品生產許可證管理條例實施辦法)

Pursuant to the Regulations of the PRC on the Administration of Production Licence for Industrial Products (中華人民共和國工業產品生產許可證管理條例) which were promulgated by the State Council and came into effect on 1 September 2005, and the Measures for the Implementation of the Regulations of the PRC on the Administration of Production Licence for Industrial Products (中華人民共和國工業產品生產許可證管理條例實施辦法) which were promulgated by the General Administration of Quality Supervision, Inspection and Quarantine of the PRC (國家質量監督檢驗檢疫總局) and came into effect on 1 November 2005, enterprises producing industrial products that may affect production safety and public safety are subject to the requirements of production licences.

- The Catalogue of Industrial Products (the “**Catalogue**”) which is subject to the system of production licence by the State Council shall be formulated, evaluated and adjusted from time to time by the competent department of production licence for industrial products of the State Council together with the relevant departments of the State Council, and be promulgated to the public after an approval is granted by the State Council.
- Any enterprise that fails to obtain the production licence shall not produce the products listed in the Catalogue, and no unit or individual is allowed to sell or use such products which do not obtain the production permits in operating activities.

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Regulations on the Safety Administration of Hazardous Chemicals (危險化學品安全管理條例) and Measures for the Administration of Operating Licence for Hazardous Chemicals (危險化學品經營許可證管理辦法)

Pursuant to the Regulations on the Safety Administration of Hazardous Chemicals (危險化學品安全管理條例) which were promulgated by the State Council and came into effect on 15 March 2002, production, management, storage, transport and use of hazardous chemicals and the disposition of waste hazardous chemicals within the territory of the PRC shall be governed by these regulations, laws and other administrative regulations of the PRC on production safety.

- Enterprises manufacturing hazardous chemicals which are established according to law must apply to the department in charge of quality control of the State Council for the licences for the production of hazardous chemicals. No production shall be commenced unless the licence for the production of hazardous chemicals is obtained.
- The production conditions of the units engaged in the manufacture of hazardous chemicals must fulfill the national standards and the relevant provisions of the PRC, obtain the corresponding licences according to the provisions of the relevant laws and regulations of the PRC, and establish and improve the rules and systems of safety control of the use of hazardous chemicals, so as to guarantee the safety use and control over dangerous chemicals.
- The PRC government carries out the licensing system for dealing in hazardous chemicals. No unit or individual may deal in hazardous chemicals without such licences.

Pursuant to the Measures for the Administration of Operating Licences for Hazardous Chemicals (危險化學品經營許可證管理辦法) which were promulgated by the National Economic and Trade Commission, which was later abolished in 2003 and whose responsibilities were assumed by the Minister of Commerce and the NDRC, every enterprise must obtain operating licences for hazardous chemicals before it engages in the retail and wholesale business of hazardous chemicals.

Production Safety Law of the PRC (中華人民共和國安全生產法) and Regulations on Production Safety Licence (安全生產許可證條例)

Production Safety Law of the PRC (中華人民共和國安全生產法) promulgated by the Standing Committee of the National People's Congress on 29 June 2002 which lays down the framework for the requirement, supervision and enforcement of safety standards in production. The enterprises involved in mining and construction or manufacturing dangerous chemicals, firecrackers and civil-used explosive equipments shall obtain the work safety licence before the production starts.

Pursuant to the Regulations on Production Safety Licences (安全生產許可證條例) which were promulgated by the State Council and came into effect on 13 January 2004, the PRC government carries out a licensing system for safety standards for mining businesses, building companies and other enterprises producing hazardous chemical products, fireworks and/or civil demolitions.

- No enterprises may engage in production activities without work safety licence.
- The valid period for a work safety licence shall be three years. If a work safety licence needs to be extended upon its expiration, the enterprise shall carry out procedures for extension at the original issuance and administration organisation of work safety licence

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at least 3 months before the expiry of the work safety licence. If an enterprise strictly follows the relevant laws and regulations on work safety and is free of any fatal accident during the valid period of its work safety licence, the work safety licence, shall be approved and extended for another 3 years upon expiry by the original issuance and administration organisation of safe work safety licence without re-examination.

Environmental Protection Law of the PRC (中華人民共和國環境保護法)

Pursuant to the Environmental Protection Law of the PRC (中華人民共和國環境保護法) adopted at the 11th Meeting of the Standing Committee of the Seventh National People's Congress on 26 December 1989 and with effective on the same day, the Administration Supervisory Department of Environmental Protection of the State Council (國務院環境保護部) set out the national guidelines for the discharge of pollutants. The people's governments of provinces, autonomous regions and municipalities may also set their own guidelines for the discharge of pollutants within their own provinces or districts in the event that the national guidelines are inadequate.

- Installations for the prevention and control of pollution at a construction project must be designed, built and commissioned together with the principal part of the project. No permission shall be given for a construction project to be commissioned or used until its installations for the prevention and control of pollution are examined and approved by the competent department of environmental protection administration.
- If an enterprise fails to report and/or register the environmental pollution it causes, it will receive a warning or be penalized. Any enterprise that fails to restore the environment or remedy the effects of the pollution within the prescribed time will be penalized or have their business licences terminated. Furthermore, if an enterprise has polluted and endangered the environment, it must bear the responsibility for remedying the danger and effects of the pollution, as well as compensate any losses or damages suffered as a result of such environmental pollution.

Prevention and Control of Atmospheric Pollution Law of the PRC (中華人民共和國大氣污染防治法)

Pursuant to the Prevention and Control of Atmospheric Pollution Law of the PRC (中華人民共和國大氣污染防治法) revised and adopted at the 15th Meeting of the Standing Committee of the Ninth National People's Congress of the PRC on 29 April 2000 and with effective on 1 September 2000, new construction projects, expansion or reconstruction projects which discharge atmospheric pollutants shall be governed by the regulations concerning environmental protection.

- An environmental impact statement (the "**Statement**") on the project to be constructed shall include an assessment of the atmospheric pollution the project is likely to produce, its impact on the ecological environment and the corresponding measures for prevention and control. The Statement shall be submitted, according to the specified procedure, to the administrative department in charge of environmental protection for examination and approval.

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- When a construction project is to be put into operation or to use, its facilities for the prevention of atmospheric pollution must be checked and accepted by the administrative department in charge of the environmental protection. If a construction project does not fulfill the requirements specified in the regulations concerning environmental protection, it shall not be permitted to put into production or to use.
- Units that discharge atmospheric pollutants must, pursuant to the provisions of the administrative department in charge of environmental protection under the State Council, report to the local administrative department in charge of environmental protection its existing discharge and treatment facilities for pollutants and the varieties, quantity and density of pollutants discharged under normal operation conditions, and provide the relevant technical data concerning the prevention and control of atmospheric pollution.

Prevention and Control of Water Pollution Law of the PRC (中華人民共和國水污染防治法)

Pursuant to the Prevention and Control of Water Pollution Law of the PRC (中華人民共和國水污染防治法) which was adopted at the 32nd session of the Standing Committee of the tenth National People's Congress of the PRC on 28 February 2008 and came into force on 1 June 2008, discharge of water pollutants shall be within the state or local standards for the discharge of water pollutants and indicators for the total discharge control of major water pollutants.

- Enterprises and public institutions which directly or indirectly discharge industrial waste water or medical sewage to waters are required to obtain the pollutant discharge licences before discharging waste water and sewage water. The entities operating the centralized disposal facilities for city and town sewage shall acquire discharge licences as well.
- The specific measures and implementation steps for sewage discharge permission shall be prescribed by the State Council. All enterprises and public institutions are prohibited from discharging the industrial waste water and sewage to waters without the pollutant discharge licence.
- The buildings, renovations and enlargement of construction projects directly or indirectly discharging pollutants to waters and other water establishments shall be subject to environmental impact assessment.
- The facilities of the construction project for the prevention and control of water pollution shall be designed, constructed and put into service with the main work concurrently. The facilities for the prevention and control of water pollution shall be checked and accepted by the competent department of environmental protection; where the facilities turn out to be unqualified upon examination, the construction project shall not be put into production or service.

The Policy on Natural Gas Utilisation

The Policy on Natural Gas Utilisation (the “**Policy**”) issued by NDRC on 30 August 2007 sets out the following restricted industrial catalogues of natural gas usage for those enterprises using natural gas in their chemical production:

1. expansion projects using natural gas as raw materials and the projects of synthetic ammonia using natural gas as raw materials instead of coal in the established synthetic ammonia factories (已建的合成氨廠以天然氣為原料的擴建項目、合成氨廠煤改氣項目);
2. C1 chemical projects using methane as raw materials whose first products including acetylene, chromethane and etc. (以甲烷為原料，一次產品包括乙炔、氯甲烷等的碳一化工項目); and
3. newly established synthetic ammonia projects using natural gas as raw materials (新建以天然氣為原料的合成氨項目).

The Policy further sets out the following prohibited industrial catalogue of natural gas usage for enterprises whose chemical production activities are based on natural gas:

1. newly established or expansion projects for producing methanol by natural gas (新建或擴建天然氣制甲醇項目); and
2. projects for producing methanol by natural gas instead of coal (以天然氣代煤制甲醇項目).

Our PRC legal advisers, Haihua Yongtai Law Firm, confirmed that there are no related regulations in the PRC prohibiting or restricting the enterprises using coal as raw material in the chemical productions.

Preferential Policies and Regulations on China’s Fertiliser Industry

As fertilisers are important agricultural materials and play a vital role in China’s agriculture industry, the PRC government has implemented a series of economic and regulatory measures to promote the production, trade and usage of fertilisers to ensure sufficient supplies of fertilisers in the domestic market with stable prices at affordable levels for local farmers.

Preferential policies for the production and transportation of fertilisers

— VAT Exemption

On 20 July 2001, the Ministry of Finance PRC and the State Administration of Taxation jointly promulgated the “*Notice of Value Added Tax Exemption Policies on Agricultural Production Materials*” (《關於若干農業生產資料徵免增值稅政策的通知》). According to the Notice, the following fertilisers were exempted from VAT since 20 July 2001: (a) all nitrogen fertilisers except urea, (b) all phosphate fertilisers except diammonium phosphate (as DAP), (c) potash, and (d) compound fertilisers which mainly use VAT-exempted fertiliser as raw materials. Urea producers would enjoy 100% VAT rebate in 2001 and 50% VAT refund starting from 2002.

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On 23 May 2005, the Ministry of Finance PRC and the State Administration of Taxation jointly promulgated the “*Notice of Provisional Exemption of VAT on Urea Products*” (《關於暫免徵收尿素產品增值稅的通知》). Urea producers have begun to enjoy full VAT exemption since 1 July 2005.

— *Preferential Electricity Rates*

On 21 December 2003, the NDRC increased electricity rates for commercial and industrial users by RMB8 cents per Kwh while keeping the rates for fertiliser producers unchanged.

On 26 March 2004, NDRC promulgated the “*Notice of Reinforcing Supervision Over Fertiliser Prices*” (《關於進一步加強化肥價格監管的通知》), requesting provincial development and reform commissions and pricing bureaus to implement preferential electricity rates for fertiliser producers. In May 2005, the Development and Reform Commission of Henan Province promulgated the “*Notice of Strengthening Administration over Preferential Electricity Rates for Fertiliser Production*” (《關於加強化肥生產優惠電價管理的通知》), reaffirming the implementation of preferential electricity rates to fertiliser producers in Henan Province.

On 29 June 2008, the NDRC promulgated the “*Notice of Increment of Electricity Price of Central China*” (《關於提高華中電網電價的通知》) that the scope would exclude the electricity price of household, agriculture and manufacture of fertiliser.

On 18 November 2009, the NDRC further promulgated the “*Notice of Adjustment of Electricity Price of Central China*” (《關於調整華中電網電價的通知》), to increase the electricity in Central China including Henan Province.

According to CNCIC Report, China’s fertiliser producers currently enjoy preferential electricity rates, which are approximately RMB10–30 cents per KWh lower than that charged on other normal industrial users.

— *Preferential Railway Freight Rates*

On 30 June 2004, the NDRC and the Ministry of Railways PRC jointly promulgated the “*Notice of Reaffirming Preferential Railway Freight Rates for Fertiliser Transportation*” (《關於進一步明確農用化肥鐵路運價優惠政策的通知》), publishing the catalogue of fertiliser products eligible for preferential freight rates (《實行鐵路優惠運價的農用化肥品種目錄》) and authorizing provincial price supervisory authorities to work out the details of preferential freight rates.

According to the latest railway freight rate list (鐵路貨物運價率表) promulgated by Ministry of Railways PRC on 23 June 2008, the railway car load rates (整車運價) comprise two components: a fixed base rate so called Base Price I (基價1) and a variable rate upon the mileage so called Base Price II (基價2). Base Price I for fertiliser was RMB4.40 per ton compared to RMB5.70 per ton for other normal goods and Base Price II for fertiliser was RMB0.0305 per ton-kilometer compared to RMB0.0336 per ton-kilometer for other normal goods.

— *Preferential natural gas prices for natural gas based fertiliser producers*

China’s natural gas based urea producers have been enjoyed preferential natural gas prices. On 8 November 2007, NDRC published the “*Notice of Natural Gas Prices Adjustment*” (《關於調整天然氣價格有關問題的通知》), by which the gas prices for normal industrial users were increased by RMB400 per 1,000 m³ of natural gas, while the gas prices for fertiliser producers and residential users remained unchanged.

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On 30 August 2007, NDRC promulgated the “*Policies on Natural Gas Utilisation*” (《天然氣利用政策》), which defined the central government’s policies on how to optimise the utilisation of natural gas in future by classifying the utilisation fields into four categories, namely encouraged items, permitted items, restricted items and prohibit items. New natural gas based ammonia facilities were classified as a restricted item, which were only allowed where (i) there was excess natural gas supply after taking into account encouraged projects and permitted projects, or (ii) local natural gas supply could not be transported to other regions. Existing coal-based ammonia facilities were prohibited from transforming to natural gas based ones. The government also reiterated its commitment in ensuring stable natural gas supply for existing natural gas based fertiliser facilities in the long term.

Price control on fertilisers

On 17 November 2004, NDRC, joined with Ministry of Finance, Ministry of Agriculture, Ministry of Commerce and State Administration of Taxation, which issued the “*Notice on Perfecting Production, Supplying of Fertiliser and Enforcing the Administration on Fertiliser Prices*” (《關於做好化肥生產供應工作加強價格監管的通知》) to impose strict control over fertiliser prices. The national government guide ex-factory price of urea had been raised to RMB1,500 per ton from RMB1,400 per ton since 1998 for large nitrogen producers with annual capacity of more than 300,000 tons with upward limit for urea price adjustment of 10%. Since 1 January 2006, the NDRC and Ministry of Finance PRC continued to set guiding ex-factory price for large nitrogen producers with annual capacity of more than 300,000 tons while relaxing the upward price increase limit from 10% to 15%.

On 24 January 2009, the NDRC and Ministry of Finance PRC jointly promulgated the “*Notice Regarding Reform of Fertiliser’s Pricing Policies*” (《關於改革化肥價格形成機制的通知》) to remove the price control on nitrogen and phosphate fertilisers and allow the market to determine their prices.

Tariffs on import and export of fertilisers

The PRC government has actively implemented comprehensive measures to adjust the import and export of fertilisers and their raw materials.

On 16 March 2004, the PRC government announced to remove the VAT rebate and impose tariffs on export of urea so as to ensure sufficient domestic urea supply.

From 1 January 2005 to 31 May 2005, export tariff on urea was RMB260 per ton. From 1 June 2005 to 31 October 2005, export of urea was subject to a tariff rate of 30%. From 1 November 2005 to 31 December 2005, export tariff on urea was reduced to 15%.

From 1 January 2007 to 30 September 2007, urea export had been imposed by a tariff of 30%; and from October to December, the urea export tariff was subject to 15%.

At the beginning of 2008, the base tariff for urea export was set at 30% from January to March, 35% from April to September and 25% from October to December. On 20 April 2008, the Ministry of Finance PRC imposed an additional special tariff of 100% on urea export in order to stabilise domestic urea price when overseas urea prices had soared driven by oil and gas prices. On 30 August 2008, the Ministry of Finance PRC increased the special tariff from 100% to 150% to further control urea export. However, as the overseas fertiliser prices started to drop since September, on 13 November 2008, the Ministry of Finance PRC announced the reduction of

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export tariffs on urea with effect from 1 December 2008. Special tariff for urea was cut from 150% to 75% only for peak seasons, and base tariffs were set at 35% for peak seasons and 10% for low seasons. Thus urea's total export tariff, including both base tariff and special tariff, was reduced from 185% to 110% during peak seasons and from 25% to 10% during low seasons. Peak seasons for urea are defined as (i) from February to June and (ii) from 1 September to 15 November.

State Fertiliser Reserve System

The PRC central government has started to build up fertiliser reserve system by purchasing fertilisers from selected producers since 2004 with initial reserve at state level totalling around 6 million tons. On 12 January 2005, the NDRC and the Ministry of Finance PRC jointly promulgated "*Administrative Measures on Commercial Fertiliser Reserve during Low Seasons*" (《化肥淡季商業儲備管理辦法》).

On 18 May 2009, the State Council announced "*Reorganization and Stimulus Package for Petrochemical Industry*" (《石化產業調整和振興規劃》), reiterating the government's determination to further develop stockpiling system for chemical fertilisers at both state level and local level, to better regulate fertiliser supplies through lull and peak seasons.

China's state reserve of fertilisers was estimated to be approximately 11 million tons at the end of 2008, increased by approximately 3 millions tons as compared to the prior year.