THINK TANK REPORT: LAW AND PRACTICE UNDER THE BELT & ROAD INITIATIVE V

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Artwork: The Plans of “Seeds” – Sprouting by Du Feichen

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PREFACE

The Belt and Road Initiative (BRI), in pursuit of open, inclusive and win-win cooperation, is a significant strategy proposed by China to address global challenges, promote common prosperity, and build a community with a shared future for mankind. Eight years after the implementation of the BRI, Chinese enterprises have greatly benefited from their "going global" endeavours, and are now on track for high-level and high-quality development.

It is an important mission of Chinese lawyers to provide a solid legal service guarantee for the BRI. King & Wood Mallesons (KWM), a well-recognised legal service brand in China and Asia, cherishing the original intention of assisting Chinese enterprises to move toward the international market, has always taken serving the BRI construction as its mission and duty.

From the meandering Mekong River to the stretching Central Asian highlands and Eastern European plains, from the natural scenery along the Red Sea to the humane landscape of countries in the Middle East and South Asia, KWM has accompanied Chinese enterprises in exploring overseas markets, pursuing a dream for the future accomplishments. We have witnessed that the projects we get involved in have contributed to local progress, like the transportation infrastructure crossing mountains, rivers and seas to become a link connecting different regions; energy and power projects lighting up thousands of households and reshaping the contours of urban and rural areas; communication projects facilitating information exchange and enhancing interpersonal connections; industrial parks provide more employment opportunities for the local people, injecting vitality into regional economic development. The year 2021 saw major progress in a wide array of our projects and legal cases, including the China-Laos Railway project, the landmark project of the BRI, the Matiari-Lahore HVDC Transmission Line project in Pakistan, and the successful completion of financing of the Bodu Akali Power Station project in Bangladesh. KWM, in representation of different customers, has also won a number of BRI international arbitration cases.

In 2021, the KWM Belt & Road Center for International Cooperation and Facilitation and KWM International CloudOffices, gathering industry experts, successfully held a seminar on "International Business in the New International Situation", focusing on overseas energy infrastructure, cross-border financing, cross-border dispute resolution and other issues in the post-pandemic era. The seminar also discussed how to help Chinese enterprises better understand international rules, deeply tap and participate in international market development, and build consensus concerning the high-quality development of the BRI.

KWM has been closely following the legal developments and practices under the BRI. Since 2017, KWM has successively issued the Series, Think Tank Report: Law and Practice under the Belt and Road Initiative. As the fifth installment of the Series, this Report is authored by KWM lawyers focusing on investment, financing, construction and projects, M&A, trade, compliance, and dispute resolution, presenting their experience and insights from different perspectives. This Report is composed of "Overview" and "Introduction by Countries". The first part covers hot topics in new infrastructure and energy transition such as RCEP, offshore wind power, hydrogen energy, liquefied natural gas, commercial satellite launch, and our thinking and analysis on practical legal issues such as new EU regulations on subsidies and project dispute resolution. The second part focuses on the market development, legislative developments and practices in key BRI countries and industries. Hopefully, this Report will be of some reference for you to tap into a specific market.

We believe that in the process of global economic recovery and green transition in the post-pandemic era, pursuing high standard, people-centered and sustainable development will continue to deepen the BRI international cooperation. Wind power, photovoltaic, energy storage and other clean energy fields will usher in more business opportunities, and the digitalization- and information-based new infrastructure has great development potential. Chinese and foreign enterprises will have closer and wider cooperation in the fields of health care, clean energy and new infrastructure. Facing the new market landscape and challenges, KWM will keep adhering to the values of collaborative spirit and professionalism, and continue to support our clients in achieving steady and sustainable growth. We will join hands with more Chinese and foreign players under the BRI, and work together to promote the construction of a healthy, green, digital and clean Silk Road. We hope that this Report will be of inspiration and help.

TIAN WENJING

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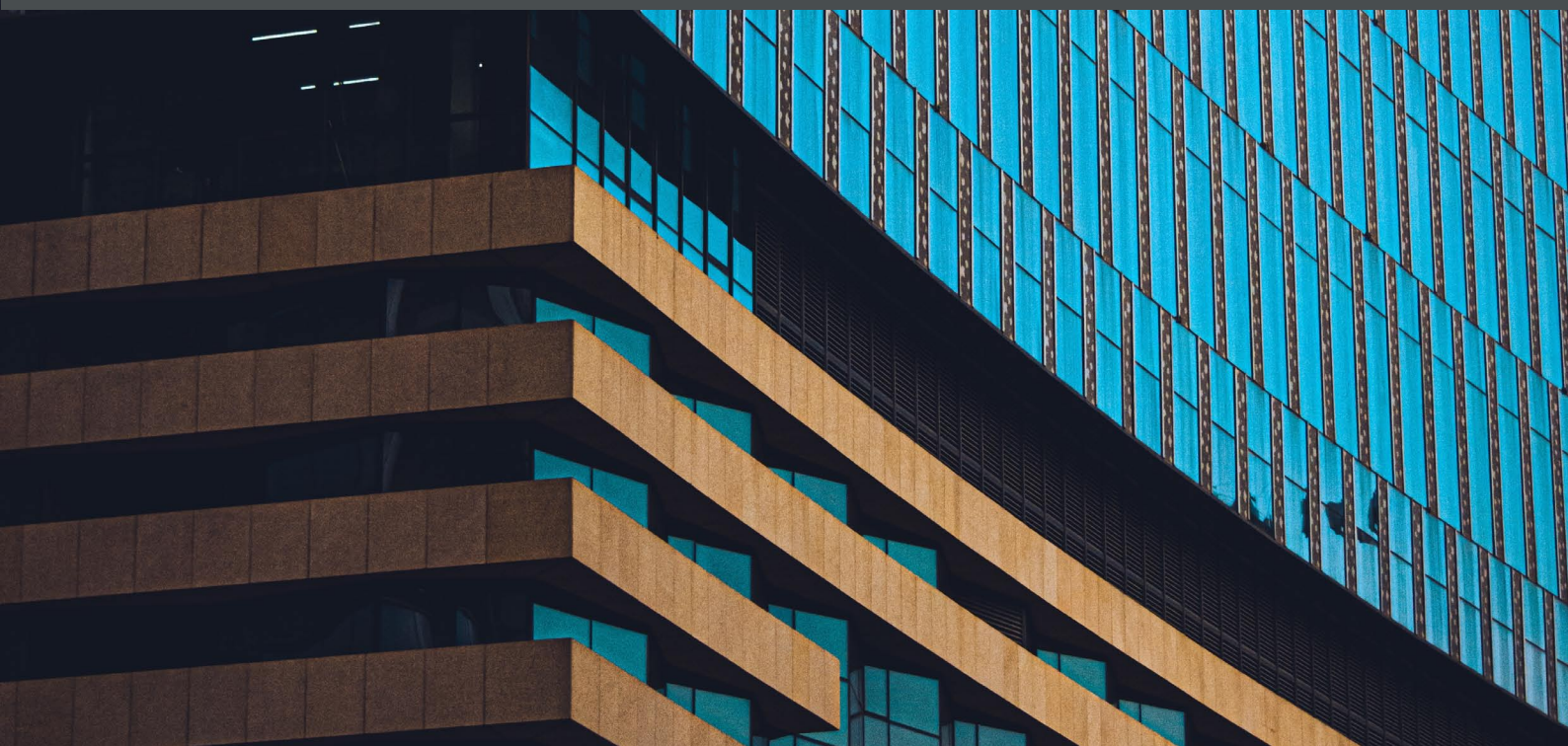

CONSTRUCTION LEGAL ISSUES INVOLVING STATE-OWNED COMPANIES AND CONTRACTORS ON THE BRI

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The Belt and Road Initiative (BRI) is improving connectivity between China and other regions of the world through the development of better infrastructure, trade and investment links. Since its launch in 2013, the BRI has encompassed large infrastructure projects in what can be challenging jurisdictions legally and practically for contractors. These are large-scale, long-term and capital-intensive projects in jurisdictions with very different legal, political and cultural traditions from China.

A feature of the BRI has been the involvement of Chinese state-owned enterprises (SOEs) as sponsors, contractors and lenders to projects. In this chapter, we focus on some of the issues that SOEs should consider when involved in BRI projects particularly as contractors. We draw out some of the risks and means for mitigating those risks through prudent contracting.

The political, operational and legal risk associated with many BRI projects means that claims are bound to arise, highlighting the necessity of paying close attention to the dispute resolution clause and modifying it where required.

In addition, we look at how SOEs can take advantage of investment treaty protections when involved in BRI projects. To date, South-East Asia, West Africa and Central Asia are the regions in which most BRI disputes have occurred, as these are the regions which have attracted most Chinese investment and construction companies.

Finally, we conclude with a case study on the challenges for SOE contractors in one region, the Middle East, to demonstrate the need for SOEs to involve international counsel with the experience and skill to navigate the challenges of a particular region.

I. The key risks in project and financing documents for infrastructure projects

SOEs participate in BRI projects as sponsors, contractors and lenders. The development of a BRI project will require SOEs to enter into various

contracts which typically include, for government-contract projects, a concession/BOT agreement, construction contracts and financing documents. We set out below some of the key legal issues which apply in relation to these documents and how to mitigate them in the context of BRI projects.

(I) Concession/BOT agreements

- **Project procurement:** SOEs are often involved in BRI projects at an early stage and their teams will spend substantial time on the ground, leading to the establishment of direct relationships with the authorities in charge. Given the time invested in developing these relationships, the possibility to be awarded a project by direct negotiations, rather than through a tender process, can be very tempting–it is quicker and provides certainty. There are also circumstances where SOEs are invited by the host country' s government to enter into a contract without a tender in order to speed up project procurement. However, the host country' s law may require a tender process. The breach of such a requirement can be fatal to a project and lead to its termination. Even if no tender is required, carrying out one will be perceived as best practice and may help to mitigate the risks on the project of cancellation due to changes of government policies or political regime. If a project is nevertheless awarded by direct negotiations, an alternative mitigant is to have the project and contractual arrangements approved by the host country' s parliament.

- **Legal gaps:** comprehensive, long-form concession/BOT agreements are often attractive to sponsors as they allow for gaps or uncertainties in the host country' s legal and regulatory framework to be dealt with in a single legal instrument. Special consideration should be given to ensuring that the concession/BOT agreement addresses these gaps in a clear and understandable manner, while complying with local law. In some cases, addressing these gaps may require amendments to existing regulation or legislation, and even the enactment of a project-specific law or decree.

- **Counterparty risk:** the identity of the counterparty (grantor) to the concession/BOT agreement will often be a determining factor in the project sponsors' ability to raise finance on a limited recourse basis. Some SOEs tend to think of local government instrumentalities, agencies and authorities as emanations of a country and are happy to simply deal with the agency assigned to lead the project by the host country' s government. However, in some countries there are government agencies with a better credit rating and contract implementation track record than others. This will be a primary concern for lenders. Depending on the circumstances, addressing counterparty credit risk might require the issuance of a government guarantee, which can be a lengthy process. Credit and reputational checks should therefore be carried out at an early stage so that any deficiencies can be addressed before execution of the relevant concession/BOT agreement.

- **Governing law:** in a number of countries covered by the BRI, investors and financiers will seek to use a foreign law as the governing law of concession/BOT agreements to limit the risk of a legislative change to the concessionaire' s rights or grantor' s obligations. However, this is very rarely agreed by host governments and grantors, who usually insist on the host country' s domestic law being the governing law. The choice of arbitration forum (discussed below) will also be driven by the concessionaire' s goal to be able to effectively enforce any award it may obtain against the host government or grantor.

(II) Construction contracts

- **Risk allocation in intragroup contracts:** it is relatively common for SOEs who operate in the construction space to sponsor a project in order to secure the award of the construction contract. Such sponsorship can take the form of a minority investment, majority investment or even sole sponsorship. When acting as majority investor or sole sponsor, some SOEs will often document the relationship between the project company and the contractor

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entity through standard intragroup construction contracts. These can differ from internationally accepted turnkey contracts both in terms of style, passthrough of obligations and risk allocation. Sponsors should be aware that the resulting project documents package can be unattractive to lenders (including those lenders which are also SOEs) and should seek to balance the interests and the risk allocation as between the different entities involved to avoid the risk of having to amend or reopen the commercial terms of agreements at the financing stage.

- **Governing law:** key construction agreements in BRI projects are usually governed by a foreign law. To ensure that such a choice of law will be effective, sponsors and contractors should confirm at an early stage whether there are any mandatory public policy rules that apply to construction contracts in the host jurisdiction, such as tendering, pricing and payment requirements. English law is the most common choice. In some recent projects, SOEs have chosen Chinese law as the governing law of some of the construction agreements. While in principle this should not be a problem, this can complicate the financing process if sponsors plan to source funds from international commercial lenders or multilaterals, as these types of lenders will be less familiar with the use of Chinese law for these contracts.

(III) Financing agreements

- **Validity of host country support:** if the financing is supported by the host government or the public sector (e.g. guarantee or preferential taxation terms), lenders will want to ensure that all applicable procedures have been complied with before the relevant contracts are executed by the government or public sector entities.
- **Governing law and dispute resolution:** the financing documents for BRI projects tend to follow market precedents based on LMA or APLMA language. These documents will most often be governed by English law.

(IV) General contracting tips

- **Ensuring valid execution:** when executing documents, our firm' s practice is to recommend advance checking that the execution process and wording meets the requirements of: (1) the place of incorporation of the foreign company; (2) the governing law of the document; and (3) the place of execution.
- **SAFE registration of guarantees:** according to *Provisions on Foreign Exchange Control for Cross-border Security*, promulgated by the State Administration of Foreign Exchange (SAFE), various securities (such as guarantees issued by certain SOEs and their parent companies)

are subject to registration with SAFE. The registration needs to be submitted to the relevant local branch of SAFE in the domicile of the security giver within 15 business days following the signing of the Deed. SAFE will issue a registration certificate upon the completion of the registration. Failure to do so may substantially reduce or even negate recoverability under the security.

II. Dispute resolution options

The dispute resolution clause merits its own special attention, particularly as many participants on the BRI overlook it at tender time and it often gets addressed last in contract negotiations. When one of our SOE clients was asked why it had chosen New York law and Singapore arbitration, it confessed that it hadn' t even looked at the clause. Another international client had taken a precedent off Google for London arbitration. Concessions are sometimes made by clients over the dispute resolution clause in negotiations over other contractual terms without fully understanding the consequences of the choices made when it comes to enforcement of their rights.

A well-considered and drafted dispute resolution clause ensures that disputes are resolved:

- before an independent tribunal in a neutral forum – critical in a cross-border context;
- more efficiently by avoiding expensive jurisdictional battles and time-wasting debates at the start of the dispute. For example, many arbitration clauses fail to specify the law of the arbitration agreement (which can be different to the governing law), how many arbitrators should be appointed and the language that should be used; and
- in a manner such that the judgment or award can be enforced at the end.

III. International arbitration should be the first choice

Of all the available forums, international arbitration is the first choice for BRI contracts. It is an optimal balance between fairness, efficiency, and enforceability. It gives SOEs the option to have their dispute resolved by a tribunal sitting in a neutral third state that includes an arbitrator of their choice. As the arbitration proceedings are seated in a neutral third state, the proceedings are governed by the laws of that third state and unlikely to be influenced by owner-state local protectionism. After the award is issued, any challenge to set aside the award has to be heard by the courts of the seat in the neutral third state, which means that the award is less likely to be overturned (provided the seat chosen is a pro-arbitration jurisdiction). While most of the BRI contracting states are also contracting states to the New York Convention, contractors sometimes face difficulties in enforcing the award in the local courts against the local party – this can be minimised by ensuring that local laws are taken into account when drafting the arbitration clause and getting good advice throughout the process.

The key choices to be made in arbitration clauses are:

- **Seat:** in which jurisdiction should the arbitration be seated? How good is the arbitration law? How good are the courts which will support the arbitration process and consider any application to set aside the arbitration award? Are interim measures available? Will I be able to enforce an award from this jurisdiction (as a minimum the seat should be in a New York Convention state)?
- **Arbitration commission/institution:** is it acceptable to both parties? Is it recognized internationally? How efficient is it? How good is its panel of arbitrators?
- **Procedural rules:** do the institutional rules allow for consolidation and joinder? Do the institutional rules include emergency arbitrator provisions for urgent interim relief? What is acceptable to both parties?

Most importantly, the Chinese SOE should push for the arbitration to be seated in a neutral third state. Arbitration seated in the local host state can be very difficult as the arbitral proceedings are subject to local court supervision, which increases the chances of local protectionism. In some countries such an arbitration may be considered a domestic arbitration and may be subject to a different legal regime for challenges and enforcement. Any challenge to the award will be heard in the courts of the host state. If the foreign party is fortunate enough to obtain an award in its favour, the foreign party is likely to face resistance when trying to enforce that award in the host state against the local company and the grounds for resisting enforcement could be wider than those in the New York Convention. The obligations in the New York Convention only apply to the enforcement of arbitration awards made in foreign jurisdictions not domestic arbitration awards.

For international arbitration in a neutral third state, the arbitral institutions most favoured by Chinese construction companies (including Chinese SOEs) are SIAC, ICC, and HKIAC, and the most common seats are Singapore, Hong Kong SAR of the PRC, London and Paris. All of these are sensible choices being well-recognised international arbitration institutions with modern up-to-date rules and seats with pro-arbitration courts and well-understood legal frameworks. A recent survey of Chinese construction companies that operate overseas asked respondents to rank their choice of arbitral institution and seat by frequency of choice in the last five years. For arbitral institutions, SIAC was chosen 156 times, ICC 120 times, CIETAC 107 times, BIAC 93 times, and HKIAC 93 times. The most popular seats are Singapore, Beijing, Hong Kong, London and Paris. (See *The BRI Construction Dispute Resolution Mechanism Research Report* on 20 April 2021 published by the Beijing International Arbitration Center, China International Contractors Association and Tianjin University (BIAC Survey). The Report is available for download at: https://www.bjac.org.cn/news/view?id=3919.)

There are strategic advantages to some seats over others and not just for the Chinese SOEs. The BRI country which said "let them (investors) arbitrate here" failed to understand the benefits which, for example, a Hong Kong SAR of the PRC seated arbitration can bring to its own nationals, when doing business with PRC companies anywhere in the world. The key here lies in the special, unique arrangements which the Chinese mainland and Hong Kong governmental bodies have made to benefit arbitration in both legal systems. Not least, the mutual arrangement regarding interim measures, whereby during or even prior to a qualifying arbitration parties can seek interim asset freezing orders and other like protection in the mainland and Hong Kong courts. For Hong Kong, a qualifying arbitration means one administered by one of the named six key institutions, including HKIAC and CIETAC; for the mainland, it is an arbitration before a mainland arbitral institution "registered with the administrative department of justice of the relevant province, autonomous region or municipality directly under the Central Government" (Article 10 of the Arbitration Law). Due to those arrangements, we successfully obtained a USD 400 million asset preservation order in the Shanghai Financial Court right at the start of an arbitration in Hong Kong. Another unique arrangement concerns mutual enforcement of arbitration awards (with enforcement proceedings allowed simultaneously), and yet a third is a unique pilot scheme in certain parts of the mainland to permit the work there of Hong Kong court-supervised liquidators.

On the flipside, if the Chinese SOE wanted to avoid interim measures being taken in Chinese mainland it should choose Singapore as the seat of the arbitration. While interim measures are available in the Singapore courts to support arbitrations seated anywhere in the world and tribunals in arbitrations seated in Singapore can order interim measures, mainland courts cannot order interim measures for foreign seated arbitrations.

Singapore has a robust pro-arbitration legal framework, excellent courts and is the home of many internationally recognised counsel and arbitrators. It is not surprising that Singapore is now the most preferred seat globally (equal with London) and the most preferred seat in the Asia-Pacific region (see *2021 International Arbitration Survey: Adapting arbitration to a changing world* published by Queen Mary University of London and White & Case (Queen Mary Survey). Chinese parties are comfortable arbitrating in Singapore and using the SIAC – last year, as published in the SIAC Annual Report 2020, 195 new cases were filed at the SIAC involving Chinese parties (147 claimants and 48 respondents).

IV. What about litigation and other options?

A court judgment can be much harder to enforce in many jurisdictions. For example, Indonesia does not recognize and enforce foreign court judgments but is a signatory to the New York Convention on enforcing foreign arbitral awards. Courts in Chinese mainland have started to enforce some foreign judgments on the basis of reciprocity (including Singapore judgments) and Chinese mainland and Hong Kong have a mutual arrangement for the enforcement of each other' s judgments.

It is risky for Chinese SOEs to agree to local litigation, due to local protectionism and differences in the legal system and cultural environment. Furthermore, it can sometimes be difficult for Chinese SOEs to obtain quality legal services in the project' s host state to represent it in local litigation.

Often, lenders will request the benefit of a unilateral option to choose between court and arbitration if a dispute arises. An opinion from local counsel will be needed to confirm that such an option does not infringe public policy in the host country.

Other dispute resolution options that the Chinese SOEs have used in the past include high-level corporate negotiation, commercial mediation, and expert determination. The use of alternative dispute resolution (ADR) along with international arbitration is the most preferred option for dispute resolution internationally (59% of the respondents to the Queen Mary Survey chose international arbitration together with ADR as their preferred method of resolving cross-border disputes, 31% chose stand-alone international arbitration with only 10% preferring either litigation or ADR by itself as the preferred method) and we would expect SOEs to be no different from other parties in this regard.

V . Are many BRI disputes being resolved in Chinese mainland?

It is our experience, supported by public surveys, that BRI disputes between Chinese and non-Chinese parties in other jurisdictions are rarely resolved in China. (See BIAC Survey referred to above.)

Chinese SOEs usually act as the general contractor or sub-contractor in the BRI contracts. The owners are for the most part local SOEs or companies with strong local connections and considerable bargaining power. Very few contracts would designate disputes to be resolved in Chinese courts or arbitration administered by a Chinese arbitration institution in China for the obvious reason that the local owners would prefer to resolve the disputes at a place and under a legal system that they are more familiar with. If the imbalance of negotiating power is strong enough, the local owners would usually opt for litigation in their home court.

There are exceptions. First, we have seen contracts providing for disputes to be resolved by arbitration in China by a Chinese arbitration institution when the Chinese SOE acts as the lender or/ is financing the project and therefore has more negotiation power. It should be noted that this is not a common scenario, the respondents to the BIAC Survey reported that 81.36% of projects are financed by the owners.

Second, there are instances in which both contracting parties are overseas subsidiaries that are controlled/owned by Chinese SOEs, e.g. in the context of a sub-contracting agreement. In those cases, the contracting parties would be more willing to consider resolving the disputes in China, e.g. arbitration seated in China, or even in Chinese courts. The highest number of respondents (83.09%) to the BIAC Survey recorded that the reason why a Chinese mainland arbitral institution would be chosen to administer their arbitration would be if both parties were Chinese companies.

VI. Do Chinese SOEs enjoy state immunity?

What if a dispute occurs on the BRI which has to be arbitrated or litigated against a Chinese SOE? Can the SOE successfully avoid suit and/ or enforcement by claiming state immunity? What if the SOE expressly waived its right to

assert immunity? Is that watertight?

The legal doctrine of sovereign immunity, or state immunity, historically provided that a state is immune to the jurisdiction of foreign courts and the enforcement of court orders, even if the acts involved are commercial in nature, unless it chooses to waive such immunity. This is referred to as the doctrine of "absolute immunity". Not until the mid-20th century when governments became more active in commercial activities, was the doctrine condemned to be unfair to private companies. Since the 1970s, the US and some European countries switched to the doctrine of "qualified immunity" or "restrictive immunity" by codifying exceptions to limit the application scope with respect to, for example, commercial transactions, personal injuries, and patents.

The United Kingdom, Australia and Singapore all take a restrictive approach to state immunity, including that an agreement to arbitrate is a waiver of immunity, proceedings in relation to commercial transactions entered into by the state are not covered by state immunity and that judgments can be executed against state property that is used for commercial purposes. That said, it is advisable when contracting with a state party to include a clause that waives state immunity in relation to both proceedings and the execution of judgments and awards.

In contrast, the PRC still adheres to absolute immunity, which means that states must be immune from suit and enforcement even if the claims arise out of purely commercial activities. Does absolute immunity attach to a SOE? The answer can be readily found in a line of Hong Kong SAR of the PRC decisions tackling this point, given that Hong Kong follows the mainland practice on this topic. In Hong Kong, the Central People' s Government (CPG) constitutes the "Crown" for the purposes of the Crown Proceedings Ordinance (Cap. 300) and at common law (*Intraline Resources Sdn Bhd v The Owners of the Ship or Vessel "Hua Tian Long"* [2010] 3 HKLRD 611).

VII. Are Chinese SOEs covered by Crown immunity in Hong Kong SAR of China?

A SOE will not inherently attract Crown immunity. The Hong Kong courts will apply the "control test" to determine whether a SOE (or other body corporate related to the CPG) is afforded the same immunities as the CPG. The material consideration being the "control" the CPG has over that corporation, which involves two primary questions:

1. Could the corporation be said to be subject to the control of the CPG?

2. Is the corporation in question able to exercise independent powers of its own?

In answering these two questions the courts will consider a number of factual matters, the determination of which will be particular to the circumstances of each case (*Intraline Resources Sdn Bhd v The Owners of the Ship or Vessel "Hua Tian Long"* [2010] 3 HKLRD 611; [2017] HKCFI 1016).

To demonstrate how the "control test" will be applied in practice, the decision of *TNB Fuel Services Sdn Bhd v China National Coal Group Corporation* [2017] HKCFI 1016, which dismissed a SOE' s assertion of Crown immunity, is instructive. The court noted:

- The party asserting Crown immunity bears the onus of establishing its assertion.
- Any application of the "control test" was on a case-by-case basis, depending on the circumstances and the evidence available, but relevant factors were:
    - independent discretion enjoyed by the entity;
    - control exercised by the Crown as investor;
    - the separate legal personality of the entity;

- the power of the Crown to appoint and remove senior officers of the entity; and

- the financial autonomy of the entity

A letter from the Hong Kong and Macao Affairs Office stating that the SOE was an independent legal entity carrying out activities of production and operation on its own, with no special status or interests superior to any other enterprises, was not considered part of the CPG, was persuasive in defeating the assertion of Crown immunity.

VIII. Are Chinese SOEs covered by state immunity in Chinese mainland?

The practice is as above. It is worth further noting that moderate state interference does not grant sovereign immunity upon SOEs. Under the Assets Law, the state, as an investor is entitled to "profits on the assets and the rights to participate in significant decision making and choice of the management members". Therefore, to the extent that the degree of control imposed on the SOE by the state is deemed as an appropriate exercise of its power as an investor, the SOE will still be regarded as an independent business entity.

IX. What if the SOE provides a waiver of Immunity?

As stated above, in states that take a restrictive approach to state immunity it is possible to waive state immunity. For example, in the United Kingdom, Singapore and Australia, an agreement to arbitrate is a waiver and it is possible to agree contractually to waive immunity in relation to proceedings and the execution of judgments and awards.

By contrast, a waiver in itself will not provide adequate protection in Hong Kong and Chinese mainland.

The agreement to arbitrate is not itself a waiver. In the Congo decision (*The Democratic Republic of the Congo and others v FG Hemisphere Associates LLC FACV Nos 5, 6 and 7 of 2010*, 8 June 2011), the Hong Kong Court of Final Appeal held that an agreement to arbitrate is viewed purely as a contractual agreement and does not constitute a waiver of immunity.

A contractual agreement to waive immunity entered into prior to the commencement of proceedings is not an effective waiver. Rather, a party who holds immunity must waive its right to immunity in front of the court. In doing so, the party must waive both: (i) its jurisdictional immunity from suit; and (ii) the immunity of its property from execution (*The Democratic Republic of the Congo and others v FG Hemisphere Associates LLC FACV Nos 5, 6 and 7 of 2010*, 8 June 2011).

In very specific factual circumstances, the courts have held that a party can waive immunity through active participation in proceedings with knowledge of its right to claim immunity (*Intraline Resources Sdn Bhd v The Owners of the Ship or Vessel "Hua Tian Long"* [2010] 3 HKLRD 611).

X. Can SOEs take advantage of investor protection in bilateral and multilateral investment treaties?

As of 2020, there are 88 Bilateral Investment Treaties (BITs) in force between China and BRI nations as well as several Multilateral Investment Treaties (MITs). These allow investors to bring claims against BRI governments should their treaty-prescribed substantive investor rights be breached. Of these BIT contracting states, 71 are parties to the *Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (also referred to as Washington Convention), which facilitates international enforcement of arbitration awards between signatories. Chinese contractors are starting to assert their treaty rights with two recent claims against African states being reported (Ross, "Chinese company brings claim against Ghana", 11 February 2021, Global Arbitration Review).

International investment disputes can be administered by the International Centre for Settlement of Investment

Disputes (ICSID) as well as other institutions, such at the Permanent Court of Arbitration, depending on the provisions in the treaty.

Investment treaties typically provide several investment protections, including:

- **Fair and equitable treatment:** the obligation not only to foster a stable, predictable investment environment, but also to act fairly and transparently.
- **Compensation for expropriation** or nationalisation of investor' s assets by the state (be it direct or indirect).
- **Full protection and security**, which provides the positive obligation to protect investment by the exercise of reasonable care.
- **Non-discrimination** in taxes, fines, penalties, licences, permits and visa restrictions.
- **"Umbrella clauses"**, which incorporate into the BIT, by reference, obligations entered into between a host state and investors in other contracts.

It is necessary both to fall under the definition of "investment" and be viewed as a qualified "investor" in order to be protected by investment treaties. Jurisdictional challenges are common in investment treaty arbitration and a significant number of claimants fail to establish that they are investors or have an investment under the treaty.

Typically, the definition of "investment" is broad and non-exhaustive and can encompass financing and construction contracts.

In order to be viewed as a qualified "investor", one must be a national of a contracting state, but not nationals of the host state. To determine the nationality of the investor, some treaties look to the place of incorporation, while others look to the place from which substantial control of investments is directed. Some definitions of "investor", such as the Ghana-China BIT, explicitly cover SOEs; however, other older treaties are silent on whether SOEs are covered, and it will be a matter of treaty interpretation. Tribunals have held that SOEs undertaking commercial activities are covered by treaty protection, as you would typically see in a BRI infrastructure project (CDC Group plc v Republic of the Seychelles, ICSID Case No ARB/02/14, Award, 17 December 2003). It would be different if the SOE was undertaking governmental activities as an agent for the government.

To minimise risk exposure, SOEs should carefully check the BITs and MITs between China and the BRI host state where an investment is being made and their specific provisions to ensure that their investment will be protected. Care should be taken to ensure that the treaty is actually in force and check the BRI host state' s history of dealing with investor claims. BRI investors should choose the optimum investment structure from the beginning, as an investor is likely to not be covered should they try to structure an investment after a dispute arises in order to access treaty rights. For example, in the investment treaty dispute brought by Philip Morris Asia against Australia under the Hong Kong SAR of the PRC-Australia BIT, the tribunal found that it did not have jurisdiction as the dispute arose before Philip Morris Asia had an interest in the investments.

XI. Case study: Dispute avoidance and management in the Middle East for SOE contractors

Construction is an industry in which common legal issues regularly arise. In the Gulf region certain of these issues take on particular importance and we highlight below some of the key legal issues for an SOE contractor on BRI projects in the region. These illustrate the importance of having infrastructure lawyers with a good understanding of the region involved at an early stage.

(I). Powers of attorney

Although powers of attorney (POAs) are often a feature of doing business, whether in construction or otherwise, they are a critical requirement in the Gulf region.

Managers and other key persons at any contractor working on BRI projects in the region will need POAs to carry out their day-to-day duties when, for example, liaising with governmental bodies or commercial counterparties such as suppliers, sub-contractors, project owners, etc.

POAs in the region need to be in Arabic. Further, if a Chinese SOE is operating in the region via a branch rather than having established a local entity, it will need to arrange for POAs executed by a head office in China to be notarised and legalised, incurring time and monetary costs. This can potentially lead to challenges when seeking to change key personnel at short notice.

Finally, checking the POAs of owners or senior contractors is important to do for SOEs and other contractors. One strategy in the event of a dispute is to challenge the legitimacy of contracts or at least any arbitration provision in them on the basis that those executing the contract did not have the necessary authority. While becoming less common, it is always best to rigorously check the authority of signatories when entering into contracts.

(II). Protecting bonds

BRI projects just like other construction projects will in their contracts normally provide for the contractor to arrange for an advance payment and performance bond or guarantee.

Given the size and scope of BRI projects, such bonds will be substantial and if the owner calls in one or both bonds this can have very serious negative impacts on a contractor' s cashflow and banking relationships. Owners are aware of this, and so in the event of a dispute arising will call in one or both of these bonds as leverage or recourse.

Although the legal systems in the region technically provide ways to challenge such action, these are difficult in practice to successfully pursue. When considering their involvement in projects, contractors need to go into BRI projects in the region aware that recourse to these bonds is a real possibility and make decisions accordingly.

(III). Decennial liability

Like in many other jurisdictions and regions, the countries and jurisdictions of the Gulf region provide for decennial liability of contractors on a statutory basis. This liability cannot be contracted out of.

Given the nature of BRI projects, most of them would be likely to attract this liability which attaches, for example in the UAE, to the construction of buildings or other "fixed installations" where the construction or installation is expected to remain in place for a period of more than 10 years.

The high value and size of most BRI projects means that the joint liability with the architect for any defect threatening the stability or safety of a building could be very substantial.

Beyond planning for and being properly insured to address the risks of decennial liability, the high-profile nature of BRI projects also means that if any later problems arise with a project during the liability period, they may cause serious reputational damage to the contractors involved as well as financial liability.

(IV). Dispute resolution forum

While the various FIDIC books by default provide for disputes to be resolved via ICC-administered arbitration, SOE contractors should be aware that contracts for BRI projects in the region will often amend this to provide for disputes to be heard in local courts or resolved by arbitration administered by a local or regional arbitral institution.

Given that BRI projects also regularly relate to real property, the contracts involved will almost inevitably be governed by local law. This brings added risk as SOEs may not always be familiar with the local laws in the region or with the applicable procedures of local courts or rules of regional arbitration institutions.

(V). Enforcement

Another common legal issue for SOE contractors in the region is that enforcement of judgements or awards against owners is regularly a long and drawn-out process.

Cashflow is always a paramount issue for contracting businesses. Accordingly, SOEs need to be mindful that pursuing an owner for non-payment will incur not just the immediate legal costs during the dispute resolution process but that any monetary recovery if successful will likely take a further period of years and also involve additional legal costs.

Given the size and importance of BRI projects in the region, the counterparties/owners will also often be governmental bodies or possibly local SOEs themselves. Enforcing against such parties can often be even more drawn out and difficult than might normally be the case.

These difficulties are one of the many reasons that a negotiated settlement is generally the preferable route to resolving disputes.

Conclusion

Our concluding tip, for SOEs and their international partners alike, is to get the infrastructure lawyers in early, at tender time. A proper evaluation/mitigation of risk, drafting as recommended above and consideration of likely problems based upon legal experience should be a must-have on every BRI project, when compared to the millions of dollars in legal fees and the business relationship damage that can be occasioned by a dispute which could have been avoided, or at least better catered for at tender.[1]

[1] This article first appeared in CDR' s publication *Essential Intelligence: The Belt & Road Initiative*, September 2021

AN UPDATE ON INTERNATIONAL LEGAL POSITIONS-LIQUIDATED DAMAGES

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I. Introduction

In cross-border transactions, parties commonly insert a "liquidated damages" clause in their contracts. Such a clause clearly stipulates the amount of damages that the defaulting party shall pay if the contract is breached. The purpose is to deter parties from breaching the contract and to allow parties to contractually preagree on a measure of damages that may be difficult to prove once incurred, thereby providing parties with certainty and allowing parties to expedite the process of recouping losses.

In an M&A context, liquidated damages often would include, for example, break fees if a party fails to proceed with the transaction, or mandatory discounted buyouts if a party commits a prohibited act post-transaction. In a sale or supply of goods context, liquidated damages would include an agreed amount of compensation payable, withholding sum, or price reduction should a party fail to perform the contract. However, it should be noted that the ease and extent to which such clauses are enforceable depends to a large part on the governing law of the agreement, amongst other factors. While many jurisdictions allow in principle for liquidated damages to be claimed, contracting parties may find it easier to enforce liquidated damages clauses in certain jurisdictions than in others, given the difference in the precise legal tests used amongst them.

In this article, we briefly examine the current legal position with regard to the enforceability of liquidated damages clauses in four jurisdictions, namely the UK, Singapore, Hong Kong SAR of the PRC, and the PRC.

II. Legal positions under different jurisdictions

(I) UK

1. Previous position

Previously, whether a liquidated damages clause was enforceable in the UK depended on whether it reflected a "genuine pre-estimate

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of the likely loss" that the innocent party will suffer upon the defaulting party' s breach (*Dunlop test*)[1]. If it is, then such clause would be enforceable. If it is not, and the amount stipulated is instead an extravagant, unconscionable, or unreasonably large amount intended to "penalise" or "punish" the defaulting party, then such a clause would constitute a "penalty clause" which would be struck down by the court as being unenforceable.

In determining whether the liquidated damages clause represents a genuine pre-estimate of the likely loss, the court will determine whether the sum stipulated is "extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach." If it is, then the clause would necessarily be penal in nature and therefore be unenforceable. If it is not, then the clause would indeed be a genuine pre-estimate of likely loss – and this is the case even if the sum mandated to be paid is eventually in excess of the innocent party' s *actual* loss.

Subsequently, in ***Alfred McAlpine Capital Projects Ltd v Tilebox Ltd*** [2], the English Court reviewed the various cases on liquidated damages and concluded that a pre-estimate of damages does not have to be right in order to be reasonable. There must be a substantial discrepancy between the level of damages stipulated in the contract and the level of damages which is likely to be suffered before it can be said that the agreed pre-estimate is unreasonable. Where possible, the court should uphold contractual terms which fix the level of damages for breach.

2. Current position

In 2015, the UK Supreme Court passed a decision (*Cavendish*)[3] that reformulated the legal test with regard to liquidated damages and penalty clauses. A liquidated damages clause is only a penalty if it is a secondary obligation imposing a detriment on the defaulting party "out of all proportion to any legitimate interest of the innocent party in the enforcement of the *primary* obligation." Under this formulation, three components need to be considered:

- First, does the clause concern a *primary* obligation (i.e. the legal obligation to procure that the contractual promise be fulfilled) or secondary obligation (i.e. obligation arising from breaches of the primary obligation)?

  The difference is this: A clause concerning a primary obligation cannot be a penalty, whereas a clause relating to a secondary obligation may amount to a penalty (and may thus be struck down by the courts).

- Second, does the innocent party seeking to enforce the clause have a *legitimate interest*?

  In this regard, such legitimate interest can include wider commercial interests (i.e. need not be an interest in the financial compensation itself), which can depend very much on the facts and circumstances of each case. [4]

- Third, is the stipulated sum or remedy under the clause out of all proportion to such legitimate interest (i.e. is it exorbitant or unconscionable having regard to the innocent party' s interest in the performance of the contract)?

  Again, the determination in this regard will depend very much on the facts and circumstances of each case with reference to local practice (if available), and could ultimately be a value judgement by the court. In a negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach.

[1] Dunlop Pneumatic Tyre Company, Ltd v New Garage and Motor Company, Limited [1915] AC 79

[2] Alfred McAlpine Capital Projects Ltd v Tilebox Ltd [2005] EWHC 281; [2005] B.L.R. 271; 104 Con. L.R. 39 TCC

[3] Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Ltd v Beavis [2015] UKSC 67

[4] For example, a fellow shareholder has legitimate interest in ensuring that the founder-shareholder does not compete against the group where loyalty and personal relationships of the founder-shareholder were essential to the group' s business (as in *Cavendish*).

(II) Singapore

As a jurisdiction that has historically inherited the common law tradition and was much influenced by the English common law in traditional areas including contract law, while recognising that local jurisprudence is the only legally binding source of case law, Singapore courts often have regard to comparable English common law precedents in the continued development and refinement of its own laws.

In a very recent case (***Denka Advantech***)[5], the Singapore Court of Appeal had a chance to reconsider the legal position on penalty clauses. It affirmed the *Dunlop* test and declined to adopt the wider legitimate interest test developed in *Cavendish*, as the concept of "legitimate interest" was too general and could, depending on the facts and circumstances of each case, be utilized in a myriad of ways resulting in great uncertainty. The Singapore Court of Appeal did however affirm the pronouncement in *Cavendish* that the rule against penalties should be confined to only apply to secondary obligations (i.e. breaches of primary obligations).

(III) Hong Kong SAR of the PRC

Similar to Singapore, Hong Kong SAR of the PRC adopts the common law system which is historically based on English common law. Although English precedents are no longer binding, Hong Kong SAR courts will continue to seek guidance from them, especially those English Supreme Court cases which are influential in the world of common law.

The *Cavendish* test was applied in Hong Kong SAR by the Court of Appeal in *Bank of China* (*Hong Kong SAR*) *Ltd v Eddy Technology Co Ltd* (*Eddy Technology*)[6]. In this case, the relevant clause under the compromise agreement for the banking facilities provided for revocation of benefits and indulgence granted under the agreement upon default. The Court applied the *Cavendish* test and held that the defendants had no evidence to show[7] that the default provisions were extravagant, exorbitant or unconscionable. When the defendants were in breach of the agreement, there was nothing penal for the plaintiff to revert to its full rights as expressly provided for under the default clause.

Subsequent Hong Kong SAR cases[8] have since followed *Eddy Technology* and endorsed the reformulated legal test with regard to liquidated damages and penalty clauses in *Cavendish*, i.e., whether the clause imposed a detriment on the defaulting party that is out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation[9].

A recent Court of First Instance case (*Dragon Access Holdings Ltd v Lo Chu Hung*)[10] has further affirmed the position in *Eddy Technology* and recognized that the Cavendish test has formed part of the laws of Hong Kong SAR. The Court, again, applied the *Cavendish* test in determining whether the liquidated damages clause in the provisional sale and purchase agreement amounted to a penalty and held that the defendant had failed to adduce sufficient evidence to demonstrate that the stipulated remedies was extravagant, exorbitant or unconscionable in nature that could justify judicial intervention, having regard to other factors such as the consideration, the period for completion and the deposit amount for the transaction in question.

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[5] Denka Advantech Pte Ltd and another v Seraya Energy Pte Ltd and another and other appeals [2020] SGCA 119

[6] Bank of China (Hong Kong) Ltd v Eddy Technology Co Ltd [2019] 2 HKLRD 493

[7] The burden is on the defendant to establish that a clause is a penalty clause (Dragon Access Holdings Ltd v Lo Chu Hung [2020] HKCU 4002 § 95, Brio Electronic Commerce Ltd v Tradelink Electronic Commerce Ltd [2016] 2 HKLRD 1449 § 14)

[8] Dah Sing Bank, Ltd v Rich Star Investment Development Ltd & Ors [2020] HKCFI 1251, FWD Life Insurance Co (Bermuda) Ltd v Lam Chi Chuen Alpha[2019] HKCFI 2878

[9] Hsin Chong Construction Co Ltd [2019] HKCFI 1531

[10] Dragon Access Holdings Ltd v Lo Chu Hung [2020] HKCU 4002

(IV) PRC

Unlike common law systems which prohibit penalty clauses altogether, PRC law does not expressly prohibit the stipulation of a "penalty" in contract. However, certain limits are imposed – liquidated damages cannot be "excessively higher" than actual losses, and in practice an amount that is more than 30%[11] of the actual losses suffered by the innocent party may be considered as "excessively high" and may be mitigated by the PRC court which will look into the actual losses incurred and award a reduced amount. However, a plaintiff would still need to show proof of actual loss in practice, in order for the court to satisfy itself that the said 30% threshold had not been breached; this contrasts with the position under common law that actual loss is not inquired into, as a key idea behind liquidated damages clauses under common law jurisdictions is to save parties the trouble and difficulty of proving actual loss.

This position was previously set out in the PRC Contract Law[12], and is reiterated in the new PRC Civil Code[13] that recently came into effect on 1 January 2021 (which repealed certain specific laws including the PRC Contract Law but systematically integrated its contents).

(V) Comparison table & brief analysis

To summarise, we set out in table form below the current legal positions with regard to liquidated damages and penalty clauses in the various jurisdictions discussed:

	Jurisdiction			
	UK	Singapore	Hong Kong SAR of the PRC	PRC
Applicable Legal Test	*Cavendish* test: secondary obligation + legitimate interest + proportionality	*Dunlop* test: Genuine pre-estimate of likely loss	Follows the UK position and adopts the *Cavendish* test	Not excessively higher than actual loss (typically not more than 30%)

Comparing the above positions, while the UK and Hong Kong SAR of the PRC have evolved a different test as compared to Singapore, these are not entirely distinct tests, and the fundamental need to ensure that the clause is "compensatory" (and not penal) still applies. In actual application, a genuine pre-estimate of likely loss (as in *Dunlop*) would likely be a useful indicator of whether an impugned provision imposes a disproportionate detriment having regard to the legitimate interest (as in *Cavendish*), and vice versa.

On the other hand, the position under PRC law is relatively more straightforward and objective with the typical application of the said 30% threshold (subject, of course, to other factors and the specific facts of the case). However,

[11] Section 29, Interpretation II of the Supreme People' s Court of Several Issues concerning the Application of the Contract Law of the People' s Republic of China, High Court [2009] No.5. Note that this is only an indicator, and other factors to consider would include, for example, the severity and duration of the breach, any fault on the part of the innocent party, the legal entity of the innocent party (whether business or individual), etc

[12] Section 114, PRC Contract Law (now repealed)

[13] Section 585, PRC Civil Code

under PRC law, the parties at the time of contract will not have certainty as to the enforceability of a liquidated damages clause because ascertaining actual loss by its nature can only be done post-contract.

III. Implications and practical tips

With the above in mind, we set out below certain practical tips that enterprises that are engaged in, amongst others, international M&A deals, long-term sale or supply agreements and construction projects may find helpful.

When using UK or Hong Kong SAR of the PRC law (which apply the wider legitimate interest test as set out in *Cavendish*) as the governing law in your contracts, given that primary obligations fall outside the penalty regime altogether, potentially penal clauses should be drafted as being a conditional primary obligation (e.g. a conditional, primary obligation to pay), as opposed to being a remedy for breach of contract. Also, key areas of the deal where parties have a commercial interest should be identified and expressly stated in the transaction document, which may make establishing legitimate interest later an easier task.

When using Singapore law (which still applies the traditional *Dunlop* test) as the governing law in your contracts, in practice contracts are often drafted to expressly indicate that parties regard the liquidated damages amount stipulated to be a genuine pre-estimate of likely loss. While the inquiry is always one of substance over form, this may to a certain extent indicate to the court that parties are on equal footing and have freely negotiated for the same. Also, documenting the calculation of likely losses in support of how the stipulated compensation amount is derived, and stipulating different compensation amounts for varying types and severities of breach, will be helpful.

Under the common law generally, as a matter of legal principle, courts have also recognized that where parties had freely negotiated a contract under equal bargaining power with the benefit of legal advice, the clause concerned would have a stronger chance of being upheld. The purpose of the underlying transaction and the particular primary obligation breached must be considered to have a composite view of the contract and the nature of parties' relationship. Evidence and documentation on these could therefore potentially aid the court in arriving at the decision that the clause should be upheld.

In addition, given the difference in position between different jurisdictions with regard to whether penalties are enforceable, some of the provisions that are considered common and acceptable in a PRC law-governed contract may be unacceptable in a common law-governed contract. For example, a PRC lawgoverned contract may elect to use language such as "penalty fee" or "for the purpose of penalising", but use of such terms would generally be considered prima facie evidence of a "penalty" in common law jurisdictions, resulting in the clause not being upheld. It would thus be prudent to avoid such language in the drafting of a common law-governed contract.

Conclusion

We hope that the above provides a useful primer to you when negotiating various international contracts, in aiding you to assess which governing law may be more beneficial in each such contract, and in understanding what adjustments and specific negotiation points need to be considered. Of course, the prevailing circumstances and particular interests of each party in each case are critical. The same contractual concept can be interpreted differently depending on the governing law of your contract. Seek appropriate advice from a qualified and experienced lawyer to ascertain the meaning and implications of such term so as to best protect your rights and interests in each contract.

RCEP DRIVES CROSS-BORDER E-COMMERCE IN REGIONAL ECONOMY

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The Regional Comprehensive Economic Partnership Agreement (the RCEP) took effect on 1 January 2022. It marked the official establishment of a free trade area with the largest population, economic and trade scale and the greatest development potential in the world.

The RCEP will make zero tariffs possible for one third of China' s foreign trade, improve the trade facilitation and the business environment in the region, and drive the opening-up of relevant services and investment, thus greatly enhancing the welfare of the contracting parties and expanding the scale of trade between them.

For cross-border e-commerce enterprises, the RCEP is currently the highest standard free trade agreement (FTA) signed by China. Under the RCEP, they may participate in the cumulation of value of origin, use a unified rule system to reduce operating costs and the risk of uncertainty in operation. The import and export enterprises will greatly benefit from the RCEP.

In the context of the rapid development of new cross-border e-commerce formats, this article will discuss the impact of the RCEP on cross-border e-commerce in China, taking into account the latest development of international treaties.

I. Brief analysis of the key contents of the RCEP

(I) Reduction or elimination of customs duties

According to the Schedules of Tariff Commitments in the Annex to the RCEP, tariff concessions for trade in goods among the RCEP members are based on their commitments to reduce tariffs to zero immediately or within 10 years. Taking China for an example, the Schedule of Tariff Commitments of China involves 8,277 eight-digit HS Codes. By the 10th

year after the entry into force of the RCEP, the tariff imposed by China on about 80% of the goods with eight-digit HS Codes from the parties to the RCEP (the Parties) other than Japan will be reduced to zero; by the 20th year after the entry into force of the RCEP, the tariff for about 80% to 90% of the goods with eight-digit HS Codes from all the Parties will be reduced to zero.[1]

For enterprises exporting to Japan, the RCEP is beneficial for cross-border e-commerce enterprises to explore the Japanese market which had previously imposed high tariffs on Chinese imports. From 2006 to 2016, the weighted average tariff rate for Japanese imports from China had been higher than that for imports from other countries and regions around the world. After the signing of the RCEP, Japan will impose zero tariffs on 86% of imports from China. Of these, 70-80% of commodities in sectors such as electrical appliances, nuclear reactors, boilers, vehicles and their accessories, and medical devices will be tariff-free immediately after the signing of the RCEP, while almost all products in sectors such as clothing and textiles, furniture and plastic products will be tariff-free after the transition period.

For countries that have previously signed trade agreements with ASEAN, South Korea, Australia, New Zealand, after the implementation of the RCEP, the tariff concessions provided in the RCEP will be implemented in parallel with those of other preferential trade agreements. Each preferential trade agreement (arrangement) has its own list of tariff concessions and rules of origin, and the same goods will correspond to different tariff concessions levels and rules of origin under different agreements. Each import and export enterprise should make a comprehensive assessment and comparison of the tariff concessions, rules of origin and their implementation procedures of RCEP and other preferential trade agreements (arrangements) according to its own situation, so as to optimise its supply chain and make full use of the preferential policies to maximise its economic benefits.

(II) Rules of origin

Rules of origin, known as “economic nationality” of goods, refer to specific provisions formulated and implemented by a country to determine the country or region in which goods are produced or manufactured, based on national laws and regulations or principles agreed in international agreements. Whether the rules of origin are met, the tariffs imposed on the commodities traded under the FTA will be significantly different, and will also have a huge impact on the cross-border supply chain arrangements and economic interests of enterprises. Fundamentally, the most important economic value of the RCEP for enterprises lies in the cumulative rules of origin. It is the accumulation of regional content on such a large scale among the 15 countries that makes it easier for commodities circulating across borders to qualify as originating goods and enjoy preferential tariffs under the RCEP.

When determining the origin of goods, companies mainly consider and apply the rules including: the rules for a change in tariff classification, the regional value content (RVC) and the regional composition accumulation rule.

1. A change in tariff classification

The determination is based primarily on whether the tariff classification number has changed, i.e. the goods are qualified as originating goods when the tariff classification number of the product has changed in relation to all non-originating materials. The de minimis, however, should also be considered. Depending on the change in the digits of the tariff classification number, a change in tariff classification consists of a change in chapter, heading and subheading. At present, the more common ones are changes in heading and subheading.

[1] *Overview of Trade and Tariff Concessions for Parties to the RCEP*, https://mp.weixin.qq.com/s/xOBeP00ovkOGeGeuGfkGbg.

2. RVC

The main determination is based on whether the regional value added exceeds a certain proportion, i.e. the goods are treated as originating goods when the production and manufacturing process creates a value above a certain level. This is another very common FTA rule of origin in addition to the rules for a change in tariff classification. In previous FTAs signed by China, the RVC was usually calculated indirectly using the build-down formula, i.e. RVC = (FOB - VNM) / FOB x 100% [FOB means free on board; VNM means value of non-originating materials]. However, under the RCEP, in addition to the above formula, the build-up formula is introduced for direct calculation, i.e. RVC= (VOM + direct labour cost + direct overhead cost + profit + other costs) / FOB x 100% [VOM means value of originating materials]. Therefore, companies can choose the appropriate applicable calculation method based on their own material costs and commodity production cost management methods, so as to improve the accuracy of the calculation of the RVC of commodities.

3. Cumulation of regional content

Within a given region, goods or production activities originating from other Parties used in the production of a good in one Party may be included in the calculation of the originating contents of that good. In accordance with the paragraph 1 of the cumulation rules under the RCEP, "goods and materials which comply with the origin requirements, and which are used in another Party as materials in the production of another good or material, shall be considered as originating in the Party where working or processing of the finished good or material has taken place". To put it in another way, the cumulated materials need to first be qualified as originating materials (goods cumulation/incomplete cumulation). It should be noted that this paragraph does not restrict the area of cumulation and thus is applicable to all Parties. At the same time, paragraph 2 of the cumulation rules provides that "[t]he Parties shall commence a review of this Article on the date of entry into force of this Agreement for all signatory States. This review will consider the extension of the application of cumulation in paragraph 1 to all production undertaken and value added to a good within the Parties. The Parties shall conclude the review within five years of the date of its commencement, unless the Parties agree otherwise." In other words, although the non-originating materials that are processed in another Party do not qualify as originating materials, the processing and value added in that Party can also be cumulated (production cumulation/complete cumulation). This will enable multinational companies to be more flexible in their industrial layout, establish a more refined and complete division of labour system in industry chain and reduce the production cost of final products. It will not only help expand trade among RCEP members, but also greatly promote the integration and development of regional supply chains and value chains.

Take goods originating from South Korea as an example. After RCEP comes into force, there will be three preferential trade agreements between China and South Korea, namely the RCEP, China- South Korea FTA and Asia-Pacific Trade Agreement (APTA). Taking lithium nickel cobalt manganese oxides, one of the main goods imported from South Korea to China, as an example, the Department of Duty Collection under the General Administration of Customs of the People' s Republic of China (GACC) enumerated the main differences in the application, tariff concessions and rules of origin of the goods under the RCEP, China-South Korea FTA and APTA.[2]

[2] *Essentials for Enterprises to Take Full Advantage of Tariff Concessions*, https://mp.weixin.qq.com/s/G04DKkcHO4U_kZ1tgNCAxg.

Main differences on lithium nickel cobalt manganese oxides under the three agreements (HS 2842.9030)			
Preferential trade arrangements	RCEP	China-South Korea FTA	APTA
Is it on the tariff reduction list	Yes	Yes	No
Agreed rate of customs duty	0	0[3]	-
Origin criteria	Change in subheadings or RVC 40	Change in headings	-
Applicable certificate of origin	Certificate of origin or declaration of origin	Certificate of origin	-

In terms of tariff concessions, the rate of customs duty applicable to the goods under the RCEP and the China-South Korea FTA is zero, while no tariff concessions are applicable under APTA. In terms of origin criteria, under the RCEP, the criteria are optional: Change in subheadings or RVC40. Under the China-South Korea FTA, it is a single criterion of "change in heading", which is not only stricter than the "change in subheading" under the RCEP, but also excludes the application of the RVC criterion. Obviously, it is much more difficult for goods to qualify as originating goods under the China-South Korea FTA. In terms of submitting certificates of origin, importers must submit certificates of origin under the China-South Korea FTA but can optionally and conveniently submit certificates of origin or declarations of origin under the RCEP. As far as lithium nickel cobalt manganese oxide is concerned, although zero tariff applies under both the China-South Korea FTA and the RCEP, the origin standard is more flexible and the related procedure is more convenient under the RCEP, more conducive forenterprises to enjoy preferential policies in a more favourable manner.

(III) Intellectual property border protection

The "Border Measures" under the Chapter 11 "Intellectual Property" of the RCEP sets out the responsibilities of the competent authorities in the border protection of intellectual property. The competent authorities may suspend the release of suspected pirated copyright goods or counterfeit trademark goods by the right holder' s application or by ex officio action, in cases where there are "valid grounds for suspecting that the importation of pirated copyright goods or counterfeit trademark goods may take place."

First, a right holder, who has valid grounds for suspecting that there may be pirated goods or counterfeit trademark goods imported, may lodge an application with the competent customs authorities for suspension of release and provide a security or equivalent assurance sufficient to protect the defendant and the competent authorities and to prevent abuse. In such case, each Party may also provide that, without prejudice to a Party' s laws and regulations pertaining to the confidentiality of information, the competent authorities have the authority to inform the right holder of the name and address of the consignor, importer, or consignee; a description of the goods; the quantity of the goods; and, if known, the country of origin of the goods. Secondly, each Party shall adopt or maintain procedures with respect to import shipments under which its competent authorities may act upon their own initiative to suspend the release of suspected pirated copyright goods or counterfeit trademark goods. In this case, the competent authorities shall have the authority to request a right holder to supply relevant information. When suspending release in either of the above two cases, the competent authorities may determine, within a reasonable period, whether suspected pirated copyright goods or counterfeit trademark goods are infringing intellectual property rights.

[3] The agreed rate of customs duty under the China-South Korea FTA is the rate agreed in 2021, while the agreed rate of customs duty under the RCEP is the rate agreed in the first year after the entry into force of the RCEP. The MFN rate for the import of the goods into China is 5.5%.

The Border Measures subsection also sets out the destruction order by competent authorities for infringing goods and the requirements for application fee, merchandise storage fee, destruction fee etc.

II. Implications for cross-border e-commerce

(I) Tariff concessions are conducive to improving the competitiveness of exports

The tariff concession measures under the RCEP will mainly bring benefits to B2B enterprises in cross-border e-commerce, especially for exporters. The tariff concessions are expected to reduce the cost of taxes and fees in the importing countries for the exported goods of China' s cross-border e-commerce enterprises, thereby bringing more favourable prices to users in overseas markets and improving the market competitiveness of exports.

In addition, the traditional foreign trade industry has been hit hard due to changes in customer acquisition channels and transaction negotiation channels after the pandemic. The tariff concessions policy is conducive to encouraging China' s traditional foreign trade export enterprises to transform into cross-border e-commerce.

(II) Trade standardisation helps weaken trade barriers

Previously, there was a greater compliance risk for export of e-commerce goods due to the differences in trade standards across countries, including rules of origin, market access policies, investment policies, and service trade policies. With the synchronisation and standardization of rules of origin, customs procedures, inspection and quarantine, technical standards and other rules in the region, the integration of trade standards in the regional market has greatly weakened the barriers to trade.

(III) Free flow of production factors facilitates the construction and operation of overseas warehouses

After the signing of the RCEP, national resources, commodity flow, cooperation in technology, service capital and talent among countries in the region will be more convenient, and the obstacles to the construction of overseas warehouses will be greatly reduced. For example, the Parties have promised that investors, company personnel, contract service providers, accompanying spouses and family members and other types of business personnel from countries in the region may be granted a certain period of residence and enjoy conveniences in visa application to carry out various trade and investment activities if they meet certain conditions. In this regard, enterprises can take the opportunity to invest in overseas capital and personnel, promote regional branding, drive up the construction of overseas warehouses and enrich their functions, and effectively integrate resources in overseas markets.

(IV) Promoting the digitisation of trade and facilitating transformation and upgrading of e-commerce enterprises

The RCEP covers a series of rules to promote the digitisation of trade and reduce the cost of information communication. For example, the RCEP requires the promotion of paperless trading and the recognition of electronic documents as having the same legal effect as paper documents; no organisation may deny the legal validity of electronic signatures, except for special requirements of laws and regulations; all organisations should encourage the application of mutually recognised electronic authentication.

It is foreseeable that cross-border e-commerce transactions will continue to be digitised in the future. This also requires cross-border e-commerce enterprises to make full use of the nascent digital economy, such as cloud computing, big data and AI. If they apply the digital technologies extensively to cross-border trade services, production, logistics and payment, they will improve efficiency and upgrade from labour-driven to smart-driven enterprises.

III. Supporting documents of customs authorities and how enterprises can enjoy the benefits

For the implementation of tariff concessions and rules of origin under the RCEP, the GACC, in accordance with the principles of strengthening supervision, optimizing services and aligning with the highest international standards, issued in November 2021 the *Measures of the Customs of the People' s Republic of China for the Administration of Origin of Imported and Exported Goods under the Regional Comprehensive Economic Partnership Agreement* (hereinafter referred to as the "Measures for the Administration of Origin of Imported and Exported Goods under the RCEP"), the *Measures of the Customs of the People' s Republic of China for the Administration of Approved Exporters* (hereinafter referred to as the "Measures for the Administration of Approved Exporters"), and four supporting normative documents. The information system of customs authorities on administration of the origin was comprehensively upgraded and 763 business segments were reconstructed. The move optimised the declaration mode and customs declaration structure for goods enjoying benefits, realised the sharing between visa data and customs clearance data, and built a three-dimensional customs supervision and service network combining administration of origin, enterprises and goods.

Pursuant to the Measures for the Administration of Origin of Imported and Exported Goods under the RCEP, in order to determine the authenticity and accuracy of the certificate of origin and to verify the eligibility and country (region) of origin of imported goods, the Customs may verify the origin by requesting supplementary information from: (a) the consignee of imported goods or his/her agent, overseas exporter or producer; (b) the exporting member' s visa agency or competent authority. If necessary, the Customs may carry out verification of the overseas exporter or producer on site with the consent of the exporting member or through other means agreed on with the exporting member. During the verification period, the Customs may handle the guaranteed release upon the application by the consignee of the imported goods or his/her agent, unless otherwise provided by laws and regulations. The Customs shall inform the consignee of imported goods (or his/her agent), the overseas exporter (or producer) or the exporting member' s visa agency (or competent authority) in writing of the verification results and reasons.

If the exporter, producer or visa authority receives a request for verification or if exported goods are obstructed from enjoying customs clearance outside the country, it may promptly report this to its respective customs offices, which will actively coordinate to resolve the problem. An enterprise subject to the verification should actively cooperate with Customs in verification.

(I) Administration of origin

The RCEP promotes free trade in the region and greatly affects the cross-border supply chain arrangements, especially in the context of the pandemic and the China-US trade friction. Relevant enterprises are advised to analyse their own goods and industrial chains in depth, make arrangements for production and logistics in advance based on the applicable rules of origin for different goods, and optimise their import and export systems and management procedures. Exporters, in particular, should pay attention to the tariff concessions granted by the RCEP Parties for their exports and make an in-depth assessment of whether the goods meet the rules of origin. If the goods do not meet the rules of origin, they may further adjust the source of raw materials. By taking into account the industrial advantages of each Party, exporters may increase the share of raw materials within the region, and thoroughly assess the compliance costs required for such adjustments. At the same time, exporters may include the relevant tariff concessions as an advantage for their own products in business negotiations, and may share the tariff concessions with importers of the Parties by adjusting pricing or otherwise.

It is necessary to remind enterprises that determination of the origin is highly professional in practice which involves classification of goods, customs valuation and other professional fields, and the rules of origin are relatively complex. For an enterprise, therefore, its internal production, purchasing, sales and finance departments need to work together to integrate data and conduct a unified management. The enterprise also needs to conduct control over its external

suppliers to ensure the authenticity and accuracy in determining the origin of raw materials. In addition, the RCEP adds an approved exporter' s declaration and an exporter' s independent declaration to the traditional certificate of origin. This heralds the change of the certificate of origin from the mode of government review and issuance to the mode of independent declaration based on enterprise credit. While improving the convenience of customs clearance, the additional options also impose higher compliance requirements for the enterprise' s administration of the origin. Enterprises, if necessary, may seek professional help to use the more refined information system for administration of the origin, in order to efficiently analyse the changes brought by the RCEP to the value chain of enterprises, and make good use of the preferences under FTAs.

(II) Procedures for enjoying preferential treatment in customs clearance of imported goods

For import enterprises, when importing goods into China, the importer should fill in the Customs Declaration Form for Imported Goods or the Customs Recordation List for Goods Entering China in accordance with the declaration requirements of the Customs, declaring the applicable agreed rate of customs duty. In addition, the importer should also submit the certificate of origin and other documents that meet the requirements of the RCEP. Imported goods with a duty-paid price not exceeding USD 200 or its equivalent in RMB, or goods exempted from the submission requirement by the Customs, may be exempted from the submission of the certificate of origin. Where goods are imported one or more times in order to evade the relevant laws and regulations on the administration of preferential tariff treatment, the exemption shall not apply. If the importer does not submit the certificate of origin at the time of import, it may apply for preferential tariff treatment by submitting a certificate of origin after the import in accordance with the domestic regulations of the importing Party. In China, the importer in this case may make a supplementary declaration to the Customs on the imported goods having the qualification of origin and provide tax guarantee. The Customs will handle the import procedures in accordance with the regulations, and the importer who submits the certificate of origin afterwards may enjoy the preferential treatment if it meets relevant requirements.

(III) Advance industrial layout

In the face of the new trade environment brought about by the RCEP, enterprises are recommended to make a good layout in advance. For example, after the RCEP came into effect, the first agricultural tariff concession arrangement was reached between China and Japan, and more than 60% of Japan' s and 80% of China' s agricultural products will be mutually exempt from tariffs. Taking the Guangxi Zhuang Autonomous Region, a large agricultural province as an example, its competitive products, such as cactus, watermelons, and golden camellia tea are expected to enter the Japanese consumer market at zero tariff. Another example is the electric vehicle industry. Japan has committed to adopting all new electric vehicles by 2035, but currently only Panasonic has a strong battery supply capacity and the price is high in the local market. The electric vehicles made in Guangxi have attracted the attention of the Japanese market with its stable performance and low price. As Japan promotes the use of electric vehicles, there will be greater development space for Guangxi electric vehicles to enter the Japanese market and cooperate with their Japanese counterparties.

Secondly, cross-border e-commerce enterprises should focus on supply chain channels and create a commodity distribution market. ASEAN countries have gathered a large number of labour-intensive production bases, while China' s strong market consumption capacity is a huge attraction for enterprises. The tariff concessions under the RCEP provide more convenience for goods to flow back to China.

Finally, enterprises should focus on the advantages of location and transform "industrial relocation" to "enterprises entering the border". Take Guangxi as an example again. Guangxi cross-border e-commerce enterprises make use of the advantages of its proximity to ASEAN, especially Vietnam, and the border policies such as "cross-border labour" to create superposition effect by combining the advantages of ASEAN labour cost advantages, China' s industry chain

and business environment, and the tariff concessions among RCEP member countries. Through this approach, they will create an industrial environment with low labour costs, beneficial business environment and a relatively sound industry chain, so that relocating industries can land at the border and be stationed.

(IV) Intellectual property compliance

Before starting import and export business, enterprises should conduct a thorough investigation into the IPR protection environment of the target market in order to arrange plans and measures for IPR risk prevention. In terms of product selection, enterprises should be more cautious in selecting high-tech IP-intensive products for import and export. Furthermore, they should require suppliers to provide proof of IP ownership and keep it for preventing the risk of IP disputes in the future. For cross-border e-commerce enterprises with independent R&D and design, they should conduct a detailed investigation and search of the trademarks, patented technologies and designs involved in the goods to understand the IPR of similar competitors; if the search reveals any potentially infringing products, the patented technologies and trademark designs should be adjusted. To protect their legitimate IPR, enterprises can apply for IPR locally in the target market and file with the Chinese Customs to achieve border protection of IPR. Before entering the target market, cross-border e-commerce operators may seek advice from local lawyers and other professionals on whether the exported commodities will infringe on IPR in the local market, so as to prevent the risk of IP disputes in the future.

After an enterprise has started its import and export business, it should focus on compliance by keeping data or evidence related to intellectual property, paying attention to policy developments and strengthening communication and training. First of all, the GACC has launched the "IPR Registration System for Customs Protection". E-commerce operators and self-operated e-commerce enterprises may inquire about the IPR registrations with the GACC through the registration system to preliminarily decide whether their goods infringe upon others' IPR. Secondly, if enterprises are still uncertain about the results of the system query, they may consult the customs through the pre-confirmation system. Although there is no clear legal basis for this practice, it has a good practical effect. Good customs-enterprise interaction facilitates the work of the Customs and improves efficiency, while building up the image of China Customs as a responsible and responsive authority.

For enterprises, pre-confirmation is to seek legal advice. As the product has not yet been imported or exported, enterprises will not be subject to penalties even if there is suspected infringement. In general, enterprises need to submit the following materials for pre-confirmation of IPR: registration materials for market supervision, and registration information with the customs; trademark and patent certificates; power of attorney, i.e., document under which the applicant is authorised to manufacture/export the relevant goods; samples of goods to be exported; and application for pre-confirmation. In order to allow sufficient time for the customs to conduct the pre-confirmation, the enterprise should apply to the customs no later than one month prior to the import/export of the goods.

Finally, exporters should actively understand the intellectual property protection policies of the places where their products are sold and the intellectual property registration of goods in the same industry. They, if necessary, should conduct market research timely, and analyse the trademarks, decorations, slogans and designs used in the products to determine whether they are infringing upon others' rights. In addition, enterprises should also have an understanding of the IPR system and judicial system of the country to which they are exporting, so that they can take appropriate measures to safeguard their legitimate rights and interests to the maximum extent after disputes.

(V) Enhancing competitiveness

On the one hand, cross-border e-commerce enterprises should make efforts to improve their products, services and their own industry competitiveness, and strive to increase the added value of products, by emphasizing the

"differentiation, personalisation, internationalisation and branding" of their products. Moreover, they should focus on the protection of IPR. On the other hand, enterprises should pay attention to the innovation. The quality of products and services of enterprises is the fundamental competitive strength. Stress should be laid on the core innovation of products and technologies, improving the ability to protect consumer rights and interests. In addition, enterprises shall also pay attention to commodity information disclosure and optimise the return and refund services.

Conclusion

The development gap among the members of RCEP, comprising high, middle and low-income countries, is relatively enormous. Therefore, the rules established by the RCEP are characterised by inclusiveness and high standard. The "high standard" is reflected in the unification of the rules of origin in the region. As long as the goods conform to the rules of origin when exporting, they will qualify as originating goods under the RCEP, without the separate confirmation of each member country. While "inclusiveness" can be found in the other provisions on the trade in goods. Especially, the tariff difference has to be addressed by additional specific rules of origin because of the adoption of "unified tariff concessions" and "country-specific tariff concessions" by the member states. With a stable political and economic environment and a strong willingness to open up and cooperate, China has been actively involved in FTAs for two decades and has achieved amazing results. Furthermore, China has explored and established a solid economic and institutional foundation.

We expect Customs to continue to provide technical support for the implementation of RCEP, introduce more measures for the application of the RCEP in China, release policy incentives for both the import and export, as well as build a more efficient information system to enable importers and exporters to enjoy the benefits. We encourage enterprises to make full use of the policy incentives brought by the RCEP, advance their industrial layout, focus on cross-border e-commerce supply chain channels, build commodity distribution and consolidation market, and focus on their location advantages. At the same time, they should make efforts to improve their products, services and their own industry competitiveness, increase the added value of their products, and carry out differentiated competition.

We hope that cross-border e-commerce enterprises will make more achievements in their way forward.

ARE YOU READY AS THE HAGUE AGREEMENT IS APPROACHING?

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On 5th February 2022, the government of China deposited its instrument of accession to the Hague Agreement Concerning the International Registration of Industrial Designs (the Hague Agreement) to the World Intellectual Property Organization (WIPO), which entered into force in China on 5th May 2022. China's accession indicates that Chinese applicants or applicants from a non-member state of the Hague Agreement who have a domicile, a habitual residence or a real and effective industrial or commercial establishment in China could submit international design applications through the Hague system.

The Hague Agreement, the Patent Cooperation Treaty (PCT) and the Madrid Agreement Concerning the International Registration of Marks constitute the "troika" of international application services for patents (inventions and utility models), trademarks and designs. The Hague international application for design, parallel to the PCT international application, grants global protection with satisfaction of certain conditions by designating countries through an international application (Article 14 of the Hague Agreement).

Although the Hague Agreement has officially entered into force in the country, for the Chinese applicants who are itching for a try, Hague international application for design is still cloaked in a shroud of mystery. We hope this article can provide you with some insights and reference concerning the pros and cons of this system.

I. The historical evolution of the Hague Agreement

The Chinese government deposited its instrument of accession to the Geneva Act (1999) of the Hague Agreement, which, in the strict sense, is the Geneva Act of the Hague Agreement Concerning the International Registration of Industrial Designs.

As early as 1925, with the aim to catalyse the simplification of design application procedures among contracting states, the Hague Agreement Concerning the International Deposit of Industrial Designs was adopted in the form of special provisions of the Paris Convention (Article 19), and came into force in 1928. Henceforth, the agreement was subjected to amendment in London in 1934 and the Hague in 1960 respectively. The

1934 amendment was not applicable to the countries with the substantive examination system, as it was primarily devised referring to the institution of the countries without this examination system. To ameliorate the state, it was revised in 1960, but the situation was not fundamentally improved, as there was a requirement for each contracting state on setting the refusal period to six months, while the countries with the substantive examination system could not guarantee to complete the examination within six months.

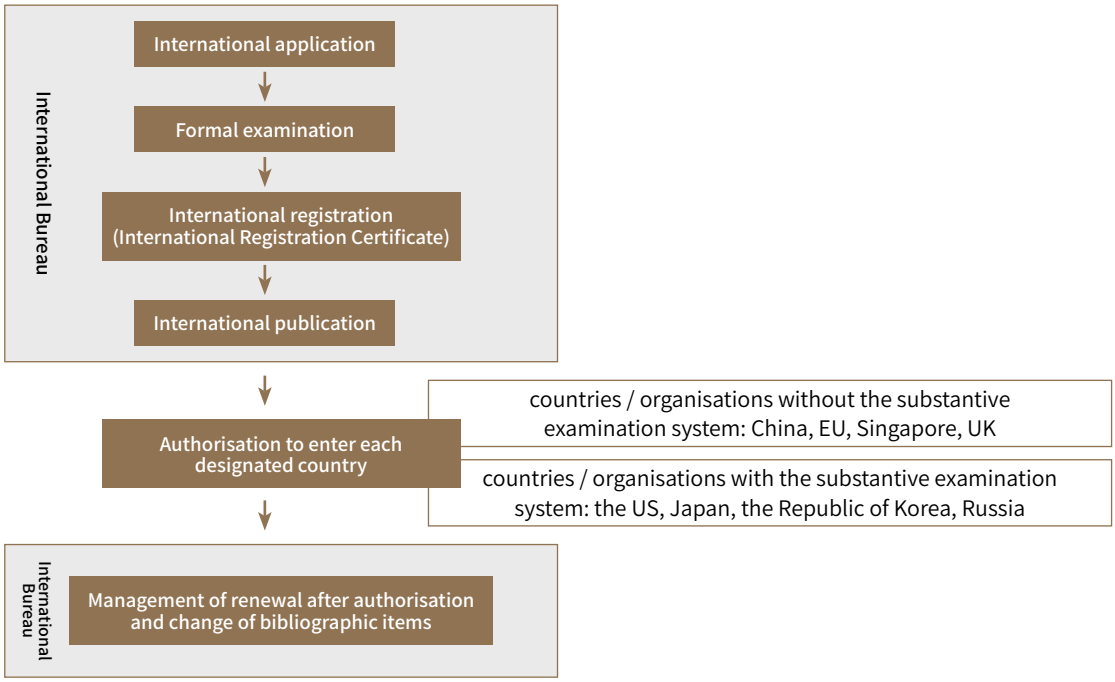
Correspondingly, to promote the accession of the countries with the substantive examination system, the agreement was further amended and improved in Geneva in July 1999 (and entered into force in 2003). In this amendment, each contracting state can extend the six-month refusal period to 12 months by making a separate declaration. This step profoundly facilitated the accession of countries with the substantive examination system, as the Republic of Korea acceded to the 1999 agreement in 2014, the US and Japan in 2015, and Russia in 2018.

The London version of the 1934 Hague Agreement was terminated on 18 October 2016. Currently, the only existing texts are the 1960 Hague version[1] and the 1999 Geneva version.

The significance of distinguishing varied versions lies in that, for an international application submitted to the Hague System, the contracting party can only be designated among the contracting states of the same version. Although major economies in the international community including China, Japan, the Republic of Korea, the European Union, the US, the UK, France (also acceded to the 1960 Hague version) and Singapore have all acceded to the 1999 Geneva version, Italy, the cradle of fashion, only acceded to the 1960 version, so Chinese applicants cannot designate Italy.

As of 24th January 2022, the 1999 Geneva version had 67 contracting parties, including 65 countries and 2 intergovernmental organisations[2].

II. Process of Hague international design application



[1] The version has been supplemented several times and is herein referred to as the 1960 version.

[2] Source: the WeChat account of China National Intellectual Property Administration.

The process of the Hague international application is demonstrated in the illustration above, in which:

- An international application can be submitted directly via eHague of WIPO (https://hague.wipo.int/#/landing/home), or through the national office of the contracting states. The application for international registration and the drawings of the design can be submitted in English, French or Spanish. WIPO' s 2021 annual report shows that, in 2020, of all the international applications to the Hague System, 99.4% were submitted electronically, 90% were made in English and 62% requested priority. When submitting an international application, one needs to designate the country to enter. An international application can contain up to 100 designs, provided that they fall into the same class in the Locarno classification.
- Formal examination will be executed in the International Bureau and the system will give an automatic prompt when e-filing is employed. The time limit for the reply to the International Bureau' s formal examination is three months from the date of notification. Failure to reply within the time limit will be deemed as withdrawal.
- The international registration will be conducted and the international registration certificate will be issued after the design gets through the formal examination of the International Bureau, nevertheless, it is important to note that the international registration certificate cannot be taken as authorisation at this moment. Generally, the international application date falls on the day when the International Bureau receives the international application and the international registration date is the day when the international application is made except when there are irregular defects leading to the postponement of the application date. The international application, from the date of international registration, has the same effect as the national application directly submitted in the designated country.
- With regard to international publication, the amendment to Rule 17 of the Common Regulations took effect on 1 January 2022. Therefore, in the light of the revised Common Regulations, if an applicant does not request immediate or deferred publication, its international application will be published as soon as possible[3] after 12 months from the international registration date (six months from the international registration date if the international application date is earlier than 1 January 2022). Nevertheless, the publication can also be made after a number of whole months, such as 1, 2, 3, and 4. When the applicant opts to postpone the publication, the timing of publication varies with the designated country. According to the current statements of countries, for instance, if the designated countries include the US, Russia, the UK, Denmark, Russia, Mexico, Vietnam, the deferment period cannot exceed 12 months from the date of application; if Singapore is designated without designation of the above-mentioned countries that cannot defer the publication, the deferment period shall not exceed 18 months from the date of application; if Singapore and the above-mentioned countries that cannot defer the publication are not included in the designated countries, the deferment period shall not exceed 30 months from the date of application (if there is a priority, it shall start from the priority date); if a number of countries are designated, and the deferment period recognised by these countries varies in length, the shorter one shall prevail for international publication.

According to the annual report of WIPO, 48.3% of the Hague international applications in 2020 were made public promptly.

- If the notification of refusal from each designated country is not received within 6 or 12 months after the international publication (for the designated countries that have made separate declarations), the design patent protection shall be obtained in the corresponding designated country from the expiration date of this period at the latest. The designated countries are divided into two categories, countries with the substantive examination system, and those without.
- After authorisation, maintenance management such as renewal of the protection period and change of the entry item is carried out uniformly at the International Bureau. The protection period of the

[3] The publication period here implicitly includes the preparation time for the publication.

Hague Agreement is renewed every five years with the payment of a fee. In principle, it can be renewed twice, except if the protection period of the designated country is longer than 15 years.

III. Who is actively using the Hague Agreement?

According to the 2021 bulletin issued by WIPO, the number of international design applications through the Hague system in 2020 was 5,792, a decrease of 1.7% compared with 2019, and the number of designs was 18,580 (slipped 15% from the same period of the previous year, down for the first time since 2006). Each Hague International application includes an average of 3.2 designs.

In terms of the number of applications, the top 10 countries using the Hague system are the Republic of Korea (1,145), Germany (702), Switzerland (531), the US (526), Japan (408), France (400), China[4] (361), Italy (273), the UK (167) and Norway (117).

In terms of the number of designs, the top 10 countries are Germany (3,666), the US (2,211), Switzerland (1,944), the Republic of Korea (1,669), Italy (1,231), Norway (999), Japan (942), France (936), China (826) and Turkey (524).

Among the global applicants using the Hague system (in 2020), the number of designs submitted by European applicants (not the number of applications) accounts for 64.2% of the total.

Take neighboring countries as an example. Judging from the top 50 applicants for published international design registrations, three companies from the Republic of Korea, Company S (ranked first for four consecutive years), Company L (ranked sixth) and Company H (ranked 21st), made the list.

In contrast, only two Japanese companies made the list, Company M (107 items, ranked 32nd) and Company T (79 items, ranked 42nd, starting in 2019 using the Hague system).

In 2020, since China was not a contracting party to the Hague Agreement, Chinese applicants on the list were Company XM (516 items, ranked 5th) that ranked in top five for the first time and Company JH (90 items, ranked 38th).

Five US companies were on the list, with Company P being the most active (623 items, ranked 2nd), followed byCompany ML (320 items, ranked 9th), Company GI (144 items, ranked 20th), Company MO (133 items, ranked 24th), and Company MS (96 items, ranked 35th).

We tested three companies in the database of the Hague bulletin, and the results are as follows:

The years of international registration and the distribution of designated countries of 487 applications submitted through the Hague system by a Chinese company having real and effective business establishment in Singapore, France and other contracting countries are as follows:

2022	3	2021	97	2020	184	2019	134	2018	63	2017	2	2016	2
2015	2												

EM	479	GB	292	US	290	KR	205	RU	196	SG	194	JP	178
UA	115	VN	89	TR	72	NO	54	MA	52	KH	42	CH	23
EG	15	OM	4	OA	3	ES	3	CA	1	PL	1	DE	1

[4] Although China was not a party to the Hague Agreement in 2020, China' s applicants were still able to use the Hague system if they satisfied the requirement of having a real and effective place of business, domicile, or habitual residence in one of the parties to the Hague Agreement.

The years of international registration and the distribution of designated countries of Company M of Japan (a total of 242 applications) are as follows:

2021	16	2020	28	2019	43	2018	36	2017	58	2016	44	2015	17
EM	229	SG	27	GB	17	TR	9	US	6	CH	2	NO	2
KR	1												

A total of six applications were filed by Company T, with the registration years and distribution of selected countries shown below.

2019	1	2017	5						
JP	5	US	1	TR	1	EM	1	EG	1

Only one application was made by Company H (in 2017), which was the transfer of another company.

IV. Does the Hague Agreement system suit us?

Is it a little surprising to see the utilisation of the Hague system by various countries and companies in Part III above? The Hague system is authorised by submitting an application in one of the three designated languages and passing the examination of each designated country. The maintenance and management after authorisation, such as renewal and change of obligee, can be managed uniformly by the International Bureau. With such a convenient and cost-effective way, why don' t we see the major automobile companies in Japan among the top 50 applicants? And why aren' t there as many US companies as expected? What are the advantages and disadvantages of the Hague system? Is the system suitable for us? This is a problem to ponder.

(I) On cost advantage

When submitting new international applications, it is possible to save costs because it is not necessary to prepare translations of the application documents and brief descriptions for each country. After authorisation, there is no need for separate maintenance management for each country, which can be carried out in a unified manner by the International Bureau. In particular, when submitting applications to various countries directly via Paris route, it is usually necessary to entrust local firms, which will also generate agency fees. When submitting an international application through the Hague system, no matter how many countries are designated, only a basic fee (CHF 397) needs to be paid, plus the designation fee of each designated country (which varies with different countries) and the international publication fee. If the company has a strong in-house application support team, it can also avoiding the cost of entrusting an agent when International Bureau is involved.

For countries without the substantive examination system, if the applicants can prepare relatively complete application documents so that a direct authorization can be expected, a considerable cost can be avoided. For example, taking a design (comprising seven pictures) as an example, designating EM costs CHF 583 (or nearly RMB 4,000 if calculated at a rate of 1 CHF for RMB 6.83, including the annual fee for the first five years). For each additional country, there will be an additional designation fee. If additional applications were to be filed in the UK and Singapore, it would add CHF 2*42

to the fee. In contrast, if a country with substantive examination system is designated, the designation fee will increase significantly. For example, the designation fee in the first part of the application is CHF 989 in the US, CHF 682 in Japan, CHF 138 in Russia, and varies with the Locarno classification in the Republic of Korea.

However, it should be noted that there may not be a cost advantage if there are only a limit number of countries to be designated or they are subject to exchange rate fluctuations (international applications are settled in Swiss francs). In particular, the designation fee in the designated country includes the annual fee for the first five years of authorisation. Except for Japan, which has an application refund system, and the US and Mexico, where the designation fee is paid in two parts (the first part is the individual designation fee paid at the time of application and the second part is the designation fee paid at the time of authorisation), if the application is not finally authorised in the designated country, the annual fees for the initial five years are not refundable.

Thus, as to whether and how much cost savings can be achieved, that depends.

(II) Speedy examination

The Hague approach also has the advantage of speedy examination. When a designated office finds grounds for refusal, it needs to notify the International Bureau within six months (EU, France, Switzerland, Germany, etc.) or 12 months (Japan, the Republic of Korea, the US, Russia, Canada, etc.). If the International Bureau does not receive the notification of refusal within the above-mentioned period, it is deemed protected in the designated country.

(III) On deferment of international publication

As described in Part II on international publication, the provisions on deferred international publication vary with countries. If any of the designated countries selected do not recognise deferment (or in other words, the deferment cannot exceed the standard publication period of 12 months) or the deferment period cannot exceed six months, because the international publication is subject to the shorter deferment period, it may affect the business considerations of some applicants. For example, it is likely that a product may be internationally published before release.

(IV) On joint applications

The Hague international application can include up to 100 designs belonging to the same class in the Locarno classification in a design application. However, when multiple countries are designated, the provisions on joint application vary with countries. For example, while the regulations of the EU and the Republic of Korea are consistent with the Hague regulations, the US requires that there can be no patentable distinction between multiple embodiments. If an application contains designs belonging to the same Locarno class but are not similar to each other, it is difficult to submit them as one application when it needs to be applied to the EU, the US and the Republic of Korea. On the contrary, if it is submitted as one application and three countries are designated, the case will be divided when the US office examines the application, which will result in an eventual increase in costs. Moreover, it will also burden the internal management of the company. Therefore, when submitting international applications, it is necessary to comprehensively consider the legal provisions of each country to be designated and make a balanced choice.

(V) The examination history of each country will be made public in the Hague Database

The refusal decisions of international design applications in all designated countries, including the referenced comparative documents, are made public in Hague Express. Although national examinations are independent, some applicants will consider that these will have adverse consequences for other countries, especially when exercising their rights at a later stage. This is one reason why many large companies overseas do not consider the Hague system.

(VI) On the entrustment of a representative

In the Hague International application, there are representatives for dealing with the International Bureau and representatives at the examination stage. It is up to applicants to entrust a representative or not. Entrusting a representative will not incur too much expenses. However, for countries with the substantive examination system, the applicant needs to make an OA reply to the patent office of each designated country rather than directly answer to the International Bureau. Many countries require applicants who do not have a residence or business office in their own country to entrust a representative. The Republic of Korea, the US and Japan, which implement the substantive examination system, have similar regulations. Therefore, it is inevitable to pay the agency fee to local firms.

(VII) Reasons for the EU to get the highest designation

From the statistics in Part III above, we see that the most preferred designated destination is the EU, because the EU regulations are naturally close to the Hague system. The EU does not implement substantive examination, and the formal examination is basically focused on whether or not it violates public order and morality, and the EU' s annual fees are paid in five-year increments, the same as the Hague system. While the Hague system allows a maximum of 100 designs to be included in an international application, it is the same with the EU, as long as they fall within the same class of the Locarno classification that can be included in a single application. Therefore, the cost saving effect will be expanded in the case of not appointing local agencies in the EU stage. Moreover, the EU has the longest deferment period for international publication.

It should also be noted that when directly applying for an EU design without using the Hague system, a maximum of seven drawings can be attached. In contrast, there is no such restriction when designating the EU through the Hague system. Considering that only seven drawings are taken into account when safeguarding the rights of EU designs, it is necessary to consider listing the drawings in order of importance if a design includes more than seven drawings.

Conclusion

The Hague system provides us with another effective way for "applications going global", but we should also pay close attention to the "pitfalls" and disadvantages. We should comprehensively consider the company' s overseas business strategy, fully compare the legal practice differences of various countries according to the characteristics of the design application to be arranged, and select the most suitable application scheme and the combination of designated countries, so as to truly benefit from the advantages provided by the Hague system.[5]

[5] References:

[1] *Hague Yearly Review 2021*.

[2] http://ipr.mofcom.gov.cn/zhuanti/law/conventions/wipo/2/Hague_Agreement.html (*Guidelines for the Hague Agreement concerning the International Deposit of Industrial Designs*)

OPENING-UP OF SERVICE TRADE UNDER THE RCEP: ARE THERE STILL RESTRICTIONS ON CHINESE DESIGN CONSULTANCY ENTERPRISES AND CONSTRUCTION CONTRACTORS GOING GLOBAL?

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The Regional Comprehensive Economic Partnership (RCEP) Agreement entered into force on 1 January 2022. It sets the stage for a free trade area with the world' s largest population, greatest trade scale and highest development potential, covering the 10 member states of the Association of Southeast Asian Nations (ASEAN) and five other countries – China, Japan, Republic of Korea, Australia and New Zealand.

The RCEP covers a huge market of about one third of the world' s economy, which has always been one of the destinations for China' s design consultancy and construction services. Have the technical standards under the RCEP been completely opened? Have the restrictions on design and construction qualifications and access been completely lifted? These are what China' s international design consultancy enterprises and construction contractors urgently need to understand while going global under the RCEP framework. To this end, based on the RCEP Agreement and the relevant practices in Vietnam, Indonesia and other popular countries of destination for project contracting in recent years, this article briefly explains the breakthroughs and progress in opening up the technical standards as well as the access to design consultancy and construction services under the RCEP framework. Hopefully, it will be helpful for the Chinese enterprises going global.

I. Overview of RCEP background

The RCEP Agreement has organically integrated the existing five "10+1" (ASEAN+1) agreements, and accordingly formed the world' s largest free trade area involving ASEAN member states and non-ASEAN countries such as China, Japan, Republic of Korea, Australia and New Zealand, with the scale exceeding the United States-Mexico-Canada Agreement

(USMCA), the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and other regional free trade areas. According to World Bank data in 2020，the 15 members of RCEP contracting states have the population of 2.27 billion and GDP reaching USD 25.8 trillion, accounting for more than 30% of global GDP.

Item	USMCA	CPTPP	RCEP
Number of economies	3	11	15
Population (in million)	490	510	2270
GDP (in USD trillion)	23.6	10.6	25.8
Share of Global GDP (%)	27.9	12.6	30.6
Share of Global exports value (%)	13.5	15.1	28

The RCEP Agreement consists of a Preamble, 20 Chapters, and 4 Annexes. The RCEP Agreement covers trade in goods – tariff commitments, customs procedures and trade facilitation, sanitary and phytosanitary measures and rules of origin, trade in services (including the market access, national treatment and most-favoured-nation treatment by making commitments in Schedules of Specific Commitments (Positive List) or Schedules of Reservations and Non-Conforming Measures (Negative List) in respect of the trade in services); and investment (including the investment promotion, protection, facilitation and liberalization, and commitments to opening up certain non-services sectors to foreign investment by making commitment in Negative List). The RCEP Agreement also sets out regulatory and encouraging measures for intellectual property, electronic commerce, government procurement, and other new topics.

The RCEP Agreement shall enter into force for those signatory states that have deposited their instrument of approval, 60 days after the date on which at least six ASEAN signatory states and three non-ASEAN signatory states have deposited their ratification documents, and enter into force for any other signatory state 60 days after the date on which it has deposited ratification documents. Most contracting states have completed the RCEP approval procedure. As of 1 February 2022, RCEP has entered into force for six ASEAN members – Thailand, Singapore, Brunei, Lao PDR, Cambodia and Vietnam, and five non – ASEAN members – China, Japan, New Zealand, Australia and Republic of Korea, and for Malaysia on 18 March 2022.

II. Have the technical standards under the RCEP been opened up?

The Chinese technical standards have not yet been widely recognised internationally. This is one of the challenges that have been limiting the breadth, depth and even quality of China' s international design consultancy and construction services going global. Among all the projects we have worked on, only a limited number of projects adopted Chinese standards, including those in high-speed railway, nuclear power and other sectors that China has core technologies and intellectual property, as well as the China financed PPP projects and EPC+F/E projects. Most owners preferred international standards and/or their local technical standards. Moreover, the overseas projects implemented by the Chinese contractors are often subject to design review and construction supervision by the western supervisors and consulting engineers engaged by the owner. Therefore, it is of practical significance for Chinese design consultancy enterprises and construction contractors to be familiar with the development of technical standards in the context of the RCEP Agreement.

Have the technical standards under the RCEP been opened up? It is not a simple yes-or-no question, the answer to which depends on the implementation of international standards as well as each country' s development and special conditions. Undoubtedly, encouraging the application of international standards as non-mandatory standards and advocating mandatory technical regulations to be in line with international standards is one of the prominent features of the RCEP Agreement. Chapter 6 of the RCEP Agreement (Standards, Technical Regulations and Conformity Assessment Procedures), which mainly draws on the WTO Agreement on Technical Barriers to Trade (TBT Agreement), makes more open and progressive provisions on the following three aspects, namely standards, technical regulations and conformity assessment procedures.[1] The following is a brief comparison of the RCEP Agreement and the TBT Agreement.

(I) Standards: Do not create unnecessary obstacles and encourage to provide the reason for the differences between the national and international standards

The RCEP provisions on standards follow the prescription of Annex 3 to the TBT Agreement (Code of Good Practice for the Preparation, Adoption and Application of Standards), requiring the standardising bodies not to prepare, adopt or apply standards with a view to or with the effect of creating unnecessary obstacles to international trade. On this basis, the RCEP Agreement further requires that a party shall, on the request of another party, encourage its standardising bodies to provide the differences between its standards and the international standards are, and the reason for those differences.

(II) Technical regulations: Narrow the exceptions of excluding international standards and require explaination of the reasons in circumstances such as where technical regulations deviate from international standards

The RCEP provisions on technical regulations have deleted certain exceptions of not using international standards as a basis for a member state' s technical regulations, including fundamental climatic, geographical factors, or fundamental technological problems as provided in Article 2.4 of the TBT Agreement. The RCEP provisions further require that a party shall explain the reasons where its technical regulations deviate from international standards, where it refuses to accept a technical regulation of another party as equivalent to its own, and where it does not specify technical regulations based on product requirements in terms of performance rather than design or descriptive characteristics. Moreover, compared with the TBT Agreement, the RCEP Agreement stipulates that a reasonable interval shall be normally a period of not less than six months except where urgent problems of safety, health, environmental protection, or national security arise or threaten to arise. This is designed to provide sufficient time for exporters to adapt their products or methods of production to the updated requirements.

(III) Conformity assessment procedures: Use international standards as a basis and six types of mechanism for facilitating acceptance of the results of conformity assessment procedures

In contrast with TBT Agreement, the RCEP provisions on conformity assessment procedures specify that each party shall ensure that central government bodies use relevant international standards as a basis for their conformity assessment procedures, and provide for six types of mechanism for facilitating the acceptance of the results of conformity assessment procedures of another party, including: (i) mutual recognition agreements for the results of conformity assessment procedures, (ii) cooperative (voluntary) arrangements between conformity assessment bodies, (iii) the use of accreditation to qualify conformity assessment bodies to recognise the accreditation granted by other

[1] The terms "Standards", "Technical Regulations" and "Conformity Assessment Procedures" under the RCEP Agreement follow the definitions in the TBT Agreement. "Standards" means document approved by a recognized body, that provides, for common and repeated use, rules, guidelines or characteristics for products or related processes and production methods, with which compliance is not mandatory; "Technical Regulations" means document which lays down product characteristics or their related processes and production methods, including the applicable administrative provisions, with which compliance is mandatory; "Conformity Assessment Procedures" means procedure used, directly or indirectly, to determine that relevant requirements in technical regulations or standards are fulfilled.

contracting states, (iv) the designation of conformity assessment bodies in another party, (v) unilateral recognition by a party of results of conformity assessment procedures conducted in another party, and (vi) manufacturer' s or suppliers' declaration of conformity. The RCEP Agreement also provides that a party shall explain its reasons for not accepting the results of a conformity assessment procedure conducted in another party.

Notably, although the RCEP Agreement provides for more restrictive measures on technical barriers to trade than the TBT Agreement in terms of standards, technical regulations, and conformity assessment procedures, Chapter 6 does not apply to the dispute settlement procedures of the RCEP Agreement. Therefore, it remains to be seen how countries will adjust the existing technical barriers.

III. Have the restrictions on access to engineering and construction services been lifted?

Foreign contractors engaged in engineering design and construction activities in the country where the project is located often involve approval and business activities such as permit applications, employment, payment and settlement, tax and other governmental and business activities. Therefore, whether it is required to set up local business entities including subsidiaries, branches and representative offices is a prerequisite question that cannot be avoided, legally or practically. Many countries may restrict the business form, shareholding percentage and qualifications of local business entities set up by foreign contractors considering their industry, capital source, scale and technical requirements of their project. In this context, it is important for Chinese design consultancy enterprises and contractors going global to understand how open the members' market of design and construction services will be under the RCEP Agreement.

(I) Core mechanism and highlights of commitments to opening up design and construction services under the RCEP Agreement

Design and construction services fall within the scope of trade in services under the RCEP Agreement, and the contracting states' opening-up commitments are mainly specified in Chapter 8 of the RCEP Agreement – Trade in Services and related annexes.

In view of the differences in current legal provisions, openness and development of the contracting states, the RCEP Agreement does not simply set a rigid or single standard for the opening up of design and construction services. Instead, it adopts a Positive List/Negative List model, requiring the contracting states to make an opening-up commitment in terms of national treatment, market access, most-favoured-nation treatment and local presence. [2]

China, New Zealand, Cambodia, Lao PDR, Myanmar, the Philippines, Thailand and Vietnam have made commitments to opening up their trade in services in Annex II to the RCEP Agreement. Each of the above eight countries sets out therein the relevant industries and types of services, restrictions on market access, conditions or qualifications on the application of national treatment commitments.

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[2] National treatment means, a party making commitments shall, in the sectors and services inscribed in the Scheduling of Commitments and subject to any conditions and qualifications set out there, accord to services and services suppliers of any other party, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers;

Market access commitment means, a party making commitments shall not, in respect of the sectors and services inscribed in the Scheduling of Commitments and subject to any conditions and qualifications set out there, adopt either on the basis of a regional subdivision or on the basis of its entire territory other market access limitations, including limitations on the number of service suppliers, limitations on the total value of service transactions or assets, limitations on the total number of service operations or on the total quantity of service, limitations on the total number of natural persons that may be employed, measures which restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service, and limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment;

Most-favoured-nation treatment means a party making commitments shall, in respect of the sectors and services inscribed in the Schedules of Most-Favoured-Nation Treatment and subject to any conditions and qualifications set out there, accord to services and service suppliers of another party, treatment no less favourable than that it accords to like services and service suppliers of any other party or of any non-party;

Local presence commitment means a party making commitments shall not, in respect of the sectors and services in the Negative List, require a service provider of another party to establish or maintain a representative office, a branch or any form of juridical person, or to be resident, in its territory as a condition for the supply of services, except where specific reservations have been made regarding the establishment of commercial presence.

Australia, Japan, Republic of Korea, Brunei, Indonesia, Malaysia and Singapore have made commitments to opening up their trade in services in Annex III to the RCEP Agreement in the form of a Negative List. Each of the above seven countries sets out therein the types of commitments involved (national treatment, market access, most-favoured-nation treatment and/or local presence), the relevant industries and types of services to which such commitments do not apply, a brief description of the circumstances where they do not apply, etc.

It should be noted that among the contracting states that make commitments through Positive Lists, China, New Zealand, the Philippines, Thailand and Vietnam shall submit their proposed Schedule of Non-Conforming Measures no later than three years, or for Cambodia, Lao PDR and Myanmar, no later than 12 years, after the date of entry into force of the RCEP Agreement, and the two group of contracting states shall complete the transition process no later than six years or fifteen years after the date of entry into force of the RCEP Agreement, respectively.

(II) The level of openness of design and construction services in different RCEP countries – case analysis

In practice, Chinese enterprises providing design or construction services in other RCEP country should be familiar with the basic principles of commitments to opening - up of trade in services as specified in Chapter 8 of the RCEP Agreement. On this basis, they can search and analyse the Positive List in Annex II or the Negative List in Annex III to the RCEP Agreement to verify the host country' s commitment to open up design and construction services in relevant industries or fields.

The following will take Vietnam and Indonesia as examples to illustrate the commercial presence and qualification requirements in carrying out engineering and construction services under local laws as well as the related commitments under the RCEP Agreement.

1. The level of openness of design services in Vietnam and Indonesia

Item	Legal requirements before the RCEP Agreement	Commitments under the RCEP Agreement
Vietnam		
Commercial presence requirements for design services	• In accordance with the commitments that Vietnam has made in the *Agreement on Trade in Services of the Framework Agreement on Comprehensive Economic Cooperation between China and ASEAN* (the China-ASEAN Agreement), Vietnam allows, in principle, Chinese companies to provide design services through the cross-border supply mode without establishing a commercial presence. • If the design work is required to be carried out locally, in accordance with Vietnamese law, it is usually necessary to establish a subsidiary or an executive office to meet the qualification requirements. There are no explicit provisions or practices in respect of the application for the corresponding licences in the name of a branch.	• There is no restriction on the provision of engineering services through the cross-border supply mode. • If it is necessary to establish a subsidiary to carry out the engineering work locally, in principle, there is no restriction on the shareholding of foreign investors.

Item	Legal requirements before the RCEP Agreement	Commitments under the RCEP Agreement
Vietnam		
Qualification requirements for design services	• In accordance with the commitments that Vietnam has made under the China-ASEAN Agreement, the provision of engineering services through the cross-border supply mode in principle does not require local qualifications. • In accordance with Vietnamese law, foreign enterprises providing engineering services through local commercial presence shall obtain relevant foreign contractor qualifications. • International law prevails over domestic law. Since Vietnam has made opening-up commitments under the China-ASEAN Agreement, Chinese design services providers in Vietnam shall not be subject to the substantive restriction of local design qualification conditions. It remains to be seen how the Vietnamese government will implement its international obligation in practice.	• There is no restriction on the provision of engineering services through the cross-border supply mode. • For national security, public order and other reasons, the approval of the Vietnamese government is required for the supply of design services in respect of topographical, geotechnical, hydro geological and environmental surveys, technical surveys for urban-rural development planning, and sectoral development planning through the local commercial presence. Other design services shall, in principle, not be subject to substantive restrictions of local qualification conditions.
Indonesia		
Commercial presence requirements for design services	• Allowing engineering services to be provided through the cross-border supply mode without establishing a commercial presence. • If the engineering work is required to be carried out locally, it is necessary to establish a joint venture with local construction companies or to establish a representative office and cooperate with qualified local companies. • If a local joint venture is established to engage in "engineering advisory services that involve high technology, and/or high risks or high value in excess of IDR 10 billion", foreign ownership may not exceed 67%.	• There is no restriction on the provision of engineering services through the cross-border supply mode. • Retaining the requirement of establishing a commercial presence to carry out the design work in Indonesia. • Relaxing restrictions on foreign investment ratio, undertaking that the foreign ownership limit in the design industry will not exceed 55%. In addition, the country cancelled the foreign ownership limit in the above engineering advisory service industry in the Presidential Decree No.10 of 2021. • If it is intended to engage in specific engineering work such as design consultancy services by establishing a representative office, it still requires local partners to be members of the Indonesian Consultant Association.

Item	Legal requirements before the RCEP Agreement	Commitments under the RCEP Agreement
Indonesia		
Qualification requirements for design services	• No local qualifications are required for services provided through the cross-border supply mode. • If design services are provided through a local joint venture, a Sertifikat Badan Usaha (SBU, or Certificate of Business Entity in English) and an Izin Usaha Jasa Konstruksi (IUJK, or Permit for Construction Services in English) are required. If provided through a local representative office, a SBU is required and a consortium needs to be formed with local qualified companies to contract for specific projects.	• There is no restriction on the provision of design services through the cross-border supply mode. • Foreign design contractors may be subject to different approval requirements from those applicable to domestic design contractors, and they may only be limited to high-tech, high-value and/or high-risk projects.

As can be seen from the table above, Vietnam has continued its commitments under the RCEP Agreement to a higher level of openness with respect to design services as made in the China-ASEAN Agreement. In principle, Vietnam has committed to lifting the qualification restrictions on foreign design contractors, except that the topographic, geotechnical, hydrogeological and environmental surveys, and technical surveys on urban and rural development planning and industrial development planning through the establishment of a local commercial presence, need to satisfy special approval requirements. Based on our years of experience in the Vietnamese market, however, there is possibility that Vietnam may impose other approval requirements on foreign design contractors in special sectors such as electricity. Generally speaking, it remains to be seen how Vietnam will implement its international obligations.

Indonesia has not made further commitments with respect to relaxing qualification requirements for foreign design contractors to provide design services. But the country has loosened the shareholding restrictions on foreign-invested design companies and has over-fulfilled its commitments to engineering services under the RCEP Agreement through the positive list issued by President Decree No. 10 of 2021.

2. The level of openness of construction services in Vietnam and Indonesia

Item	Legal requirements before the RCEP Agreement	Commitments under the RCEP Agreement
Vietnam		
Commercial presence requirements for construction services	• In accordance with Vietnamese law, it is usually necessary to establish a subsidiary or an executive office to meet the qualification requirements. However, there are no explicit provisions or practices in respect of the application for the corresponding licence in the name of a branch.	• Allowing legal persons of other contracting states to carry out construction projects in Vietnam by establishing a branch, provided that the responsible person of the branch must be a resident of Vietnam.

Item	Legal requirements before the RCEP Agreement	Commitments under the RCEP Agreement
Vietnam		
Qualification requirements for construction services	• In accordance with Vietnamese law, foreign enterprises are required to obtain foreign contractor license or the qualification certificate for construction enterprises to carry out construction services locally through commercial presence. • International law prevails over domestic law. As Vietnam has made opening-up commitments under the China-ASEAN Agreement, Chinese construction services providers in Vietnam shall not be subject to the substantive restriction of local construction qualification conditions. It remains to be seen how the Vietnamese government will implement its international obligation in practice.	• Providing national treatment, and construction contractors from other contracting states shall, in principle, not be subject to the substantive restrictions of local qualification conditions.
Indonesia		
Commercial presence requirements for construction services	• In carrying out the construction services in Indonesia, it is required to establish a joint venture with local construction service companies or to establish a representative office and cooperate with qualified local companies. • If a local joint venture is established to carry out "construction projects that involve high technology, and/or high risks or high value in excess of IDR 50 billion", foreign ownership may not exceed 67%.	• Retaining the requirement of establishing a commercial presence to carry out the engineering construction in Indonesia. • Relaxing restrictions on foreign investment ratio, undertaking that the foreign ownership limit will not exceed 55%. In addition, the country cancelled the foreign ownership limit in the above construction projects in the Presidential Decree No.10 of 2021.
Qualification requirements for construction services	• If construction services are provided through a local joint venture, a SBU and an IUJK are required. If provided through a local representative office, a SBU is required and a consortium needs to be formed with local qualified companies to undertake project contracting.	• No commitment.

As shown in the table above, Vietnam has made further opening commitments under the RCEP Agreement with respect to construction service qualifications compared with those under its domestic law. The country not only explicitly allow legal persons from other contracting states to carry out construction work in Vietnam by establishing branches, but also commits to providing national treatment to other contracting states except for particular restrictions such as the nationality of the head of the branch. Therefore, in principle, construction contractors from other contracting states will not be subject to substantive restrictions on local qualification requirements to carry out works in Vietnam. At present, it is hardly operable for foreign contractors to obtain relevant qualifications and permits by establishing a local branch under Vietnamese law. Thus, it also remains to be seen how Vietnam will honour its commitments with respect to opening access to construction services.

Indonesia' s further opening-up of the construction services is similar to that of the design consultancy services, which is mainly reflected in the relaxation of foreign ownership limit. The country has also over-fulfilled its commitments under the RCEP Agreement by removing the foreign investment ratio restrictions on specific construction projects.

Conclusion

The formal entry into force of the RCEP Agreement implies a synergistic trend of mutual recognition of technical standards and professional qualifications among contracting states in the RCEP free trade area, as well as commitments to a higher level of openness of trade in service, including design consultancy, construction and other services. The RCEP Agreement is an evolving and general agreement. The extent to which Chinese international design consulting enterprises and construction contractors can enjoy the facilitation measures and preferential commitments provided under the RCEP Agreement largely depends on the detailed transition rules issued by the contracting states from the perspective of domestic regulation and their implementation in practice. Meanwhile, the enjoyment of the facilitation measures and preferential commitments also relies on whether the investors can give due regard and make good use of the facilitation and preferential measures brought by the rules in each specific project in the bidding, implementation planning and project implementation processes so as to seize more business opportunities.

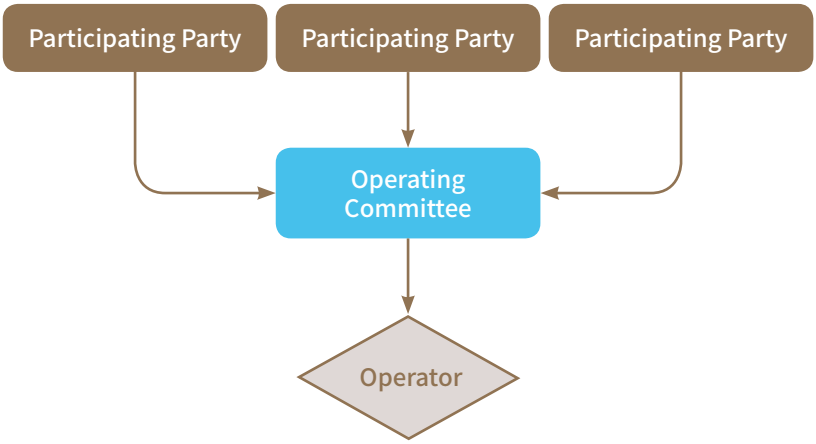
Thanks to intern Liu Yifan for his contribution to this article.

POSITIONS AND BALANCE OF OPERATORS AND NON-OPERATORS UNDER JOAS

Fan Duoling (Grace), Zhang Jingjia

The joint operating agreement, or JOA, is an important instrument that restricts the way of joint operation among multiple investors in the field of resource development. It can also be understood as a shareholders' agreement in the energy sector. As no legally independent entity is created under the joint operating arrangement, the JOA demonstrates more characteristics specific to the energy sector.

After obtaining approval from the government of the resource country, investors usually sign a JOA to specify the rights, obligations, liability and benefits of each party during the exploration, evaluation, development and production phases. Under the JOA, an operating committee, comprising the members appointed by the participating parties, will authorize, supervise and direct the joint operations. Roles are clearly defined among investors: operator – the party authorized to conduct operations in the field; and non-operators – all other parties.



Operating structure under the JOA

A participating party with strong exploration technology, extensive experience and substantial financial resources will traditionally be selected as the operator. In some resource countries, the local national oil companies may be the operators. With the development of Chinese oil and gas enterprises in the international oil and gas field in recent decades, they may be either an operator or a non-operator (who has less

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than 30% participating interest) in different projects. Presently, even as a non-operator, an experienced participating party can also contribute to the project under the JOA. For example, although a national oil company is designated as the operator under a JOA, the non-operators are composed of a group of experienced and highly skilled international oil companies which also have high professional experience and capabilities as operators in other projects. These non-operators are willing to share their experience with the operator, and the JOA can be a bridge for communication between them.

Although operators and non-operators are both participating parties under the JOA, they often have different views on how to conduct joint operations under the JOA. It is necessary to identify and reconcile their opposing views in order to make the JOA practically operable and maintain the project better. The table below sets out the different positions of operators and non-operators in four aspects: **operational control, financial commitment, asset development decision-making**, and **joint operations information management**.

Key points	Operator	Non-operators
Operational control	The operator desires to have operational control without excessive interference from non-operators. Specifically: • The operator is only required to obtain the approval of non-operators for relevant work plan and budget (WP&B) and is not required to ensure that the authorization for expenditure (AFE) is subject to approval on an ongoing basis. • The operator has greater discretion in awarding JOA-related contracts, including ancillary services contracts and federal contracts; and • The voting mechanism adopted by the operating committee prevents non-operators from unduly interfering with joint operations.	Non-operators desire to have fully equal operational control. Specifically: • Non-operators require that the operator obtain their approval for any WP&B and that the AFE is subject to approval on an ongoing basis; • Non-operators control all forms of contracts related to joint operations; and • The voting mechanism adopted by the operating committee empowers non-operators to influence joint operations. **The operator usually does not want non-operators to participate in the day-to-day management of joint operations. After the 2010 Gulf of Mexico oil spill, however, the operator actually wants non-operators to be more involved. Non-operators thus cannot be exempt from liability for the consequences of operations. But non-operators may be reluctant to participate in operations.**
Financial commitment	The operator expects a mandatory financial commitment from non-operators, i.e., non-operators are required to make their contribution in accordance with cash calls and bills and perform other payment obligations in a timely manner and non-payment cannot affect joint operations. Specifically: • Paying close attention to the credit of non-operators;	Non-operators expect the financial commitment to be controllable, i.e.: • Reasonably anticipating the joint operations related expenditures they will be required to contribute, to ensure the flow of their capital and avoid the risk of default or, in extreme cases, the loss of their interest under the JOA; • Defining a non-consent right for related capital contribution obligations and the procedure for the exercise of the non-consent right to avoid the risk of default;

Key points	Operator	Non-operators
	• Requesting collaterals and other support from non-operators; and • Ensuring that the JOA contains a default mechanism to facilitate the timely payment of amounts due.	• Participating in the development of WP&B and controlling costs and expenditures through, e.g., an ongoing AFE approval mechanism; • Controlling the frequency of capital calls under the JOA; and • Ensuring that penalties for failure to make scheduled contributions are not unduly harsh.
Asset development decision-making	The operator prefers flexible asset development, i.e.: Developing the concession area and assets under joint operations, including the mineral deposits and any production, processing, storage and transportation infrastructure, to the extent of authorisation and in a manner that the operator believes will maximise benefits.	Non-operators desire to make mandatory agreements on asset development: • Ensuring that the operator conducts the development and operations for the shared benefit of all parties to maximise the development of the concession area, rather than conducting any other unrelated operations based on the operator' s preference; and • Requiring the operator to make specific work plan commitments in the JOA. In practice, however, the operator is usually not under any fiduciary duty. If such differences of opinions are irreconcilable, they may be resolved by assignment, exit, or even default or forfeiture of assets.
Joint operations information management	The operator desires to assume the obligation to manage joint operations information to a controllable extent, i.e.: • Recognising that non-operators have legitimate rights to joint operations information but they are reluctant to assume correspondingly onerous obligations; • Undertaking "limited reporting obligations" under the JOA; and • Providing information to non-operators at the joint operating committee and other sub-committee meetings.	Non-operators require the right to be timely and adequately informed of joint operations information. • Requiring the operator to provide a timely, adequate and controllable flow of information and comply with the reporting requirements under the JOA to understand the status of planned and actual joint operations; and • Being informed at the operating committee and other subcommittee meetings during the development of WP&B, the AFE process and the contract award process.

I. Contention centred on the operating committee

Any JOA requires a balance of interests between the operator and non-operators. In general, the operator desires to conduct joint operations without restrictions and avoid excessive interference from non-operators. Non-operators, however, do not want to be forced into costly operations by the aggressive operator and expect operations as fair as possible.

Under economic stress, operators face certain risks. Some of the protective measures set out in the JOA to protect the legitimate interests of non-operators will be unreasonably interpreted and applied, and may even hinder joint operations from proceeding as expected. Therefore, all parties need to act cautiously during the process of JOA negotiations to ensure that provisions designed to restrict the operator' s activities will not affect the progress of the project or lead to avoidable disputes.

The coordination between the operator and non-operators is primarily carried out through the operation committee. The relationship between the operator and non-operators under the JOA and the degree of control that non-operators can seek over the operator can be seen in the relevant descriptions of the internationally accepted model JOAs in the table below.

General JOA forms	Operator	Non-operators
Association of International Petroleum Negotiators (AIPN) JOA	• Under the terms of the JOA, the operator has the right, function and responsibility to conduct operations based on the authorization and has an exclusive right to all the joint operations.	• An operating committee is established to provide overall supervision and guidance for joint operations. • In the joint operations, the operator shall perform duties in accordance with the decisions of the operating committee. • The operating committee has the authority and responsibility to authorize and supervise such joint operations as are necessary/ appropriate to achieve the authorisation.
Australian Mineral and Petroleum Law Association (AMPLA) JOA	• The operator reports to the operating committee and is under the overall supervision and control of the operating committee.	• The operating committee' s role is to supervise the management activities of the operator in the joint venture.
Canadian Association of Petroleum Landmen (CAPL) JOA	• The operator will consult with the other parties on a regular basis. • The other parties appoint the operator to explore, develop and operate the joint lands and manage the joint property on their behalf. • The operator has no obligation to lead or optimise the development of the joint lands. • The operator is an independent contractor for the activities under the JOA.	• No operating committee.
Oil and Gas UK (OGUK) JOA	• Under the JOA, the operator has the right and obligation to conduct joint operations by itself or through its agent/ contractor under the overall supervision and control of the operating committee.	• Subject to the overall supervision of the operating committee, the operator has limited responsibility. • The operating committee has overall supervision and control over all matters of the joint operations.

II. Trends in balancing the responsibilities of non-operators and operators

A JOA traditionally gives the operator the exclusive right to conduct joint operations without any actual responsibilities (e.g., no duty of prudence to non-operators). In contrast, the other parties without joint operation rights cannot implement joint operations, but they should jointly assume all relevant responsibilities.

Therefore, the balance of rights and responsibilities between operators and non-operators has been highly discussed in recent years. Non-operators are also attempting to reasonably increase their protection. For example:

(1) From the perspective of non-operators, it is a good policy for them to participate in the operating committee or its sub-committees as appropriate to their actualities to gain a greater voice. Specific practices include sending their professionals from their own teams to participate in certain technical or financial tasks;

(2) Non-operators generally propose to provide in the JOA that, in certain areas where there is no clear control over the operator, the operator is obligated to enter into contracts in such a manner as they consider reasonable and in the best interests of the parties and the operator' s performance. The operator must demonstrate that the costs of such contracts (which will be returned to the parties based on their contributions) are clearly comparable to the target market rates;

(3) Under special circumstances, non-operators may remove the operator by majority voting. The JOA often lists all the circumstances under which the operator may be removed, such as bankruptcy, major breach of contract, or corruption. In addition, it takes considerable time and effort to dismiss the existing operator and nominate a replacement. This also makes it less common to remove the operator; and

(4) A common JOA generally stipulates a high threshold for non-operators to prove that loss was caused by the operator' s gross negligence. This is part of the tradition of protecting operators in the energy sector. The high threshold, coupled with the operator' s no duty of care to non-operators, makes it very difficult for non-operators to make claims. Recently, however, there have been successful cases where non-operators have lowered the threshold of "negligence of on-site staff" of the operator, gaining certainty for claims in the definitions of "on-site staff" and "negligence".

Conclusion

In the various transactions after the Gulf of Mexico oil spill, Anadarko Petroleum Corporation, one of the non-operators, made an interesting comment, "The operator of the oil well determines the detailed planning and implementation of the oil well, and is responsible for the daily activities of, and decisions executed by, personnel on the drilling platform. Consistent with standard industry practices around the world, non-operating investors rely upon the operator to make the appropriate decisions on the drilling platform." The comment represents an admission of frustration on the part of non-operators for not being involved in operational decision-making, which runs counter to the long-standing demand of non-operators for more involvement in operations.

There are historical reasons for the traditional JOA' s preference for operators, including the legal system of the resource country, the jurisprudential considerations, and the characteristics of specific projects. As mentioned at the beginning of this article, however, some experienced non-operators are willing to share their project experience with operators, and the JOA can be a bridge of communication right between them. With the prevalence of technology and the increased capabilities of personnel in the energy sector, we may see more "aggressive" non-operators. In another word, non-operators with rich experience and more supervisory authority will make valuable contributions to the project as the operator does, achieving a balance under the JOA.

Thanks to intern Xie Zixuan for the contribution to this article.

NEW CHALLENGES FOR CHINESE ENTERPRISES INVESTING IN EUROPE: A THOROUGH INTERPRETATION OF EU'S PROPOSED REGULATION ON FOREIGN SUBSIDIES

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On 5 May 2021, the European Commission (the Commission) issued a new regulation draft on the subsidies from foreign governments outside the European Union (foreign subsidy) distorting the EU market[1] (the Proposed Regulation), along with an impact assessment report (the Impact Assessment Report)[2] for public consultation. The Proposed Regulation closely follows the Commission' s White Paper on foreign subsidies released on 17 June 2020[3] (the White Paper), introducing a new review mechanism to tackle foreign subsidies that cause distortions and harm the level playing field (the New Review Regime).

If approved in its current form, the Proposed Regulation will burden companies investing in Europe with new advance notification obligations, specifically:

- **Notification obligations for concentrations:** Before closing any foreign-subsidised concentration that satisfies the corresponding notification thresholds (see Section II below for details), enterprises must report mergers and acquisitions involving foreign government subsidies to the Commission, and the settlement can be carried out only after approval. The concept of "M&A transaction" under the reporting system is relatively broad, covering not only the merger of two or more undertakings but also the acquisition by one or more undertakings, whether by purchase of securities or assets, by contract or by any other means, of direct or indirect control of one or more other undertakings, and the establishment of joint ventures

[1] Proposal for a Regulation of the European Parliament and of The Council on foreign subsidies distorting the internal market, see https://ec.europa.eu/competition/international/overview/proposal_for_regulation.pdf.

[2] Commission Staff Working Document Impact Assessment Accompanying the Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, see https://ec.europa.eu/competition/international/overview/impact_assessment_report.pdf.

[3] White Paper on levelling the playing field as regards foreign subsidies, see https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf.

between several enterprises[4]. This declaration will be a new additional obligation in dependent of current antitrust notification requirements in the EU and its member states.

- **Notification obligations in public procurement procedures:** When submitting a tender or a request to participate in a public procurement procedure that satisfies the notification thresholds (as detailed in Section II below), undertakings shall either notify to the contracting authority or the contracting entity all foreign financial contributions received in the three years preceding that notification or confirm in a declaration that they did not receive any foreign financial contributions in the last three years. Undertakings which do not submit such information or declaration shall not be awarded the contract. The above-mentioned "public procurement" covers works, supplies and services[5].

In addition, the Proposed Regulation, if adopted, will empower the Commission to review the foreign government subsidies granted in the ten years prior to the date of application of the Proposed Regulation where such foreign subsidies are considered to distort the EU market after the start of application of the Proposed Regulation. The relevant enterprises may be required by the Commission to provide all necessary information for examination, covering the M&A transactions under the thresholds and green field investments. At the same time, when the corresponding conditions are met (see Part IV below for details), the relevant companies may be subject to investigation by the Commission within and outside the EU.

In our experience, in its review of M&A notifications in recent years, the Commission has often enquired Chinese companies whether they have received subsidies, especially those directly related to the notified M&A transactions. This indicates that the Commission has started to understand and assess the impact of subsidies on the market in its M&A reviews. The Proposed Regulation also reflects the Commission's concerns about subsidies for Chinese enterprises' investing in Europe and its possible future law enforcement trends. Below is a detailed introduction and analysis of the core highlights of the above-mentioned Proposed Regulation.

I. Key concept: scope of foreign government subsidies

"A foreign government subsidy" granted to a undertaking is a precondition for the application of the Proposed Regulation. Therefore, it is crucial to understand the definition and scope of "foreign government subsidies".

"A foreign government subsidy" is broadly defined under Article 2 of the Proposed Regulation as meeting four requirements, including: 1) financial contribution 2) granted by a third country 3) conferring a benefit to an undertaking engaging in an economic activity in the EU market and 4) limited or specific, in law or in fact, to one or more undertakings or industries. These four elements will be elaborated in details below.

The Proposed Regulation is still in the legislative process and has not been applied in practice. We noted that the Commission explained in the accompanying Questions and Answers[6] that the "foreign government subsidies" under the Proposed Regulation had the similar meaning to that within the context of EU State Aid Control[7]. The Commission also noted in the White Paper that the suggested notion of "foreign subsidies" builds on the subsidy definition set out in the EU Anti-subsidy Regulation[8] and those definitions also rely on the subsidy definition set out in the relevant WTO

[4] Proposed Regulation, Article 18.

[5] Proposed Regulation, Article 26.

[6] Questions and Answers: Proposal for new Regulation to address distortions caused by foreign subsidies in the Single Market.

[7] EU State Aid Control, Articles 107 and 108 of the Treaty (Article 40(1) of the Proposed Regulation provides that "This Regulation is without prejudice to the application of Articles … 107 and 108 of the Treaty).

[8] EU Anti-Subsidy Regulation, i.e. Regulation 2016/1037 of the European Parliament and of the Council of 8 June 2016 on protection against subsidised imports from countries not members of the European Union (Article 40(2) of the Proposed Regulation provides that "This Regulation is without prejudice to the application of Regulation (EU) 2016/1037 …".

rules, in particular in the SCM Agreement[9] [10]. Therefore, the Commission' s above provisions and relevant enforcement practices are of considerable reference significance in predicting the scope of "foreign government subsidies" under the New Review Regime. We will discuss further in combination with the Commission' s previous legislation and practices in other "subsidy-related" areas.

(I). How to define a "third country" providing subsidies

Under the Proposed Regulation, the Commission adopts an expanded interpretation of the definition of "third countries" to cover not only the central government and other government authorities at all levels, but also foreign public institutions, and any private entity whose actions can be attributed to a third country. In brief, the Proposed Regulation requires that the provision of subsidy can be attributed to a country.

For the wording of "can be attributed to", however, neither the Proposed Regulation nor the White Paper provides any further explanation. This issue has been often discussed in EU anti-subsidy investigations, which could be a reference. In South Korea DRAM case, taking into account that the South Korea' s government owns 100% equity interest in the Korea Development Bank (KDB), and the KDB, as an executor of public decisions, is obliged to implement government decisions, the Commission therefore determined the KDB as a public entity whose actions can be attributed to the country[11]. In the case concerning imports of soya meal originating in Brazil, the Commission found that Banco do Brasil has close links with government, which appoints key management position of Banco do Brasil and holds a majority of its capital, and therefore determined the bank implementing the subsidy scheme on behalf of the government was a government organ or public institution[12]. The above cases show that in determining whether the "actions can be attributed to the third country" during the anti-subsidy investigation, the Commission focuses on (1) whether the government has control over the entity; and (2) whether the entity implements public policy objectives.

In addition, in the Impact Assessment Report issued in conjunction with the Proposed Regulation, the Commission explicitly cited its final decision of an anti-subsidy investigation concerning pneumatic tyre originating in China[13]. In the above case, the Commission held that loans provided by a consortium of Chinese state-owned policy banks (and state-owned commercial banks), and equity contributions by government-invested funds can be attributed to the state, and these entities were therefore be considered as providers of subsidies under the EU anti-subsidy regime[14]. These entities may also be identified as a "third country" under the New Review Regime. It remains to be seen whether wholly state-owned enterprises may also be identified as subsidising "third countries" providing subsidies under specific circumstances, such as providing raw materials or making investments.

(II). What are the forms of financial contributions?

Instead of providing a general definition of financial contribution, the Proposed Regulation states in Article 2 that it includes the following three categories:

[9] Agreement on Subsidies and Countervailing Measures, see https://www.wto.org/english/docs_e/legal_e/24-scm_01_e.htm#ArticleI

[10] White Paper, p. 47.

[11] Konstantinos Adamantopoulos, Maria J. Pereyra – Friedrichsen, EU Anti-subsidy Law and Practice, 2nd ed., 207, p. 120.

[12] Commission Decision, *Soya Meal* (Brazil) [1985] OJ L106/19.

[13] Commission Implementing Regulation (EU) 2018/1690 of 9 November 2018, Imposing definitive countervailing duties on imports of certain pneumatic tyres, new or retreated, of rubber, of a kind used for buses or lorries and with a load index exceeding 121 originating in the People' s Republic of China.

[14] Impact Assessment Report, p. 13.

- **The transfer of funds or liabilities**, such as capital injections, grants, loans, loan guarantees, fiscal incentives, setting off of operating losses, compensation for financial burdens imposed by public authorities, debt forgiveness, debt to equity swaps or debt rescheduling. Notably, as discussed above, loans provided by a consortium of Chinese state-owned policy banks and state-owned commercial banks, and equity contributions by government-invested funds, can be considered as a subsidy[15];
- **The foregoing of revenue that is otherwise due**. Neither further details under the Proposed Regulation nor cases in practice can be found in this regard. Therefore, we can refer to the EU State Aid Control and anti-subsidy investigation enforcement where tax exemption can serve as a typical example. In its anti-subsidy investigation concerning stainless steel products originating in India[16], the Commission examined the tax exemption issues. The Commission held that by waiving the income tax that would otherwise have been levied on the profits from exports, the Indian government had provided financial contributions to the companies involved, which constituted a subsidy. Meanwhile, it is stated in the White Paper that the financial contribution can consist in preferential tax treatment or tax credits[17].
- **The provision of goods or services or the purchase of goods and services**. The Proposed Regulation does not provide further explanation. Referring to EU anti-subsidy investigations, it should be noted that this category is not necessarily limited to the government' s providing relevant goods and services free of charge, but may also include their provision of certain non-market discounts and preferences during provision or purchase of goods and services. In the countervailing duty proceeding concerning imports of ball bearings originating in Thailand,[18] the Commission decided that the Electricity Generating Authority of Thailand provided subsidy by establishing a programme of rebates on electricity rates for exporters, which will be equivalent to about 20% of the cost charged to the producer.

(III). How to understand "conferring a benefit"?

Such a financial contribution should confer a benefit to an undertaking engaged in economic activities in the EU market. A financial contribution that benefits an entity engaging in non-economic activities or engaging in economic activities outside the EU does not constitute a foreign subsidy under the Proposed Regulation. [19]

A more important issue is how to understand the term "conferring a benefit". The Proposed Regulation clarifies that a comparison should be made between the relevant conduct of the government and the usual market conduct. If the provision of financial contribution by the government is consistent with market rules and the conduct of a private investor under the same circumstances, such financial contribution will not be considered as a foreign government subsidy[20]. The comparative benchmarks include the investment practice of private investors, rates for financing obtainable on the market, comparable tax treatment and the adequate remuneration for a given good or service[21]. The EU Anti-Subsidy Regulation has made detailed provisions on the comparison approach as follows[22]:

[15] Impact Assessment Report, p. 13.
[16] Konstantinos Adamantopoulos, Maria J. Pereyra – Friedrichsen, EU Anti-subsidy Law and Practice, 2nd ed., 207, p. 135.
[17] White Paper, p. 46.
[18] Commission Decision, Ball bearings (Thailand), [1990] OJ L152/59.
[19] Proposed Regulation, p. 16, (10).
[20] Proposed Regulation, p. 16, (10) and White Paper, p. 46.
[21] Ibid.
[22] EU Anti-Subsidy Regulation, Article 6.

- Government provision of equity capital shall be considered to confer a benefit, if the investment can be regarded as inconsistent with the usual investment practice, including for the provision of risk capital, of private investors;
- A loan by a government shall be considered to confer a benefit, if there is a difference between the amount that the firm receiving the loan pays on the government loan and the amount that the firm would pay for a comparable commercial loan which the firm could actually obtain on the market, and the difference between the two amounts is the benefit obtained;
- A loan guarantee by a government shall be considered to confer a benefit, if there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay for a comparable commercial loan in the absence of the government guarantee. In that case the benefit shall be the difference between those two amounts, adjusted for any differences in fees;
- The provision of goods or services or purchase of goods by a government shall be considered to confer a benefit, if the provision is made for less than adequate remuneration or the purchase is made for more than adequate remuneration (the appropriate level of compensation should depend on prevailing market conditions for the product or service in question in the country of provision or purchase, including price, quantity, availability, marketability, transportation and other conditions of purchase or sale).

The Proposed Regulation does not make further provisions on the above benchmarks, but with reference to the provisions of the EU Anti-Subsidy Regulation, if there are no such prevailing market terms and conditions for the product or service in question in the country of provision or purchase which can be used as appropriate benchmarks, the terms and conditions prevailing in the market of another country shall be used[23]. In its investigation concerning anti-dumping and countervailing duties on imports of farmed Atlantic salmon originating in Norway, the Commission used the minimum interest rate set by the OECD (known as the Commercial Interest Reference Rate, CIRR) as the comparative basis for the export credit interest rate provided by the government[24].

(IV). How to understand that the financial contribution should be "limited"?

It means that the financial contribution is limited or specific, in law or in fact, to one or more undertakings or industries. The specificity in law means the relevant document explicitly provided that the financial contribution is provided for certain undertaking(s) and/or industry(ies). The Proposed Regulation is silent on the specificity in fact. Under the EU Anti-Subsidy Regulation, factors to be considered to determine the specificity include[25] (1) use of a subsidy programme by a limited number of certain enterprises; (2) predominant use by certain enterprises; and (3) the granting of disproportionately large amounts of subsidy to certain enterprises. This approach is echoed in the EU' s anti-subsidy investigations. In its investigation concerning imports of styrene-butadiene-styrene thermoplastic rubber originating in China' s Taiwan region[26], exemption from import duties on anti-pollution equipment constitutes a subsidy limited to certain undertaking(s) and/or industry(ies), since in practice, only specific industries use such equipment and only companies that have invested in such equipment benefit from that exemption.

II. Key threshold: standards and calculation

In addition to foreign government subsidy, the Proposed Regulation also provides for other notification thresholds with respect to turnover and the total amount of foreign subsidy. Only when such thresholds are met will the

[23] Ibid.

[24] Council Regulation, *Farmed Atlantic Salmon (Norway)*, [1999] OJ L267/19.

[25] EU Anti-Subsidy Regulation, Article 4(2) (c).

[26] Commission Regulation (EC) No 1091/2000 of 24 May 2000 imposing a provisional anti-dumping duty on imports of styrene-butadiene-styrene thermoplastic rubber originating in China' s Taiwan region.

enterprises be subject to the notification obligations. The notification thresholds and calculation approach are summarised below.

(I). Thresholds for triggering the notification obligations

Thresholds	
For concentrations:	• The acquired undertaking, or at least one of the merging undertakings, or the joint venture or one of its parent undertakings is established in the EU and generates an aggregate turnover in the EU of at least EUR 500 million (RMB 3.9 billion); and • The undertakings concerned, or the joint venture itself and its parent undertakings, received from third countries an aggregate financial contribution in the three calendar years prior to notification of more than EUR 50 million (about RMB 390 million).
For public procurement:	The estimated value of that public procurement is equal or greater than EUR 250 million (about RMB 2 billion).

(II). Calculation of aggregate turnover

Similar to the EU' s current antitrust notification requirements, the "aggregate turnover" is calculated on an aggregate group-wide basis. In short, the calculation should penetrate to the ultimate controller, i.e. using the combined turnover of all the undertakings controlled individually or jointly by the ultimate controller. The calculation of aggregate turnover, however, generally excludes those among different undertakings of a same group[27].

For the purchase of assets or the transaction type, only the turnover relating to the parts which are the target of the concentration shall be taken into account. It should be also noted that two or more acquisition of assets or transactions which take place within a two-year period between the same persons or undertakings shall be cumulatively calculated and treated as one and the same concentration arising on the date of the latest transaction[28].

Chinese enterprises need to pay special attention to the fact that there have been cases where the Commission has explicitly treated the relevant enterprises under the Chinese State-owned Assets Supervision and Administration Commission (SASAC) as the same group in the concentration review. The Germany competition regulator confirmed in the acquisition of Vossloh Locomotives GmbH by a Chinese company[29] that the state-owned enterprises where the Chinese government is a majority shareholder shall be considered under the same group. In our experience, the Commission and the German authority have followed the above practice by requesting information and materials about the Chinese enterprises under the SASAC or its local branches. The Proposed Regulation does not clearly stipulate whether it will adopt the above approach and calculate the aggregate turnover on that basis. Yet it is wise to closely follow the regulatory trends under this new regime. If the same approach is adopted, it will undoubtedly have a significant impact on the scope of the Chinese state-owned enterprises' notification obligations under the New Review Regime.

[27] Proposed Regulation, Article 21(4).

[28] Proposed Regulation, Article 21(2).

[29] "Following extensive investigations, the Bundeskartellamt clears the acquisition pf Vosslo Locomotives GmbH by the Chinese company CRRC Zhuzhou Locomotives Co", p. 5, see https://www.bundeskartellamt.de/SharedDocs/Entscheidung/EN/Fallberichte/Fusionskontrolle/2020/B4-115-19.pdf?__blob=publicationFile&v=5.

(III). Aggregation of foreign subsidies

Similar to the calculation of aggregate turnover, the aggregation of foreign subsidies also adopts a group-based approach. The aggregate foreign subsidies to an undertaking concerned shall be calculated by adding together the respective foreign subsidies received from third countries by all undertakings individually or jointly controlled by the ultimate controller[30].

III. Focus of assessment: The distortive effects of foreign subsidies

Under the Proposed Regulation, the substantive review of the Commission will be divided into three main steps, namely:

- to confirm whether relevant entities have received a foreign government subsidy within the meaning of the Proposed Regulation exists (see Section I for details);
- to assess whether such foreign government subsidies may distort the EU market; and
- to weigh the positive effects against the negative effects of a foreign subsidy in terms of distortion on the EU market.

Assessment on the potential distortive effects of foreign subsidies is a core focus, which will be detailed below.

(I). Framework for assessing the distortive effects

A distortion on the EU market shall be deemed to exist where a foreign subsidy is liable to improve the competitive position of the undertaking concerned in the EU market and where, in doing so, it actually or potentially negatively affects the EU market. The Proposed Regulation provides an overall evaluation framework on how to evaluate the above distortion effects.

- **Indicators**: Whether there is a distortion on the EU market shall be determined on the basis of indicators[31], which may include the following:

  (1) the amount of the subsidy;

  (2) the nature of the subsidy;

  (3) the situation of the undertaking concerned and the markets concerned;

  (4) the level of economic activity of the undertaking concerned on the EU market;

  (5) the purpose and conditions attached to the foreign subsidy as well as its use on the EU market.

- **De minimis rule**: from the perspective of subsidy amount, it also makes it clear that the total amount of a foreign government subsidy below EUR 5 million (about RMB 39 million) over any consecutive period of three fiscal years is presumed unlikely to give rise to distortive effects[32].
- **"Negative lists"**: The Proposed Regulation identifies several categories of foreign subsidies most likely to distort the EU market[33]:

[30] Proposed Regulation, Article 22, Article 21(4).
[31] Proposed Regulation, Article 3(1).
[32] Proposed Regulation, Article 3(2).
[33] Proposed Regulation, Article 4.

(1) a foreign subsidy granted to an ailing undertaking which will likely go out of business in the short or medium term in the absence of any subsidy;

(2) a foreign subsidy in the form of a guarantee without any limitation as to its amount or duration;

(3) a foreign subsidy directly facilitating specific M&A transactions; and

(4) a foreign subsidy enabling an undertaking to submit an unduly advantageous tender, on the basis of which the undertaking would be awarded the public contract.

(II) Considerations and priorities in the review of concentrations and public procurement

The Proposed Regulation did not provide explicitly the assessment considerations and priorities in the context of concentrations and public procurement respectively. The Impact Assessment Report discusses in detail the Commission' s standpoints about possible distortions, which may serve as reference:

- **For concentrations**: One potential short-run consequence is that the subsidised companies may face less pressure for financing, while potentially more efficient competitors of the subsidised acquiring company may find themselves in a more difficult position to raise funds and therefore would be crowded out from the acquisition process. In the long run, the cost advantage of subsidised companies will be more helpful for them to achieve a dominant position in the market, leading to an increase in market concentration[34].
- **For public procurement**: In the short term, the subsidised companies may be awarded a public contract due to its cost advantage that may be obtained at the cost of quality and innovation. Even if it fails to win the bid, foreign subsidies create unrealistic and false signals to the market about prices of material, quality and the price of technology, employee salaries, delivery routes and time etc. In the long run, subsidised bidding can lead to higher prices, crowding out the competitors and the foreign control of public infrastructure[35].

IV. Procedure rules

The Proposed Regulation also provides detailed provisions on the procedures of the above two types of notifications and reviews of foreign subsidies granted prior to the application of the Proposed Regulation, which are summarised as follows:

(I) Who is obligated to notify foreign contributions?

	Obligated party
For concentrations[36]	• Merger: jointly by the parties to the merger • Acquisition of joint control: jointly by the parties acquiring joint control • All other cases: by the person or undertaking acquiring control

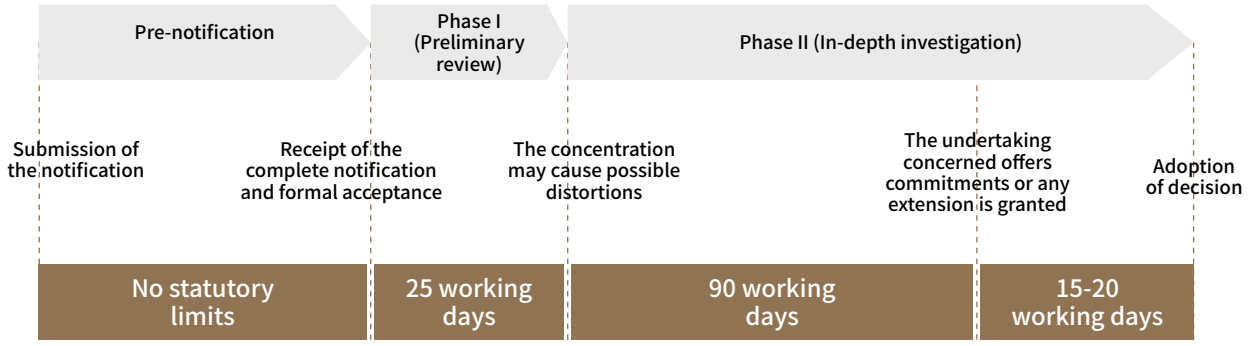
[34] Impact Assessment Report, pp. 10-12, "2.2 Problem 1: Distortions in acquisitions".
[35] Impact Assessment Report, pp. 17-18, "2.3 Problem 2: Distortion in public procurement".
[36] Proposed Regulation, Article 19.

Obligated party	
For public procurement	• The economic operator, main subcontractor and main supplier participating in the public procurement[37]. • For groups of economic operators, main subcontractors and main suppliers: the lead economic operator[38].

(II) Procedures and time limits

1. For concentrations

A notifiable concentration shall not be implemented before its notification. The procedures and time limits for notifiable concentrations are described below[39]:



It should be noted that, similar to the antitrust declaration, the Commission will not formally accept the notification until it has received a complete notification. The Proposed Regulation only provides for time limits after the receipt of the complete notification, while there is no statutory time limits for the determination of completeness (i.e. the period after the submission of the notification but before theformal acceptance). Referring to current antitrust notifications in the EU, the period before formal acceptance may vary from two weeks to several months. Under the New Review Regime, it may take a total of 25 to 135 working days for the Commission to clear the notification after receipt of a complete notification.

2. For public procurement

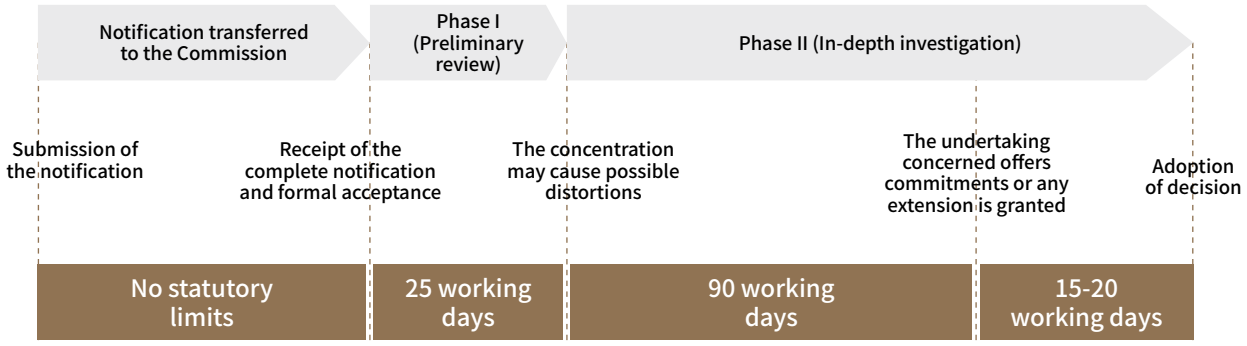
When submitting a tender or a request to participate in a public procurement procedure, undertakings shall either notify to the contracting authority or the contracting entity all foreign financial contributions received in the three years preceding that notification or confirm in a declaration that they did not receive any foreign financial contributions in the last three years. The review procedures and time limits are shown in the following figure[40]:

[37] Proposed Regulation, Article 28(2): A subcontractor or supplier shall be deemed to be main where their participation ensures key elements of the contract performance and in any case where the economic share of their contribution exceeds 30% of the estimated value of the contract.

[38] In accordance with the Public Procurement and Repealing Directive 2004/18/EC, groups of economic operators, including where they have come together in the form of a temporary association, may participate in award procedures without it being necessary for them to take on a specific legal form.

[39] Proposed Regulation, Articles 8, 9, and 23.

[40] Proposed Regulation, Articles 28, 29, and 30.



It should be noted that the notification will be forwarded to the Commission, which will not initiate a formal filing and review until it has received the notification. The Proposed Regulation provides for no statutory time limits for the transfer of the notification to the Commission. In addition, during Phase II (in-depth investigation), under special circumstances, the Proposed Regulation allows extension upon negotiation yet without specifying these special circumstances or specific period of extension.

3. Reviews of foreign subsidies granted prior to the application of the Proposed Regulation

The Commission has the power to initiate an investigation into distorting foreign government subsidies on its own initiative. The Proposed Regulation empowers the Commission with the right of enquiry, i.e. the power to request all necessary information from the recipient of the foreign subsidy or other relevant undertaking. The Commission also has the power to initiate an investigation in EU member states and third countries that are not EU members, provided that an investigation in a third country is subject to the consent of the relevant undertaking and formal notification to and consent of the government of the third country.

The Commission may take a decision on the basis of the facts available, if an undertaking concerned fails to cooperate with information requests or investigation. The result of the procedure may be less favourable to the undertaking concerned than if it had cooperated[41]. Where an undertaking concerned fails to provide the necessary information to determine whether a financial contribution confers a benefit to it, that undertaking may be deemed to have received such benefit[42].

The investigation consists of two phases:

- **Preliminary review**: The Commission will collect all the information necessary for preliminary evaluation. When having sufficient indications that the financial contribution constitutes a foreign subsidy and distorts the EU market, the Commission will initiate an in-depth investigation and then notify the relevant companies. That is to say, during the preliminary review phase, the subsidised company may have no knowledge that it is under review.
- **In-depth investigation**: The Commission will further asses at this stage. Where there are sufficient indications that a financial contribution constitutes a foreign subsidy and distorts the EU market and there is a serious risk of substantial and irreparable damage to competition on the EU market, the Commission may take interim measures. The particulars and procedures of the interim measures are not detailed under the Proposed Regulation.

[41] Proposed Regulation, Articles 11 and 14.
[42] Proposed Regulation, Article 14.

The Commission can exercise the above-mentioned powers of inquiry and investigation within and outside the EU at both the preliminary review and in-depth investigation stages.

(III) Decision and punishment

After substantive review, the Commission may make three decisions: prohibition, unconditional approval (no objection decision) and a decision with redressive measures. Possible redressive measures may include[43]:

- **Structural remedies**: divestment of certain assets; requiring the undertakings concerned to dissolve the concentration;
- **Behavioural remedies**: offering access under fair and non-discriminatory conditions to an infrastructure that was acquired or supported by the distortive foreign subsidies; reducing production capacity or market size; prohibiting specific investments; licensing on fair, reasonable and non-discriminatory terms of assets acquired or developed with the help of foreign subsidies; publication of results of research and development; repayment of the foreign subsidy, including an appropriate interest rate.

To ensure the implementation of the rules and decisions under the Proposed Regulation, the Commission is empowered to impose fines for non-compliance, detailed as follows[44]:

Violations	Fines and periodic penalty payments
Intentionally or negligently, failing to notify a notifiable concentration, implementing a notified concentration prior to the grant of approval, or a notified concentration prohibited, failing to notify a subsidy during the public procurement procedure	Fines not exceeding 10% of the aggregate turnover of the undertakings concerned in the preceding business year
Violating a decision with commitments, a decision ordering interim measures or a decision imposing redressive measures	• Fines: not exceeding 10 % of the aggregate turnover of the undertaking concerned in the preceding business year; and • Periodic penalty payments: not exceeding 5% of the average daily aggregate turnover of the undertaking concerned in the preceding business year for each day of non-compliance, starting from the day of the Commission decision imposing such penalty payments, until the Commission finds that the undertaking concerned complies with the decision
Supplying incorrect, incomplete or misleading information in response to a request or refusing to cooperate with the investigation	• Fines: not exceeding 1 % of the aggregate turnover of the undertaking or association of undertakings concerned in the preceding business year; and • Periodic penalty payments: not exceeding 5% of the average daily aggregate turnover of the undertaking or association of undertakings concerned in the preceding business year for each working day of delay, calculated from the date established in the decision, until the complete and correct information as requested by the Commission is submitted.

[43] Proposed Regulation, Article 6.

[44] Proposed Regulation, Articles 15, 25, and 32.

It remains to be clarified in future legislative and practical developments that whether the aggregate turnover in the above fines shall adopt group-based calculation and refer to the global turnover.

(IV) Transitional provisions

In general, the systems stipulated in the Proposed Regulation will apply to foreign financial contributions granted in the three years prior to the date of its application and foreign subsidies granted in the ten years prior to such application and with a distortive impact on the EU market after the start of application. The Proposed Regulation has no retroactive effect. It shall not apply to concentrations for which the agreement was concluded, the public bid was announced, or a controlling interest was acquired before the date of its application, and it should not apply to public procurement procedures that have been initiated before the date of its application[45].

V. Conclusion and takeaways

The Proposed Regulation currently is under review by the European Parliament and the Council of the EU based on the ordinary legislative procedure. Based on past legislative practices, the Proposed Regulation may have gone through the complete legislative procedure by the end of 2022. We will keep a close eye on the legislative developments and provide further in-depth analysis for Chinese enterprises.

If the Proposed Regulation is adopted, Chinese companies conducting investment and M&A in the EU may be subject to three types of notification obligations at the same time: 1) notification of foreign subsidies as provided under the Proposed Regulation; 2) antitrust notification as required by the EU or its member states; and 3) foreign investment notification in the EU member states, imposing more obstacles in terms of time, cost, and uncertainties. For bids in public procurement above EUR 250 million, Chinese companies participating in the bidding need to fulfill their declaration obligations and will also face more stringent scrutiny.

In addition to reflecting opinions to the Commission through consultation and other channels, we suggest that Chinese companies intending to invest in M&A transactions or participate in large public procurement in the EU in the future fully prepare in advance and actively respond to difficulties and challenges that may arise.

- Chinese companies intending to tender for M&A or bid for large public procurement projects in the EU after 2022 are advised to reasonably determine the sources of and arrangements for capital financing, in particular carefully assessing relevant arrangements involving specific government fund financing.
- Chinese companies that have received foreign government subsidies should fully consider the impact of the New Review Regime if they plan to conduct investment M&A transactions in the EU after 2022. On the one hand, it is advisable to prudently assess possibility of the transaction being prohibited or subject to additional restrictive conditions as a result of the foreign subsidy review; on the other hand, full considerations should be given to the transaction timing, conditions precedents and break-up clauses in advance during the design and negotiation of the transaction.
- For enterprises active in M&A and bidding activities in the EU, they should maintain regular statistics and confirmation of their own access to government subsidies, sort out whether the relevant subsidies are captured by the Proposed Regulation and count the amount, and keep important supporting documents and materials on file.

[45] Proposed Regulation, Article 47.

A GLOBAL VIEW OF RENEWABLE ENERGY PROJECTS: THREE KEY ISSUES FOR INVESTMENT DECISIONS ON DOMESTIC AND FOREIGN OFFSHORE WIND POWER INVESTMENT, CONSTRUCTION AND OPERATION PROJECTS

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Under the background of the 1.5 °C temperature control target set in the Paris Agreement and the successive commitments of countries around the world to “carbon peak” and “carbon neutrality” schedules, it has become an important objective and task for investors to find investment opportunities in renewable energy projects globally.

Compared to onshore wind power projects, offshore wind power projects have the merits of abundant resources, higher utilisation hours and more advanced technology, making it on the frontier of renewable energy development. Therefore, many countries regard offshore wind power as the key to implementing emission reduction strategies and achieving the goal of carbon neutrality. From a project lawyer’ s perspective, there are some common project-related and transactional issues for investors to consider wherever the project is located. Investors need to accurately identify the differences and make appropriate choices with due regard to local laws and practices as well as experiences in similar projects.

Electricity generation from offshore wind power in Europe sustains steady growth, with the UK, the Netherlands and Denmark being the engines of offshore wind development in this region. In the Asia-Pacific region, China is the leader in offshore wind power generation, with new installed offshore wind power capacity of 14.48GW in 2021, ranking first in the world. Vietnam has become an emerging market for offshore wind power development in the Asia-Pacific region as a result of its unique location and climate advantages as well as government policy support. This article briefly introduces the relevant laws and practices in China, Vietnam and the UK on certain selected issues that may affect and shape the decision on investment, construction and operation of offshore wind power projects. We hope to provide useful references for your proper decision on investment in these projects.

I. Development rights and key permits for offshore wind power projects

(I) Investment access restrictions

Investors seeking opportunities in offshore wind projects around the world undoubtedly need to make it clear whether and what investment access restrictions exist in the country or region where the project is located in the first place.

In China, in the early offshore wind power projects, the Chinese side must hold shares (more than 50% equity). However, now the offshore wind sector is generally open to foreign investment under the current laws and regulations, and foreign investment in wind power sector is encouraged. On 20 October 2020, China' s first Sino-foreign joint venture offshore wind power project was officially launched in Dongtai, Jiangsu Province[1].

In Vietnam, the legislation on foreign investment in the offshore wind power sector has similarities to China' s earlier legislation for this sector. In accordance with Law on Investment of Vietnam and its implementation regulations, offshore wind power remains a sector conditionally open to foreign investment.

The UK has long been open to foreign investors developing offshore wind power projects. However, due to the acquisition notification procedure under the National Security and Investment Act 2021 which came into force recently, it' s foreseeable that investment in the energy and power (including offshore wind power) sector would become difficult to some extent.

For countries with investment access restrictions, investors may explore the legal feasibility of different transaction structure designs to meet the relevant foreign investment limitations.

(II) Key permits required to obtain development rights of projects

In China, in accordance with relevant laws and regulations, the core approval permission involved in the development right of offshore wind power projects includes the incorporation of the project into the offshore wind power planning at or below the provincial level, competitive allocation of guaranteed grid connection quota, preliminary approval of sea use and land use, and project approval documents.

Key permits	Illustration
Offshore wind power plan at or below the provincial level	The provincial energy authorities are responsible for compiling the offshore wind power development plan within the sea areas under the jurisdiction of that province (which includes offshore wind farm project planning); offshore wind power projects shall not be constructed if they are not included in the development plan.
Competitive allocation of guaranteed grid connection quota	The provincial energy authorities determine the annual new guaranteed grid connection quota of their provinces based on the responsibility weight for the consumption of electricity generated by non-hydropower renewable energy projects and the reasonable target utilisation rate of renewable energy in the region. Electricity grid enterprises guarantee the grid connection of new grid-connected projects necessary for achieving the minimum ratio of the consumption of electricity generated by non-hydropower renewable energy projects, and these guaranteed grid-connected projects shall be optimized by the provincial energy authorities through competitive allocations.

[1] Xinhuanet: "The First China-foreign Joint Venture Offshore Wind Power Project Unveils in China": http://www.xinhuanet.com/power/2020-10/21/c_1210851433.htm

Key permits	Illustration
Preliminary approval of the sea use and land use	Before applying for project approval, the project owner should submit an application to the competent maritime authorities for the preliminary approval of sea use. After reviewing the application in accordance with the prescribed procedures and requirements, the competent maritime authorities will issue preliminary approval for granting the sea use rights[2]. The preliminary approval will be valid for two years. In case of any change in the area, location or purpose of the relevant sea areas within the valid period, a new application should be filed. The construction of offshore substations and other onshore ancillary facilities for an offshore wind power project also requires a preliminary approval of land use. If the state-owned land use right is allocated without any consideration, the "opinion on planning and location" should also be obtained. Fortunately, such opinion has been consolidated with the "preliminary approval of land use".
Project approval document	The competent energy authorities at or below the provincial level shall, in accordance with the relevant laws and regulations and based on the offshore wind power development plan approved by the National Energy Administration (NEA), approve offshore wind power projects that meet the construction conditions. The approval documents shall be made public in a timely manner and copied to the NEA and the maritime authority at the same level.

In Vietnam, the approval process for offshore wind power projects is relatively complicated due to the rapid update of law and the involvement of different authorities. At the initial stage of project development, in order to secure the development right of an offshore wind power project, a foreign investor is generally required to obtain (i) the approval from the Prime Minister (through the Ministry of Industry and Trade) to include the project into the national or provincial power plan, (ii) the in-principle approval of the project from the Prime Minister or the provincial people's committee, and (iii) the investment registration certificate. Subsequently, the foreign investor is required to conduct a feasibility study and obtain other approvals and sign agreements, which include approval of environmental impact assessment, sea area allocation decision, grid connection agreement, etc..

In the UK, the approval process for offshore wind power projects is relatively straightforward. To gain the right to develop an offshore wind power project, a foreign investor needs to obtain key approvals and consents such as the seabed lease, the development consent and the generation license. In addition, the investor also needs to conduct environmental impact assessments, obtain marine license and other necessary approvals and permits, and bid for contract for difference (CFD). To enter into a Crown Estate seabed lease is the first step of the development of offshore wind power projects in the UK. The Crown Estate, who is responsible for managing the seabed, is currently conducting the Offshore Wind Leasing Round 4. An investor who wins the bid will sign an agreement for lease with the Crown Estate, with the maximum term of ten years. During the term of the agreement for lease, the investor needs to obtain the development consent and generation license, bid for CFD and achieve financial close. The development consent or the similar will be granted by different authorities[3] depending on the installed capacity, and the generation license is issued by the Office of Gas and Electricity Markets.

[2] In addition to Article 21 of the *Administrative Measures for Offshore Wind Power Development and Construction*, Article 22 of the *Administrative Measures for Approval and Filing of Enterprise Investment Projects* (National Development and Reform Commission Order No. 2) also provides: "When a project owner submits a project application report, the following documents shall be attached pursuant to the State laws and regulations: … (2) the preliminary approval of land (sea) use issued by the land and resources (maritime) administrative authorities (except where the land and resources administrative authorities specify that preliminary approval of land use is not required)".

[3] An offshore wind power project of less than 100 MW shall be subject to a Planning Consent granted by the Marine Management Organization or the Welsh Government; an offshore wind power project of more than 100 MW is classified as a "national significant infrastructure project" and shall be subject to a Development Consent Order granted by the Secretary of State from the Planning Inspectorate.

II. Electricity pricing and financing models of offshore wind power projects

(I) Guarantee for electricity prices of projects

In brief, the electricity pricing models of renewable energy projects (including offshore wind power projects) mainly include competitive tariff plus subsidy, feed-in tariff and cost-plus tariff. From investors' perspective, cost-plus tariff is the best, followed by feed-in tariff, and then competitive tariff plus subsidy. Different countries adopt varied electricity pricing models based on their development stages and policy orientations.

The electricity pricing of China' s offshore wind power projects have evolved from feed-in tariff to guide price plus subsidy and eventually to "grid parity" (i.e. the "subsidiary free" tariff). In June 2014, the National Development and Reform Commission (NDRC) issued the *Notice on the Policies of On-grid Electricity Prices for Offshore Wind Power* (Fa Gai Jia Ge [2014] No. 1216). The policy specifies for the first time the benchmark feed-in tariff for non-tendered offshore wind power projects, which distinguished nearshore wind power and intertidal wind power projects.

In May 2019, the NDRC issued the *Notice on Improving the Policies for On-Grid Wind Power Prices*, which changes the benchmark feed-in tariff for onshore and offshore wind power to guide prices.

At the beginning of 2020, the Ministry of Finance, the NDRC and the National Energy Administration jointly issued the *Several Opinions on Promotion of the Sound Development of Power Generation with Non-hydropower Renewable Energy Resources*. As clarified by the new policy, any new offshore wind power project shall no longer be included in the coverage of the central government financial subsidies but may be supported by local authorities according to the actual situation. The new policy is not applicable to any existing offshore wind power project which had been approved (filed) as required and generating units of which had all been connected to the grid by the end of 2021.

In Vietnam, in accordance with the current policies and regulations, the feed-in tariff announced by the Vietnamese Government only applies to offshore wind power projects that had operated commercially by 1 November 2021. For wind power projects that are difficult to achieve commercial operation by that date due to the COVID-19 pandemic, the Vietnamese Government is considering the possibility of extending the period of feed-in tariff in view of investors' demands. As of now, however, the Vietnamese Government has not promulgated any relevant decrees or policies to extend the period, or any new incentive policies for feed-in tariff applicable to offshore wind power projects which commenced commercial operation after 1 November 2021. The subsequent adjustment of offshore wind power price policies in Vietnam is worth more attention.

In addition, the investors of offshore wind power projects in Vietnam may apply to Vietnam Electricity (the EVN) for execution of long-term power purchase agreements. Under the model power purchase agreement published by the Ministry of Industry and Trade of Vietnam, the validity period shall be 20 years from the commercial operation date. Within the amount of power the seller is able to provide, the purchaser shall perform the "take or pay" obligation for the power supplied by the power station, thus ensuring the stability of the seller' s power revenue to some extent.

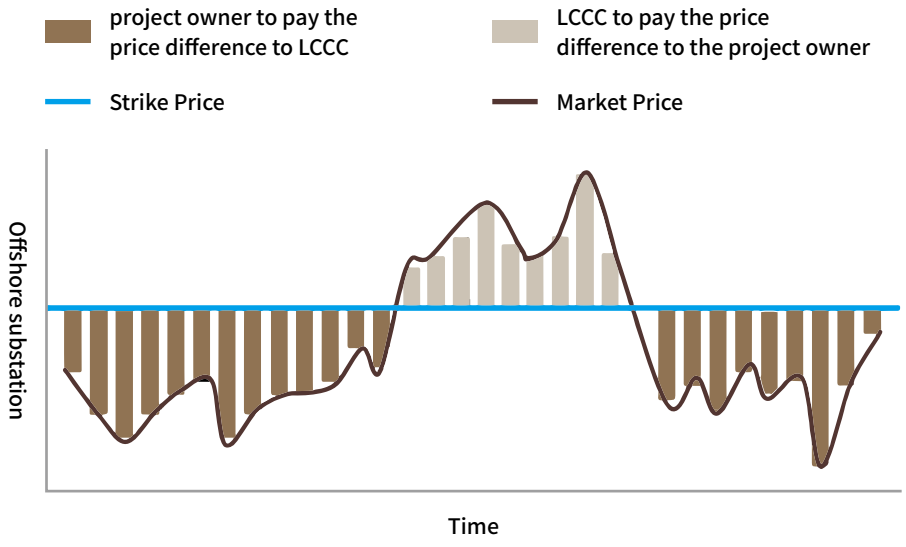
Similar to the gradual electricity price adjustment models based on different development stages in China, the UK has introduced a series of policies at different stages of renewable energy development, including the renewables obligation certificate, feed-in tariff and contract for difference(CFD). In general, the competitive tariff has become the latest model for offshore wind power development in European countries (including the UK), and it has become the consensus of European countries to accelerate the cost reduction of offshore wind power. Europe is now widely utilizing the bidding model to develop offshore wind projects. The level of electricity price subsidy has decreased significantly, making the price of offshore wind power increasingly competitive.

(II) Availability of non-recourse or limited recourse project financing

At present, offshore wind power projects in the UK, the Netherlands, France, Germany and other European countries are developing rapidly[4], and the financing methods adopted by these projects mainly include project finance, corporate finance, capital market finance and bond finance, among which project finance is the most commonly used. Many famous offshore wind power projects such as Galloper and Dudgeon in the UK and Blauwwind in the Netherlands adopted project finance method.

Taking the UK as an example, the government introduced the CFD in 2014, securing long-term "fixed" power prices for investors of renewable energy projects, which is the key to adopt project financing model in their offshore wind power projects.

The basic principle of CFD model is that the government, through its wholly-owned Low Carbon Contracts Company Limited (LCCC), and the project owner agree in advance on a strike price by competitive bidding, and the LCCC will subsidise the difference between the strike price and the market price. Under the CFD, if the market price is higher than the strike price, the power generation enterprise shall return the excess; if lower, the project owner will be compensated for the price difference. This mechanism, as shown below, ensures the stability of the income of the project owner derived from electricity generation:



In determining the strike price under the CFD, costs and returns of investment, construction and operation in the whole lifecycle of the project are considered, and the term of the CFD can be up to 15 years. During this term, the strike price may only be adjusted in accordance with the CFD (mainly based on the CPI). Except for the mandatory technical indicators, the government shall not unilaterally modify such contract.

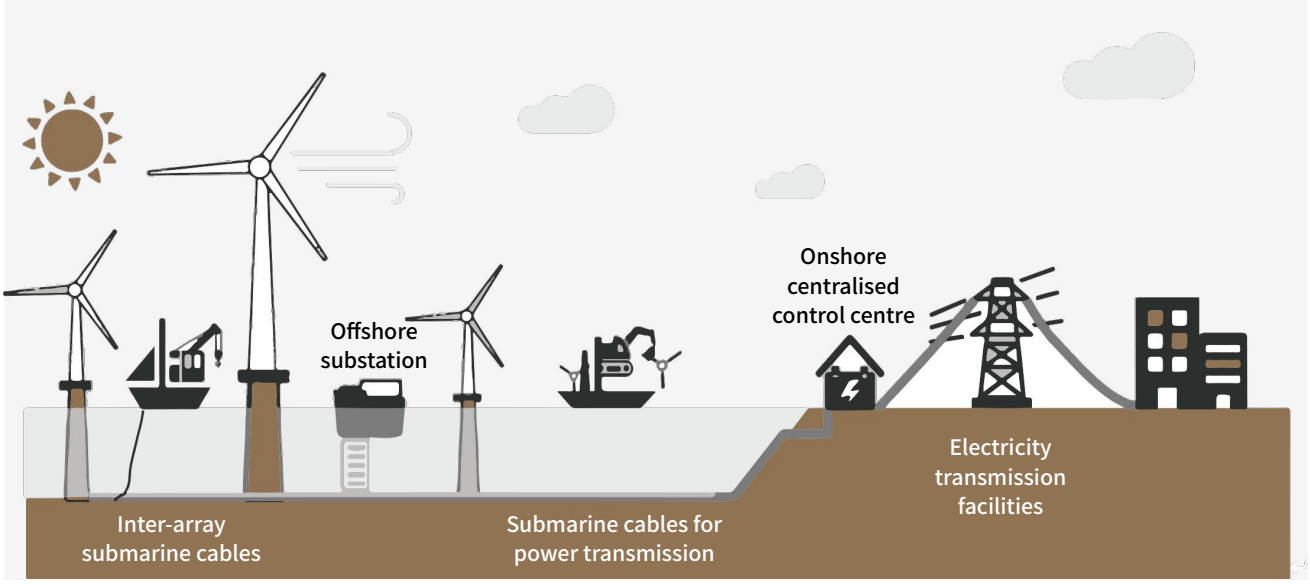
Under the certainty of such "fixed" tariff specified in the CFD, the power generation enterprises can reduce costs by means of technology upgrading, thus increasing profits. This promotes technology development, cost reduction and efficiency increase. In addition, all the fees of the power generation enterprises to whom the CFD apply will be paid by the LCCC on schedule, which ensures the stable electricity tariff income of the enterprises and satisfies the requirements of bankability under the project finance model.

[4] WindEurope, *Financing and Investment Trends 2020*, p.20.

In contrast, restricted by market conditions, most renewable energy projects (including offshore wind power projects) in China adopt the traditional corporate financing mode. In this method, the project owner is the borrower while the sponsors (i.e. the shareholders of the project owner) or its parent company provides the guarantee and other security interests over their assets. Financial institutions grant loans for the project mainly based on the credit worthiness of the borrower and the guarantor (usually the sponsors), rather than based on the benefits and assets of the project. In case of a loan default, the financial institution has the right of recourse against the sponsors[5]. With the implementation of the policies on "grid parity" and the possible introduction of long-term fixed-price power purchase agreements (for a term of no less than 20 years), we expect that the offshore wind power projects of China can learn from the advanced experience of Europe, explore use of project financing model and promote industrial development.

III. Construction and operation of offshore wind power projects

An offshore wind power project normally consists of offshore wind turbines, offshore substation, submarine cables and other offshore facilities. Onshore centralised control centres, onshore transmission facilities and other onshore facilities may also be included. Therefore, it is more complicated to implement and manage offshore wind power projects than onshore power projects. For each investor, it is a challenge to ensure that the construction contract of an offshore wind power project is performed in accordance with the price determined in the investment budget and the construction period. This is also a core concern for banks regarding the bankability of construction contracts under the project financing model.



(I) Project site risks to be considered in investment decision-making

For offshore wind power projects, site conditions are not only one of the vital factors that affect project completion time and construction, operation and maintenance (O&M) costs, but also greatly affect the generation revenue to a

[5] Zhong Liang, "Introduction to the European Green Finance Project Financing Models — Taking the Offshore Wind Power Industry as an Example", http://www.greenfinance.org.cn/displaynews.php?id=2357.

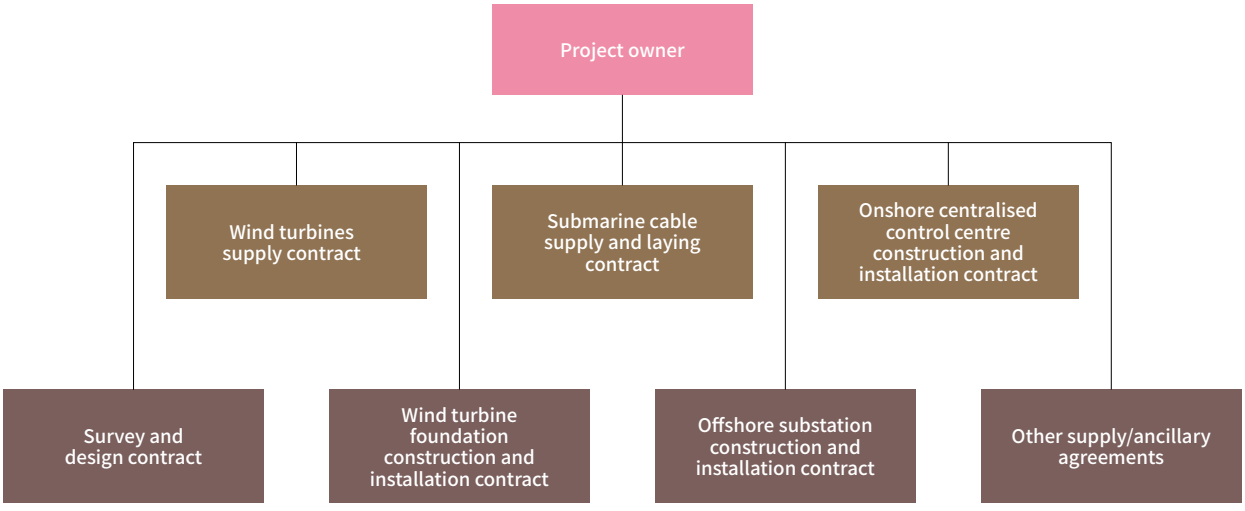
large extent. Therefore, investors need to conduct the economic and technical feasibility analysis of the project based on a rigorous evaluation. Common site conditions/risks of offshore wind power projects include:

- Wind speed. The generation incomes of offshore wind power projects are greatly influenced by the future wind speed. The factors affecting wind speed include not only the location and height of the wind measurement, but also the time of collecting the wind information. Generally, the longer the collection time, the more comprehensive the wind information, the stronger the reference for predicting the future wind speed for the project.
- Geological conditions of the seabed. The construction of wind turbines foundations and the laying of submarine cables are done on the seabed. It is impractical to require every contractor to visit the construction area for on-site inspection. Thus, the contractors often reply on the geological conditions of the seabed and other geological information provided by the project owner for their quotation. The construction window is limited due to the seasonal changes of the ocean climate. Thus, there may be risks of construction delay and/or cost overruns of the offshore wind power project if such information is inaccurate or unclear.
- Conditions of grid connection. The conditions of grid connection affect the future power generation revenue. The project owner needs to know the specific location of grid connection points, the expected grid connection time, the grid consumption capacity and other conditions in advance in order to comprehensively consider the overall planning of the offshore wind power project.

(II) The procurement/contract models for project construction

In the construction of infrastructure projects, limited by their own experience in engineering and construction management, project owners usually choose the EPC contract to effectively manage the completion risks and ensure the bankability of the project. However, the procurement/contract models for offshore wind power projects are not always the same. Although in some offshore wind power projects EPC model are used, it' s more common that most project owners enter into multiple parallel contracts with different contractors/suppliers.

Taking an offshore wind power project in China as an example, the multi-contract model is shown below:



Although the multi-contract model is more common in current offshore wind power project construction practice, it poses additional challenges to the project owner' s ability to coordinate multiple resources such as design, supply, construction and installation, as well as the responsibilities under multiple contracts. The risk of the overall project being completed at the scheduled price and duration increases. For the project owner and lenders, the multi-contract model also reduces the maximum liability limit guarantee available to the project owner under an EPC contract. As a result, it is often not the first choice of lender where the non-recourse/limited recourse project finance method is used. If multi-contract model is chosen, the banks will pay more attention to and deeply get involved in supervising the effectiveness and performance of the contracts.

(III) Major issues to be considered for O&M of offshore wind power projects

Affected by many factors such as the site conditions (wave height, wind speed, seabed geological conditions, offshore distance, etc.), climate and technical conditions, it is generally more complex and costly to operate and maintain an offshore wind power project than other infrastructure projects (including onshore wind power projects). The project owner should enter into a long-term O&M contract with a professional O&M contractor for operating and maintaining the offshore wind power project. Based on our relevant experience, the wind turbine technology for offshore wind power projects is relatively sophisticated and cutting-edge, and thus many wind turbine manufacturers are also wind turbine O&M service providers. The project owner is also inclined to choose a specialised contractor responsible for laying submarine cables to participate in the O&M of the submarine cables. Accordingly, the major issue in the O&M contract for an offshore wind power project is to define the service scope of the O&M contractor and the guaranteed minimum availability. Even if the O&M contractor can accept the guaranteed minimum availability, during the negotiation of the O&M contract, it will still be difficult to negotiate the operation and maintenance contract by considering the reasonable minimum availability exclusion in combination with the actual situation of the project (for example, the overlapping of the O&M obligations in the first year and the obligations during the warranty period under the turbines supply contract).

Conclusion

The International Renewable Energy Agency (IRENA) predicted that under the goal of controlling global warming below 1.5 °C, by 2050, the global offshore wind power installed capacity will exceed 2000GW, accounting for 1/4 of the global wind power capacity. The Global Wind Energy Council (GWEC) forecasts that by 2050, the Asian offshore wind power market will account for 40% of the global market, followed by Europe with 32%. It can be seen that the global energy system is undergoing transformation, and offshore wind power, as a key renewable energy technology, has huge development potential.

After many years of rapid development, nearshore market of offshore wind power have tended to saturate, and offshore wind power projects have also entered the era of "grid parity" in China. Therefore, it will be a challenge for the high-quality and sustainable development of China' s offshore wind power industry to motivate all relevant parties to promote the innovation of core offshore wind power technology, the cost reduction in the industry, the upgrading and improvement of the industrial chain, the exploration of floating power generation technology and the development of offshore wind energy in the deep and distant sea. The Chinese government is gradually implementing supporting policies for the renewable energy "grid parity" era (including long-term stable power purchase) to improve the percentage of renewable energy consumption. We believe that the offshore wind power industry will achieve large-scale development and have a higher ratio in the total energy consumption in the future after short-term adjustments.

Thanks to Ms. Ding Hongxu for her contribution to this article.

PROSPECTS FOR HYDROGEN IN ASIA-PACIFIC

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In a region responsible for the majority of the world' s energy consumption, Asia-Pacific region is faced with critical tension between a pressing need for energy to fuel economic development and global pressure to reduce carbon emissions.

Under the Paris Agreement, which was signed in 2015 by all countries in the Asia-Pacific and other countries in the world, the objectives are to reduce greenhouse gas emissions to limit global temperature increase in this century to 2 degrees Celsius above preindustrial levels, and to pursue efforts to limit the increase to 1.5 degrees Celsius. To this end, it is critical that the world transitions away from a fossil fuel economy and, for this to occur, a sustainable and green source of alternative energy needs to be found.

Hydrogen (produced from low or no carbon energy), in particular, green hydrogen, has been cited as a potentially key enabler for this energy transition to occur. Strong government and commercial support, coupled with technological advancements, point to promising prospects for development of clean hydrogen in the Asia-Pacific region. However, there remain various significant challenges to be overcome before a true hydrogen economy in the region can mature and take root. In the immediate term, the push for hydrogen as a clean energy source must confront and overcome economic uncertainties brought about by the COVID-19 pandemic. In the longer term, industry participants and government will need to develop both the supply and demand ends of the hydrogen economy (balancing that development so as to ensure its overall commercial viability).

This article provides a broad overview of the hydrogen market – introducing some of the market' s key concepts and fundamentals, and analyzing some of its key opportunities, challenges and recent developments. In the article which follow, we will dive deeper – focusing on specific commercial, policy and regulatory issues, and the hydrogen landscape in particular regional jurisdictions.

I. Production of Hydrogen

Hydrogen can be produced through different methods, which differentiate in the carbon intensity involved in the production method. It is common

in the industry to categorize those methods through a "color-coding" system based on the methods of production. Broadly, hydrogen can be divided into brown, grey, blue and green hydrogen.

- **Brown** – Brown hydrogen is produced from the gasification of coal to produce what is known as syngas (which contains, amongst other things, hydrogen). Due to the production of carbon dioxide and carbon monoxide, the production process is relatively polluting. Most of the hydrogen produced by China (currently the world' s largest hydrogen producer) is produced in the form of brown hydrogen.
- **Grey** – Grey hydrogen production is currently the most common form of hydrogen production. Under this process, grey hydrogen is produced by steam reformation of natural gas - natural gas is reacted with steam at a high temperature to produce carbon monoxide and hydrogen. The process is energy intensive, and similar to brown hydrogen, not environmentally friendly.
- **Blue** – Blue hydrogen production adopts the same production process as grey/brown hydrogen production, but utilizes carbon capture and storage (CCS) technology for the capture and storage of associated CO_2. However, due to the need for CCS infrastructure, this is a more expensive method of hydrogen production (compared to brown/ grey hydrogen). Blue hydrogen is considered to be a transitional step on the path to green hydrogen production.
- **Green** – Green hydrogen is produced by electrolysis, which is essentially the process of splitting water molecules into hydrogen and oxygen, by passing electricity through water. If the electricity for electrolysis is generated through renewable energy sources, the production process does not result in a carbon by-product, and it is therefore an ideal (clean) form of hydrogen production from an emissions reduction perspective.

One of the main challenges for clean hydrogen (i.e. blue or green hydrogen) lies in its production costs. When compared to conventional sources of energy, these costs are simply too high for hydrogen to be produced (economically) at a scale sufficient to substantially replace conventional fossil fuels. Continual reductions in the cost of production infrastructure and related technology will be key to encouraging the widespread adoption of hydrogen. Apart from the cost of electrolysers (which has been decreasing over time due to technological and design improvements[1]) the cost of renewable energy used in producing electricity is an important factor when it comes to the final cost of production for green hydrogen. In recent times, wind and solar costs have come down significantly, particularly in countries with plentiful access to sunshine and wind. Given the effect of economies of scale – the larger the scale of clean hydrogen production becomes, the more likely that the costs of production will fall, whether in the form of CCS infrastructure, electrolyser technology or otherwise.

While the emissions reduction benefits of clean hydrogen are well-acknowledged, the way clean hydrogen can make a significant impact on greenhouse gas emissions (in line with the emissions targets of the Paris Agreement) is for clean hydrogen to become a commercially affordable source of energy and cost-competitive against fossil fuel. As further discussed below, there remains promise that reductions in the cost of renewable energy, advancements in green hydrogen production technology and scaling-up of hydrogen production will help to improve the commercial viability of hydrogen production. Government and policy intervention to make carbon intensive fuels more expensive (for example, through carbon taxes or emissions trading schemes) or to lower the cost of hydrogen production (for example, through green energy subsidies). This kind of intervention can help to level the playing field in terms of costs, and facilitate continued investment and technology development, with the long term view of enabling green hydrogen to become cost-competitive in its own right.

[1] https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/experts-explain-why-green-hydrogen-costs-have-fallen-and-will-keep-falling-63037203

II. Hydrogen policy development in the Asia-Pacific region

In Asia, there continues to be a heavy reliance on fossil fuels and the overall energy demand is projected to continue to grow in the longer term (albeit that we have seen a recent drop in demand due to the effects of the COVID-19 pandemic). In line with the Paris Agreement, there has been a regional push to reduce greenhouse gases and to lower local environment pollution. We discuss below the current state of hydrogen-related policy making as well as the hydrogen production and utilization potential for various countries in the Asia-Pacific.

China: At a virtual meeting of the UN General Assembly in September 2020, Chinese President Xi Jinping announced a commitment from China to achieve carbon neutrality before 2060. This will require a significant shift away from fossil fuels, and it is expected that clean hydrogen will have a major role to play in that transition. Already, China has stepped up investments in clean hydrogen and announced initiatives to promote the usage of hydrogen, particularly in the transportation sector – according to the *New Energy Vehicle Industry Development Plan* (2021 – 2035) released by China' s State Council, China will focus on expanding the use of hydrogen in heavy transportation and developing infrastructure to support such expansion[2]. Between 2016 – 2019, the number of hydrogen refueling stations doubled every year[3] and there are clear steps to roll out new subsidy policies to promote the usage of hydrogen fuel cell vehicles[4]. Issued last year, the new draft *Energy Law of the People' s Republic of China* lists hydrogen as an energy source for the first time and, while there are few other details relating to hydrogen in the draft law, this is an important step towards hydrogen gaining recognition as a green fuel in the Chinese economy.

ASEAN: While still in its infancy for many countries in the ASEAN region, some initial steps have been taken to promote the development of the hydrogen industry. Increasingly, there is a growing recognition that hydrogen has significant potential to reduce the region' s dependence on fossil fuels. In 2020, the Singapore government announced a $49 million (approximately USD 36 million) Low-Carbon Energy Research Funding Initiative, which will support the research and development of low carbon technologies such as hydrogen[5]. In the same year, a number of agreements were executed between Singaporean and Japanese companies to explore the importation and usage of hydrogen as a green energy source[6 7]. In Brunei, preliminary steps have also been taken to explore the production and transportation of hydrogen – last year, as part of a hydrogen supply chain demonstration project, a total of 4.7 metric tonnes of hydrogen was shipped to Japan from Brunei Darussalam' s first pilot hydrogenation plant, which is operated by the Advanced Hydrogen Energy Chain Association for Technology Development[8].

Japan: Under the Basic Hydrogen Strategy announced by METI in 2017, the Japanese government announced its plans to realize a hydrogen-based society, via measures such as the creation of a commercial hydrogen fuel supply chain, expansion of usage of fixed fuel cells and fuel cell vehicles (FCV) and the promotion of hydrogen usage in power generation[9]. Related to the Basic Hydrogen Strategy, Japan has also released a New Strategic Roadmap for Hydrogen and Fuel Cells[10] to set new targets related to the utilization of hydrogen technologies and to set out measures for achieving these goals. Japan is a world leader in the funding of research into hydrogen technologies,

[2] https://www.chinadailyhk.com/article/154211

[3] https://energyiceberg.com/hydrogen-fueling2019/#:~:text=Since%202016%2C%20the%20number%20of,or%20in%20the%20planning%20stage.

[4] https://theicct.org/blog/staff/china-sketching-roadmap-hydrogen-vehicles-aug2020

[5] https://www.ema.gov.sg/media_release.aspx?news_sid=20201025eyksiX0dgcEH

[6] Under a memorandum of understanding, PSA Corp. Ltd., Jurong Port Pte. Ltd., City Gas Pte. Ltd., Sembcorp Industries, Singapore LNG Corp. Pte. Ltd., Chiyoda Corp. and Mitsubishi Corp. will develop ways to utilize hydrogen as a green energy source. See https://www.offshore-energy.biz/psa-jurong-port-others-to-launch-hydrogen-import-study/

[7] Keppel Data Centers and Mitsubishi Heavy Industries signed a memorandum of understanding to jointly explore the implementation of a hydrogen powered trigeneration plant concept for data centers in Singapore through the Steam Methane Reforming process. See https://www.kepcorp.com/en/media/media-releases-sgx-filings/keppel-and-mitsubishi-heavy-industries-to-jointly-explore-hydrogen-powered-tri-generation-plant-concept-for-data-centres-in-singapore/

[8] https://borneobulletin.com.bn/brunei-ships-4-7mt-hydrogen-japan/

[9] https://www.meti.go.jp/english/press/2017/1226_003.html

[10] https://www.meti.go.jp/english/press/2019/0312_002.html

and for the financial year (ending March 2021) the total government budgetary support for hydrogen is 70 billion yen[11] (approximately USD 650 million). Given its relative lack of renewable resource, Japan is also slated as one of the potential top Asian importers of green hydrogen.

South Korea: In January 2019, South Korea announced its Hydrogen Economy Roadmap with the objective of placing South Korea at the forefront of the global hydrogen transition. The roadmap sets out the government' s plan to increase hydrogen production and usage, and to promote the continuing development of hydrogen technologies, in particular fuel cell technology. Amongst other things, the Roadmap outlines goals of producing 6.2 million fuel cell electric vehicles and rolling out at least 1200 refilling stations by 2040[12]. There is also strong support from the commercial sector to back the government' s plan. As part of its "FCEV Vision 2030" plan Hyundai Motors plans to invest approximately KRW 7.6 trillion (approximately USD 6.7 billion) in hydrogen-related R&D and facility expansion[13]. As outlined by South Korean government, hydrogen is seen as a key means of bolstering economic growth, improving energy security and improving reducing environmental pollution[14].

Australia: Under the National Hydrogen Strategy unveiled in November 2019, Australia aims to become a hydrogen "powerhouse" by 2030, particularly blue and green production through CCS and access to substantial renewable resources, both for local consumption and overseas export[15].

A number of State governments in Australia have declared similar intentions[16]. At least a dozen hydrogen projects for production, transportation or export and consumption have been announced or are underway. Some of these are "pilots", to test new technologies and production processes. The "Hydrogen Energy Supply Chain" project, recently commenced commercial-scale production, liquefaction and export in the world' s first LH2 carrier, the *Suiso Frontier*[17]. Another project of note is the"Asian Renewable Energy Hub" located in the Pilbara region of Western Australia, designated with "major project" status by the Australian government in October 2020. It will use around 15 GW of wind and solar energy to produce green hydrogen for export to Asian consumer centers. By supporting industry, the Australian government is working towards a goal to produce clean hydrogen for under $2 per kilogram. Australia is positioning itself as a prime country for future commercial exports of green hydrogen to Asian consumers.

III. Potential for hydrogen usage and production

Hydrogen has a wide array of uses, and it has been used in various applications for many decades. As of now, hydrogen is most commonly used in industrial applications (for example, in oil refining, as a reagent in industrial sectors such as chemical and fertiliser production, and as an ingredient in the production of plastics, fabrics and dyes). A key to realizing hydrogen' s potential as a decarbonisation tool is encouraging its adoption as a fuel source in transportation and power generation and also as a means of energy storage. There are promising signs of a building momentum for the usage and deployment of hydrogen in these areas.

[11] https://www.mfat.govt.nz/en/trade/mfat-market-reports/market-reports-asia/japan-strategic-hydrogen-roadmap-30-october-2020/

[12] https://www.iea.org/policies/6566-korea-hydrogen-economy-roadmap-2040

[13] https://www.hyundai.news/eu/brand/hyundai-motor-group-reveals-fcev-vision-2030/

[14] https://english1.president.go.kr/briefingspeeches/speeches/110

[15] https://www.industry.gov.au/data-and-publications/australias-national-hydrogen-strategy#:~:text=It%20aims%20to%20position%20our,governments%2C%20industry%20and%20the%20community.

[16] *Western Australia Renewable Hydrogen Strategy* (July 2019); *Victorian Hydrogen Investment Program* (December 2018); "Hydrogen Roadmap for South Australia" in 2017 followed by the *South Australian Hydrogen Action Plan* (September 2019); Queensland Hydrogen Industry Strategy (May 2019). A significant number of other State and Federal Government studies and roadmaps have been produced over the past few years, including the "H2 under 2" initiative, which is the first economic target pursuant to the National Hydrogen Strategy.

[17] See hydrogenenergysupplychain.com. The project is developed pursuant to intergovernmental and host government agreements between Japan, Australia, Victoria and the project' s sponsors.

- Transportation has been identified as a leading area of hydrogen deployment (albeit still in its initial phases). In the Asia-Pacific region, there is a broad range of commitment across the government and private sectors to support the usage of hydrogen in the transportation sector, being a major emissions contributor. While battery electric vehicles are presently the preferred choice as a low carbon solution for small vehicles travelling shorter distances, heavy vehicle transportation has been identified as a promising sub-sector for hydrogen FCVs and more vehicle manufacturers are seeking to invest in this area of hydrogen usage. China, Japan and South Korea all have an express objective to promote the usage of hydrogen FCVs. According to Japan' s Basic Hydrogen Strategy, the goal is to have 200,000 FCVs by 2025 and 800,000 FCVs by 2030, and also expand the number of hydrogen stations to 320 by 2025. Apart from road vehicular transportation, hydrogen is already used as a rocket fuel, and there is also potential for its use as a marine fuel (especially given the International Maritime Organization' s new bunker fuel regulations limiting sulphur content of marine fuels to 0.5% from 1 January 2020) as well as an aviation fuel.
- In the power and heating sector, there are also plans afoot to gradually replace natural gas with hydrogen. Already pipeline hydrogen injection is part of the national hydrogen strategy for various countries, and a key plank in the broader decarbonisation strategy. Initial plans are to blend hydrogen in a low concentration with natural gas for injection to avoid major modifications to pipeline networks (higher concentrations may require network modifications such as replacement of steel with polymer pipes or replacement of compressors). Certain newer and more advanced gas turbines are already able to accept fuel blends which may contain 50% or more hydrogen, and already major turbine manufacturers are developing gas turbines that could run on 100% hydrogen. While there is a long way to go before hydrogen might fully replace natural gas, the substitution of natural gas with hydrogen will be a very significant step away from fossil fuels and towards a low carbon economy.
- As a means of energy storage, hydrogen can work in tandem with renewable energy projects to address the drawbacks of reliance on renewable energy. By producing green hydrogen through electrolysers (powered by renewable energy), energy generated by wind or solar power projects can be stored and transported from regions with higher production and lower demand to areas with lower production and higher demand, or otherwise simply stored during low consumption periods until there is peak in energy demand. Naturally, production of hydrogen for energy storage purposes will carry some costs in financial terms and energy losses. However, the falling cost of renewable energy enhances the economic viability of hydrogen as a means of long term, seasonal and transportable green energy storage. The utilization of hydrogen as a means of localized energy storage may be the most practical and promising usage, as a step towards long distance / cross-border transportation of hydrogen.

On the supply side, Asia-Pacific region holds the potential for clean hydrogen exports from regions with plentiful access to renewable resources to high demand centers in Asia. As noted, Australia may stands out as a potential exporter of clean hydrogen, due to its geographic proximity, existing infrastructure and abundance of renewable resources. New Zealand has also demonstrated interest in exploiting its hydrogen export potential. Presently the majority of New Zealand' s power is generated from renewable energy sources and the government is keen to support the development of green hydrogen projects – one example is the development of a pilot geothermal-powered hydrogen production facility in New Zealand by a joint venture between the a Trust and Japanese company. As mentioned above, Brunei have exported a maiden shipment of hydrogen to Japan. Due to land constraints, Brunei' s hydrogen is more likely to be produced from gas rather than wind or solar power, and the development of CCS infrastructure will be key to enabling its production of blue hydrogen. Overall, while it remains to be seen whether hydrogen production and export can take off on a commercial scale, there are already several potential candidates in the Asia-Pacific which could serve to supply green or blue hydrogen to users throughout the region.

IV. Challenges

Despite the promising prospects for hydrogen, there are still some significant challenges in the path of its development as a clean fuel in widespread use. In this section, we briefly discuss some of these challenges, and how they might be overcome, in order for a successful transition to a hydrogen economy.

- Production of blue or green hydrogen remains expensive compared to fossil fuels. Currently, the cost of production of green hydrogen is estimated to be USD $2.50-6.80 per kilogram, whereas the cost of production of blue hydrogen is estimated to be $1.40-2.40/kg[18]. For green hydrogen to become cost-competitive with the fossil fuels, it has been said that the production cost needs to be lowered to US$2 per kg[19]. A key to reducing green hydrogen costs will be lowering the cost of renewable electricity and prices for electrolysis facilities. In recent years there has been a precipitous drop in solar and wind power costs[20], and there are expectations that this trend will continue. For blue hydrogen, the cost of CCS technology will also need to reduce to improve its cost-competitiveness, and already there are various CCS projects being developed to explore the use of CCS technology on a significant commercial scale[21].

- For projects which need to source power (rather than self-produce), managing the electrolyser to meet downstream demand will generally require certainty of firm power purchase arrangements. If those arrangements are with a retailer, "firming" of the supply adds further cost, and "partial firming" can add complexity. Project proponents in this position will want to dispatch power into the grid at higher electricity market prices where this market option is available. For projects and markets with these characteristics, this may drive participation by those with a strong power portfolio (or access to one) rather than infrastructure investors without vertical integration and who are seeking more stable returns.

- Concurrently, there is also increasing government support for the uptake and usage of hydrogen. Government support works in the form of financial subsidies and investment to make hydrogen production and usage more economical, and in the form of carbon taxes and emissions trading schemes, to increase the cost of fossil fuels. Various countries in Asia (e.g. China, Japan and South Korea) have already implemented emissions trading schemes in different forms, and in 2019 Singapore became the first country in Southeast Asia to introduce a carbon tax. Especially during the initial deployment phases, policy and financial support from the government for hydrogen technology and infrastructure will be critical to improving the commercial competitiveness of hydrogen versus fossil fuels. Hydrogen subsidy schemes should be coordinated with other environmental incentive schemes (for example, relating to carbon pricing or CCS) to ensure that desired policy outcomes are achieved in an efficient and targeted manner.

- Transportation of hydrogen (particularly over long-distances) can comprise a significant component of the final landed cost of hydrogen. For long distance transportation, the most realistic options will be for hydrogen to be liquefied or converted into ammonia prior to loading on specialised vessels. Both processes involve a degree of energy consumption and losses during the conversion and transportation process. For instance, during the ammonia conversion process, energy will be utilised to convert hydrogen and nitrogen to ammonia, and at the landed destination chemical processing is required to convert liquid ammonia back to gaseous ammonia. Being able to control and reduce transportation costs of hydrogen will be key in promoting the long-distance export of clean hydrogen.

[18] https://www.rechargenews.com/transition/a-wake-up-call-on-green-hydrogen-the-amount-of-wind-and-solar-needed-is-immense/2-1-776481

[19] https://www.biofuelsdigest.com/bdigest/2020/12/09/the-green-hydrogen-catapult-aims-for-2-kg-h2-and-needs-110-billion-if-youve-any-to-spare/

[20] From 2010 – 2019, the cost of energy production from solar photovoltaics fell by more than 80% and the cost of energy production from onshore wind fell by nearly 40%. See https://energypost.eu/5-charts-show-the-rapid-fall-in-costs-of-renewable-energy/#:~:text=Although%20all%20forms%20of%20renewable,Energy%20Agency%20(IRENA)%20says.

[21] For instance, Australia' s CarbonNet Project seeking to integrate various CO_2 capture projects and inject CO_2 into underground storage sites in Victoria' s Gippsland region.

- Widespread deployment of hydrogen will also require more investment in the distribution infrastructure. While certain existing natural gas pipeline networks can accept a limited concentration of hydrogen, existing pipeline infrastructure will generally need to be retrofitted to accept the injection of more concentrated or pure hydrogen. Similarly, for refuelling infrastructure, the current infrastructure is inadequate to promote and support a significant increase in FCVs. Already FCVs cost considerably more than cars with normal combustion engines, and without the construction of hydrogen refuelling stations, it is unlikely that there will be a significant uptake in demand for hydrogen FCVs. Due to the commercial dynamics (i.e. parties may not invest in infrastructure unless there is demand but demand will not materialise without the infrastructure), there is a need for investors to take a long-term view and also a role for governments to provide financial and policy support for additional infrastructure investment.

- The development of a hydrogen economy will require a clear and comprehensive regulatory framework. For instance, operational, environmental, safety and technical standards need to be implemented to in order ensure consistent standards for utilisation, transportation and storage of hydrogen. In particular, the cross-border transportation of hydrogen is still in its infancy, and the more consistent and clearer that such regulations pertaining to transportation can be, the more likely this will in turn promote the growth and development of hydrogen projects. Some countries have already rolled out initial laws pertaining to hydrogen usage and domestic safety standards (for example, in January 2020, the Korean National Assembly passed the Hydrogen Economy Promotion and Hydrogen Safety Management Law). However, substantial further work is still required to develop detailed rules and regulations, particularly in the sphere of international and cross-border regulation of hydrogen trade and transportation.

- In the longer term and for large scale hydrogen export projects to truly take off, there is a need for the development and integration of the full commercial, and operational value chain for hydrogen. This covers all of the factors described above, requiring each link in the value chain (production, storage, transportation, importation and downstream distribution) to be progressed in tandem (and at least in some cases as part of integrated projects). Due to the complexities and costs of the hydrogen value chain, the cross border export of hydrogen will also likely need to be underpinned by long term offtake agreements, which in turn will provide the capital and guaranteed cash flow for project development.

- The development of deep and liquid markets for the marketing, trading and transportation of hydrogen will also be fundamental to the long term success of the hydrogen economy. Features such as appropriate pricing mechanisms, conventions for measurement and determination of quality specifications, and consistent methodologies for the labelling and tracing of hydrogen (such as certifications for “green” or “blue” hydrogen) will all be important. Resilient, trustworthy and traceable certification of hydrogen as having been produced from clean energy sources will be key to accelerating hydrogen’ s success in the global push to reduce carbons emissions. Already, there are several green hydrogen certification and guarantee of origin schemes proposed in different markets (for instance, in Europe and Australia). However, these schemes are in their infancy – whether and how any of them is successfully developed, tested and adopted at any critical scale remains to be seen.

- In this regard, it is possible to look to the development of the LNG industry as providing something of a roadmap for hydrogen. Originally relatively localised and dependent on transport by physical pipeline, the gas industry transformed its product into a global commodity through liquefaction at source, regasification at destination and long distance ship-based transport connecting the two. The industry developed on the back of the project financing of extremely capital intensive infrastructure, supported by revenue under long term multi-billion dollar sale and purchase agreements. In terms of pricing, LNG has also developed certain pricing indices for its sale contracts (for instance, the Japanese Crude Cocktail (JCC) and more recently the Japan Korea Marker) and

increasingly become a more liquid and flexible traded commodity over time. Indeed, the connections to LNG may not end with parallels of this nature – already we are seeing examples of planning for LNG terminals to have hydrogen capacity too.

Conclusion

Despite the potential advantages offered by hydrogen in terms of energy decarbonization, there is still a long way to go before hydrogen can be deployed on a wide commercial scale. That said, the signs are promising given the falling cost of production, and strong, growing government and commercial support for hydrogen projects.

As a part of the world which holds both significant potential for clean hydrogen production and is home to potentially significant demand and consumption centers, there are strong prospects for countries in the region to lead in the transition to an international hydrogen economy. In these early days, broad-based government support and commercial commitment (taking a long-term view of hydrogen' s potential) will be critical to accelerating the trend towards widespread hydrogen usage. Over the long term, hydrogen technology and commercial supply and production chains will also need to form a commercially viable and cost-competitive alternative to fossil fuels.

In the series of articles to come, we will discuss how this is already beginning to take shape (and the particular challenges, opportunities and potential solutions) in various Asia-Pacific countries.

LNG SERIES: PRICING AND PRICE REVIEW MECHANISM IN MEDIUM- AND LONG-TERM LNG SALE AND PURCHASE AGREEMENT

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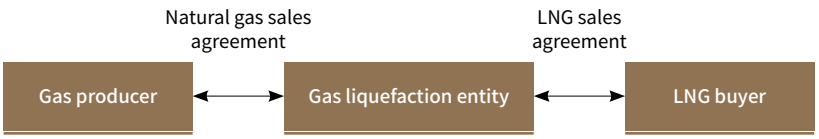
In the Asia-Pacific region, liquefied natural gas (LNG) occupies a prominent trade position. As one of the largest LNG importers in Asia, China will maintain the rapid growth of its LNG market during the 14th Five-Year Plan period, driven by the transformation of China' s energy structure under the goals of "carbon peak and carbon neutrality". Large international oil and gas companies will also take expanding their LNG investment scale as one of the key steps in the transition to clean energy. As a result, global LNG trade will play an increasingly important role in energy development. This article focuses on the pricing and price review mechanism in the medium- and long-term LNG sale and purchase agreements (SPAs) in legal and commercial negotiations.



At present, LNG trade is mainly conducted in the form of futures and spot trade, the prices of which affect each other. By the end of 2020, the spot prices of LNG in Asia continued to rise, bringing the medium- and long-term SPAs in LNG futures trade back into the market spotlight[1]. Before that, the spot price of LNG kept dropping between 2015 and 2019, which

[1] www.cnenergynews.cn: "Global LNG Market Will Return to the 'long-term SPA' Era", http://www.cnenergynews.cn/zhiku/2020/12/30/detail_20201230870 86.html

impacted the pricing mechanisms in the medium- and long-term LNG SPAs[2]. Designing a sound price mechanism in the medium- and long-term LNG SPA has become an important issue and focus of controversy in LNG trade and collaborative negotiations.

I. Pricing mechanism in the medium- and long-term LNG SPA in Asia

LNG price negotiation usually involves three aspects: pricing mechanism, price review mechanism and dispute resolution. Since the 1970s, the prices provided in the medium- and long-term LNG SPAs in Asia has been generally linked to oil prices, with the pricing mechanism expressed in the form of a straight-line equation. The Japan Crude Cocktail (JCC), a pricing index of crude oil, was mainly adopted in determining the price of the linked crude oil. The first oil price-linked contract was signed in 1973 between an Indonesian national oil company and a consortium of Japanese buyers. The pricing mechanism in the contract adopted a simple straight-line equation:

$$P_{LNG}=A\times P_{(crude\ oil)}+B$$

P_{LNG} is LNG price

$P_{(crude\ oil)}$ is crude oil price

A and B represent constants to be decided by both parties through negotiation; A is the constant slope, while B is linked to inflation and transportation costs.

In the case of high oil prices, the straight-line equation pricing mechanism is a win-win solution for both buyers and sellers: sellers could avoid the influence of low oil prices while buyers may obtain stable supply. In the event of a sharp drop or substantial fluctuation in oil prices, sellers may wish to adjust the pricing formula to increase the LNG price. In order to obtain a stable supply of LNG and avoid supply risks resulting from sellers' cost reduction due to lower price, most buyers are also willing to adjust the LNG price provided in the medium- and long-term LNG SPA. Therefore, the S-curve pricing formula, as a compromise, came out:

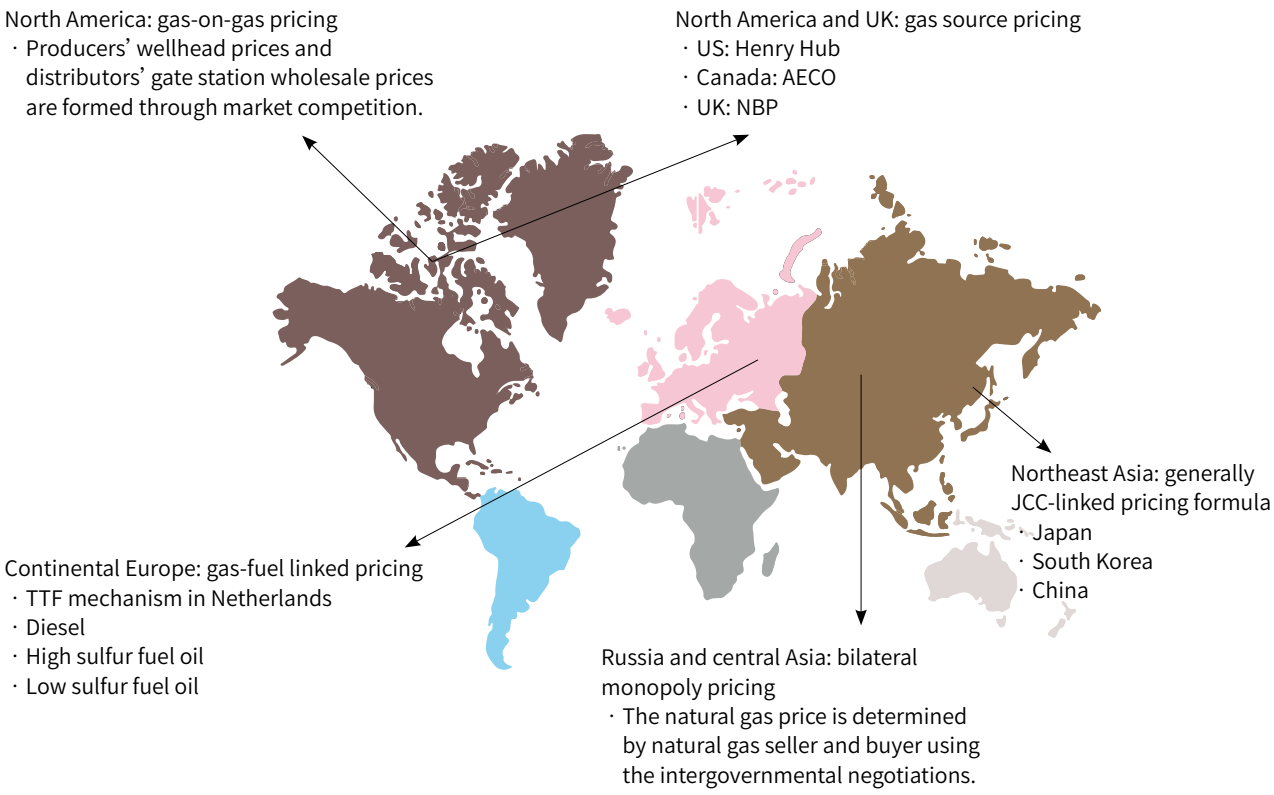
$$P_{LNG}=A\times P_{(crude\ oil)}+B+S$$

S represents the curve when the oil price is too high or too low. A range of oil price to which the formula applies is also usually specified in the contract. If the oil price exceeds the range, adjustment will be made through negotiation. This practice effectively protects all parties to the contract from substantial fluctuations in oil price[3]. In other words, the buyer and the seller may agree on the LNG price in case of the fluctuation of oil price, i.e., the LNG pricing mechanism can be adjusted through negotiation. Therefore, when the oil price is too high, the S-curve pricing formula will be replaced by the straight-line equation.

[2] www.china5e.com: "Why Is It So Difficult to Import Spot LNG Cargoes?", https://www.china5e.com/news/news-1066856-1.html

[3] Hua Ben, Luo Jiaxi. (2007). "Analysis of the Global LNG Price Trend". *Natural Gas Industry*, 27(1), 140-144.

Traditional global LNG pricing mechanisms



Source: "China LNG Industry Analysis Report – Study on Market Operation and Future Trend", *Insight and Info*.

With the increased activities in the natural gas market, the trend where the LNG price in the medium- and long-term LNG SPA is generally linked to the oil price has been gradually changed, and buyers and sellers have started to explore a broader range of pricing mechanisms. For example, in 2019, Shell and Tokyo Gas entered into a long-term hybrid LNG SPA whereby part of the LNG price was linked to the coal price. In other words, part of the LNG supply would be priced using a coal index-based pricing formula, while the remaining portion priced through the traditional mechanism where the LNG price is linked to oil prices.[4]

II. Price review mechanism in the medium- and long-term LNG SPA

Traditional LNG trade is typically based on a minimum contract period of at least 20 years, supplemented by short-term, spot transactions. However, with the continuous increase in the global LNG trading volume and the increasing liquidity of the LNG spot market, the developers of gas fields, pipelines and liquefaction plants are less reliant on the downstream buyers under the long-term SPAs. In addition, to contribute to trade flexibility, an increasing number of LNG sellers are adopting sales strategies similar to LNG portfolio. A portion of long-term supplies is covered by establishing independent trading companies to coordinate the global LNG purchase and sale. From the perspective of buyers, since 2010, some large state-owned power generation groups, regional energy companies, state-owned and private urban gas companies have been involved in the international LNG import trade. Some energy companies have

[4] Reuters: "Tokyo Gas, Shell sign LNG deal linked to coal pricing in rare move", https://www.reuters.com/article/us-lng-tokyo-gas-shell-idUSKCN1RH0UB

reduced their focus on the supplies under the new medium- and long-term LNG SPA and increased their spot demand instead. Given the more attractive spot price of LNG, the expectations of new buyers in the LNG trade regarding the price in the medium- and long-term LNG SPA have added uncertainty to the price negotiations.

Based on the development trend of the above industry and the pricing mechanism in the medium- and long-term LNG SPA, during contract execution, when the LNG price does not match the market price, the buyer and the seller will often adjust the LNG price formula through the price review mechanism, in order to avoid the risk of either party refusing to perform the contract. In particular, the "Take-or-Pay" clauses in the medium- and long-term LNG SPAs in Asia make market liberalization efforts more difficult by reducing liquidity by interlocking the project parties for long periods of time. This further promotes the development of price review mechanism.[5]

The price review mechanism allows the buyer and seller in the medium- and long-term LNG SPAs to periodically review the price, and revise the price formula in some cases. The clause of the agreement is often designed to describe the mechanism as a LNG price " "review", "inspection", "reconsideration", "revision", "adjustment" or "re-opening" mechanism. Generally, there is no fixed drafting standard for the provisions relating to price revision. The typical provisions in the clause include:

(1) Events/situations that may trigger the revision;

(2) Procedures to initiate the revision;

(3) Specific price review mechanism;

(4) Dispute resolution mechanism when the parties cannot reach an agreement; and

(5) Applicable frequency.[6]

Price review mechanism is typically divided into two phases: the trigger phase and the adjustment solution phase. During the trigger phase, the party seeking a revision must indicate that the prerequisites for a price revision have been met. During the adjustment solution phase, the parties address what the appropriate adjustment, if any, to the contract price should be.[7] Two examples of price review provisions are given below:

"If Seller or Buyer desires a review of the prices set out in this Agreement due to a change in relevant circumstances resulting in such prices being significantly disadvantageous to either Seller or Buyer compared with the prices for other LNG sold into [Country] on similar terms to this Agreement, then ... Buyer and Seller shall meet and discuss in good faith to review such prices."[8]

"A Party may give a notice ('Price Review Notice') to the other Party to renegotiate the Contract Price no earlier than [Date]. Following the issue of the Price Review Notice, the Parties shall meet in good faith and discuss the matter with a view to agreeing what Price Adjustment (if any) is required. If both Parties agree upon such matters, they shall amend the Contract Price to reflect the modifications (if any) so agreed. Such revised Contract Price shall apply from the Review Date until the end of the Supply Period and neither Party is entitled to give a further Price Review Notice to the other Party. If, within a period of six (6) months after the Price Review Notice was issued, the Parties fail to agree upon

[5] Kim Talus, "Price review arbitration in the Asian LNG markets — 'The times they are a-changin' ", *The Journal of World Energy Law & Business*, Volume 14, Issue 2, April 2021, Pages 100–115, https://doi.org/10.1093/jwelb/jwab009

[6] S. Finizio, J.A. Trenor, and J. Tan, "Trends in LNG Supply Contracts and Pricing Disputes in the Asia Pacific Region", *Oil, Gas & Energy Law Intelligence*, Vol. 18 - issue 3, May 2020, Page 21

[7] S. Finizio, M. Bock, *The Adjustment Phase in Gas Price Reviews Under Long-Term Gas Supply Contracts*, J. Freeman and M. Levy, *Gas and LNG Price Arbitrations* (2nd ed., 2020), page 169

[8] Lord Justice Leggatt, "Negotiation in Good Faith: Adapting to Changing Circumstances in Contracts and English Contract Law", *Jill Poole Memorial Lecture* (Aston University, 19 October 2018).

a Price Adjustment, either Party may terminate this Agreement upon giving notice to the other Party and such notice shall come into effect at the end of the Contract Year during which it is served."[9]

In the context of the global LNG trade, the price review mechanism in the medium- and long-term LNG SPAs in the Asia Pacific region differs from that in other regions. For example, in European LNG contracts, the price review clauses may consider material changes in the economic environment in a particular market, which is rarely the case in Asia-Pacific LNG contracts. The following table sets out the key differences in price review mechanisms between Europe and Asia Pacific.

Region	Europe	Asia Pacific
Common terms	• Frequency, i.e., when and how many requests can be made; • Additional unscheduled requests; • The process for requesting a price review, i.e., how to obtain a price review (often setting forth requirements for providing notice of the price review request, as well as requiring the parties to meet and discuss or negotiate in response to a request); • Standards, i.e., what must be established to obtain a revision and how the price will be revised, if the requirements are met; and; • Consequences, i.e., what rights the parties have if they cannot reach agreement in response to a price review request (which usually include the right to commence an arbitration)	• Frequency, by providing that a party could only request a price review once every five or ten years or that there may be only one or two opportunities to make a request over the term of the contract (although in more recent clauses it is increasingly common to provide the right to seek a price review more frequently); • Additional unscheduled requests; • The process for requesting a price review; • Standards, which are different from those in European contracts. • Consequences: some contracts provide for the right to terminate the contract, and others expressly provide for a dispute resolution mechanism such as arbitration or expert determination.
Trigger requirements	• The change of circumstances must: • Have taken place within a defined market; • Be an "economic" change or be significant or substantial; • Be unexpected; • Be beyond the control of the parties; and/or • Not already be reflected in the existing contract price.	• Do not require the establishment of a change of circumstances; and • It has been more common to refer to comparisons to price benchmarks such as current market prices for LNG or prices under new long-term LNG contracts in a specified region as a basis for triggering a price revision.

[9] Kim Talus, "Price review arbitration in the Asian LNG markets — 'The times they are a-changin' ", *The Journal of World Energy Law & Business*, Volume 14, Issue 2, April 2021, Pages 28, https://doi.org/10.1093/jwelb/jwab009

The LNG price is the core of the medium- and long-term LNG SPAs, and the pricing formula and business models of the LNG SPAs are increasingly diversified. Thus, it is easy for disputes to arise between buyer and seller should there be a price adjustment or a need for adjustment in the course of the performance of pricing mechanism. Gas Natural v Atlantic LNG[10] is a representative public case that introduces the relevant provisions of the price review mechanism into the arbitration field.

In July 1995, Gas Natural and Atlantic LNG signed a 20-year LNG SPA, under which Gas Natural planned to transport LNG to its receiving terminals in Spain or New England. After the signing of the SPA, prices in the New England market became more attractive to Gas Natural due to the decline of Spanish natural gas price. Gas Natural later signed a long-term agreement to resell all LNG purchased under the SPA at the receiving terminal in New England. After that, Atlantic LNG informed the Gas Natural that it was seeking to modify the agreed price, but the parties failed to agree on a new price. As such, Atlantic LNG referred the dispute to arbitration and requested an upward revision to the LNG price to reflect the value of the LNG in the New England market. The tribunal found the necessary conditions precedent to the application of the price reopener clause had been satisfied. The tribunal then implemented a two-part pricing scheme: first, the tribunal retained the original Spanish pricing formula but adjusted the base price component; secondly, the tribunal added a "New England Market Adjustment" for the portion in which more than a specified percentage of LNG under the SPA was delivered to the New England receiving terminal. Based on this ruling, as a result of the revised pricing scheme, Atlantic LNG owed Gas Natural an amount in excess of USD 70 million. Atlantic LNG challenged the tribunal' s imposition of the two-part pricing scheme, asserting that the pricing scheme distorted the original transaction between the two parties, which in fact constituted a modification of the agreement and went beyond the jurisdiction of the arbitration tribunal, and brought a lawsuit to the court accordingly. Therefore, Atlantic LNG instituted an action in the United States District Court for the Southern District of New York. The Court held that the tribunal did not exceed its scope of authority. In addition, the court specifically pointed out that, in respect of the tribunal's imposition of the two-part pricing scheme, the LNG SPA did not "set a structural limitation on permissible price revisions"; and only required the tribunal to make "fair and equitable revisions" to the contract price.

This case has led to much discussion on the view that "Don' t go to arbitration if you can possibly avoid it."[11] The case demonstrates the high risks and uncertainties when the buyer and the seller delegate determination of the LNG price to an independent third party (whether an arbitrator or other expert). The LNG price and price formula is the most commercially sensitive element of the LNG SPA. Failure by the buyer and seller to agree on a revised price will upset the fundamental commercial balance between them. As such, any mechanism to independently determine the LNG price should seek an outcome that most closely reflects the views of the buyer and the seller. This also reminds the parties to pay close attention to the price review provisions.

For some parties to Asian LNG contracts, particularly state-owned companies, while avoiding arbitration is often their primary consideration, they consider that the threat posed by arbitration is a sufficient incentive for the parties to negotiate a settlement. As an alternative to arbitration, expert determination (referred to in the table above) is another dispute resolution method preferred by parties to Asian LNG contracts.[12]

Conclusion

In addition to the price review mechanism, medium- and long-term LNG SPAs also specify other adjustment mechanisms, such as Take or Pay-Make Up, DQT/DFQ-Make Good, UQT/UFQ-Excess Gas, Ramp Up Period, and FM

[10] Kim Talus, "Price review arbitration in the Asian LNG markets — 'The times they are a-changin' ", *The Journal of World Energy Law & Business*, Volume 14, Issue 2, April 2021, Pages 100–115, https://doi.org/10.1093/jwelb/jwab009.

[11] "Gas Natural v Atlantic LNG: a rare glimpse into price reopener clauses", *LNG Business Review*, JULY 2009, https://www.google.com.hk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwig38D847ryAhVUIaYKHaYADM0QFnoECAMQAQ&url=https%3A%2F%2Fcms.law%2Fen%2Fcontent%2Fdownload%2F80111%2F3016351%2Fversion%2F1%2Ffile%2FPages%2520from%2520LNGBR_200907.pdf&usg=AOvVaw23p2xxpbNgFJ3ssHf9SacH

[12] Kim Talus, "Price review arbitration in the Asian LNG markets — 'The times they are a-changin' ", *The Journal of World Energy Law & Business*, Volume 14, Issue 2, April 2021, https://doi.org/10.1093/jwelb/jwab009.

Restoration.[13] These mechanisms ensure the contract performance and the stability of LNG supply in a flexible way. In the process of commercial and legal negotiations, the buyer and seller in the medium- and long-term LNG SPAs should carefully choose the mechanisms in order to achieve the ideal effect. In recent years, the National Development and Reform Commission and the National Energy Administration have issued the *Pricing Catalogue Initiated by the Central Government,* the *Guiding Opinions on Accelerating the Development of New Energy Storage* and other documents, to encourage diversified entities to engage in the LNG business including at receiving terminals. As a major LNG importer in the world, China will strive to have a greater say in the global LNG trade under the requirements of low-carbon transformation and development. In this era of opportunities and challenges, the pricing mechanism, price review mechanism and other adjustment mechanisms in the medium- and long-term LNG SPAs are key topics to be considered in commercial negotiations and legal review of agreements.

Thanks to interns Li Dian and Xie Zixuan for their contributions to this article.

[13] Sun Ye and Zhang Jia: "The Overview of the LNG SPA", https://www.sohu.com/a/219731311_100011668

KEY CONSIDERATIONS FOR ENTERING INTO FARM-OUT AGREEMENTS

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Farm-out/farm-in is one of the most common exploration and financing approaches in upstream oil and gas transactions. A Farm-out Agreement (FOA) is a transaction document whereby the holder of an interest in the oil and gas assets (Farmor) transfers to the buyer (Farmee) part of his/her rights and interests in a granting instrument (such as a concession or a production sharing agreement).

Focusing on the Model FOA issued by the Association of International Petroleum Negotiators (now known as AIEN) in 2019, this article delves into the key considerations of farm-outs, including background introduction, comparison with other upstream asset transaction documents, and introduction of key terms.

AIEN:

AIEN is an independent not-for-profit professional membership association that is committed to supporting international energy negotiators around the world and enhancing their effectiveness and professionalism in the international energy community. To this end, the AIEN has developed and introduced a series of model form contracts since 1990. Often used to start negotiations about international oil and gas transactions, these model form contracts help participants focus on key commercial and contractual terms rather than standard clauses, thereby increasing transaction efficiency.

I. Background of the FOA

FOAs apply to assets that are in the **exploration stage**, and Farmor often sells its participating interest in only a portion of the target assets it holds (such as certain contract blocks or formations) and retains participating interests in other portions of the blocks or formations. The consideration under an FOA is typically a combination of **cash payments** and **the performance of work obligations**.

In 2019, the AIEN issued an updated version of FOA (2019 Model FOA). Unlike the 2004 Model FOA, the 2019 Model FOA is drafted primarily from an English law perspective as the research conducted by AIEN members

shows that English law is more commonly applied to FOAs in the international market. The legal concepts of representations, warranties and damages in the Model FOA are of great significance in defining the rights of the parties, while English law provides more comprehensive precedents. The 2019 Model FOA also contains optional provisions and expressions to facilitate the drafting of FOAs governed by other common laws, such as the special provisions regarding U.S. federal income tax in Article 8.2.1.

II. FOA and other oil and gas asset transaction documents

(I) FOA vs. APA

Work obligations, as part of the consideration, make the FOA significantly different from general assets sale and purchase agreements (APA). The purchase consideration of the latter is based entirely on **cash**.

In farm-outs, Farmor usually retains a portion of the working interest in accordance with the relevant granting instrument, in the hope of continuing to share the potential profits of the oil and gas project. Therefore, the parties of the transaction are still bound to each other by a Joint Operating Agreement (JOA) after the completion of the farm-out.[1]

In general sale and purchase of oil and gas assets, the seller always seeks to recoup the existing investment, obtain a cash consideration and exit the project. APAs are generally applied to mature oil and gas assets in the development and production stages; the seller' s status as the operator may also be transferred if the seller is also the operator.

(II) FOA vs. Earn-in

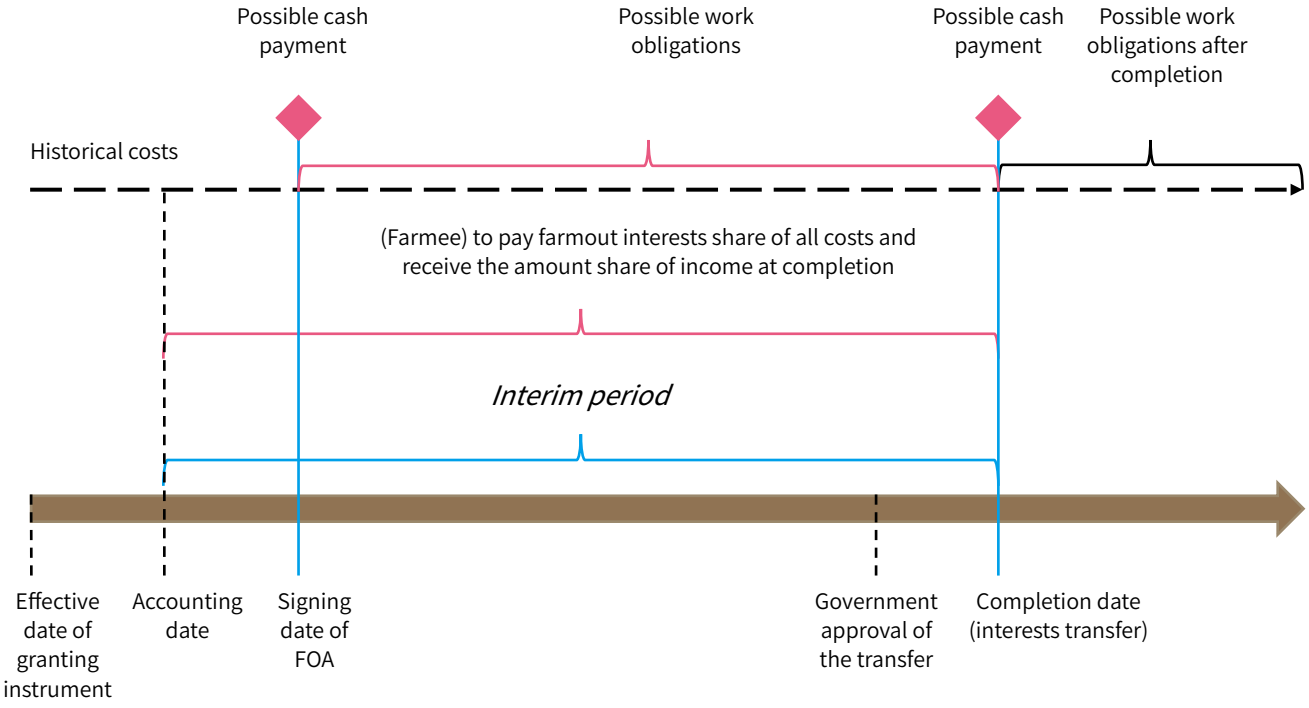
Earn-in agreements are a unique type of interest transfer contract used in asset M&As in the oil and gas sector. Such agreements are mainly used in the circumstance where the buyer **makes payment by installments** or where the buyer commits to paying consideration by performing work obligations under the FOA.

In the above circumstances, the buyer cannot pay the full consideration on the completion date. If the seller transfers the ownership of the target assets on the completion date, once the buyer fails to pay the purchase consideration in full after the completion, the ownership of the target assets will be transferred back to the seller, which may require relevant approvals and third-party consents again.

III. Key terms of the 2019 Model FOA: assignment, valuation, consideration, termination or reassignment

Farm-outs and farm-ins focus on different objectives of the buyer and the seller, i.e. the seller wants to receive consideration as soon as possible, while the buyer wants to acquire the rights and the interest under the granting instrument as soon as possible. The chart below illustrates a simplified farm-out timeline.

[1] See: "Position and Balance Between Operators and Non-operators in Joint Operating Agreements", https://mp.weixin.qq.com/s/LhfaQBmuOLMDlUk4JkiXOQ



(I) Assignment

Due to the particularity of oil and gas assets, there is usually little room for negotiation between Farmor and Farmee on the timing of the assignment. The timing basically depends on the provisions of **local law** or **granting instruments**, and prior approval of the farm-out is normally required by the host government or one of its competent authorities. Therefore, such approval is vital for determining the timing of the assignment.

Failure to obtain the above approval prior to the assignment of interests will invalidate the assignment and may even result in the termination of the granting instrument. Both parties to the transaction should carefully review the relevant approval requirements and make them a **condition precedent** in the FOA. In some specific jurisdictions, failure by the government to issue approval within a specified period of time may be deemed as approval or rejection of an assignment of interest. Therefore, particular attention should be paid to the definition of "approval" in the FOA.

In addition, the 2019 Model FOA includes the concept of "**Long Stop Date**" which is common in M&A transactions. It requires that all conditions precedent be satisfied or waived by the parties by such date and after which, if any condition precedent is not satisfied or waived, either party has the right to terminate the FOA.

(II) Valuation

The 2019 Model FOA changed the "Effective Date" in the 2004 Model FOA to "Accounting Date". The Accounting Date is agreed upon by both parties and is normally the date on which Farmee completes due diligence or the completion date of the financial accounting period, which is prior to the signing date of the FOA. From the Accounting Date, Farmee will assume all benefits, costs, obligations and liabilities attributable to the farm-out interests.

Under the Model FOA, Farmee is generally obliged to pay for the farm-out interests' share of all costs incurred since the Accounting Date and subject to completion, will also receive the benefits incurred since the Accounting Date. Therefore, Farmee agrees to pay or compensate Farmor for the farm-out interests' share in cash calls in the interim

period. The parties shall agree on the timing of payment, i.e. whether Farmee will pay such costs in cash calls or in a lump sum on the completion date. Usually, Farmee pays partially in advance on the signing date or in one lump sum on the completion date.

Apart from the costs incurred after the Accounting Date, the parties may agree that Farmee will also pay for certain past or historical costs incurred prior to the Accounting Date, usually at an agreed amount in a lump sum payment. The 2019 Model FOA provides for optional provisions regarding audit rights and adjustments after the Accounting Date. Among other things, the audit of the joint account is based on the audit provisions in the JOA and should therefore be drafted in a manner consistent with the JOA. If a JOA has not been duly executed, the parties should consider the audit provisions with discetion.

(III) Consideration

Article 3 (Consideration) of the 2019 Model FOA contains a variety of options. The parties may structure consideration in any combination in practice. The two main options are cash payments (Article 3.1.1) and work obligations (Article 3.1.2). Regarding the cash obligation(s), the 2019 Model FOA provides for the following (including relevant options):

Option 1: Reimbursement of past costs

Farmee shall pay an agreed amount to compensate for past costs on the signing date or at the time of the transfer of the interests. Such amount is fixed or audited and adjusted by Farmee. From the Accounting Date, Farmee will assume all proceeds and costs attributable to the farm-out interests. The payment of past costs enables Farmee to achieve financial parity with Farmor in respect of the farm-out. (Article 3. 1. 1 (a))

Option 2: Retained interest, cash calls

Farmee shall pay to the operator or Farmor the amount of a cash call (in a lump sum at the time of the cash call or at the time of completion) up to an agreed amount. (Article 3.1.1 (b))

Option 3: Premium payment

Farmee shall pay a premium of an agreed amount (not attributable to past costs, operations of the project, etc.) to Farmor for acquiring the Farmout interests on the signing date or at completion. (Article 3.1.1 (c))

(IV) Termination/reassignment

Under the 2019 Model FOA, the agreement may only be terminated prior to completion (Article 11.1.5). If, as of the Long Stop Date, completion has not been done or a final, unappealable written notice of disapproval by the host government of the assignment of the granting instrument has been received, the parties are permitted to terminate the FOA by written agreement, or by notice from the (non-defaulting) party, prior to completion.

Considering the uncertainty of governmental approval in the host country, both parties should carefully consider the expected timing of governmental approval of the assignment of the granting instruments and the legal effect of such approval. If the assignment of the granting instruments is approved prior to completion, and such approval has in fact resulted in the assignment of the granting instruments, then both parties should amend Article 11 on the basis of the Model FOA, and neither party is entitled to exercise the termination right and the reassignment clause shall apply at the time the assignment of the granting instruments is approved by the government of the resource host country (rather than the time of completion).

Reassignment provisions also need to be formulated with great caution. Such provisions must be enforceable under both the legal regime of the host country and the governing law of the FOA. To this end, both parties must consider any possible legal issues, including the equitability of the reassignment, the enforceability of a trust arrangement, the requirements and timing of governmental approvals, and additional costs and potential liabilities arising therefrom.

IV. Logic of FOA

Why do oil and gas interest holders conduct farm-outs at the exploration stage after they have invested a large amount of capital, technology and other resources in winning a project? The logic of an FOA can be basically classified into five categories as follows:

(I) Risk sharing

Despite the continuous progress of exploration and development technologies, it remains risky and challenging for equity holders to discover **commercial-scale** oil and gas resources, especially in deep-water projects.

(II) Financial capacity

Holding oil and gas rights and interests also means investing a significant amount of capital to undertake exploration obligations, which can be very costly for smaller companies. Therefore, these companies tend to introduce a financially sound company to bear all or part of the costs.

(III) Evaluation of geology and resources

At the exploration stage, there may be differences in the professional evaluation of geology and resources. Different professional institutions may have different conclusions on the collected data. Therefore, even if an oil and gas project is deemed to be commercially viable after resource evaluation, the equity holder may still want Farmee to share the uncertainty by Farm-outs.

(IV) Technology, management and marketing

Some equity holders may not be concerned about potential investment risks, but the planning, development and commercialization of oil and gas projects also require more sophisticated technological, management and marketing skills. There are also differences in marketing strategies and techniques between crude oil and natural gas. Therefore, an equity holder may need to cooperate with a company with the above skills to jointly commercialize the project.

(V) Localization requirements

Some host countries link localization to oil and gas investment policies (e.g. tax and fiscal incentives), while the participation of local companies can provide support for local commercial operations to a certain extent. Therefore, companies holding oil and gas interests may grant part of their interests to local companies based on these factors.

V. Considerations before drafting an FOA

Before formally drafting an FOA, it is necessary for Farmor to comprehensively consider the following factors with reference to the local laws of the host country as well as the granting instruments:

Access to existing confidential data

If Farmor is not the sole owner of confidential project data, it is common to require the express consent of all data owners to disclose such data, even if they are not involved in the farm-out. In practice, such data owners may exchange their consent for a share in the farm-out.

Ensuring the fulfillment of operation obligations

Farmor should specify the specific provisions for the Farmee' s operation obligations by taking account of the signed and effective JOA. Therefore, signing or amending a JOA is often a condition for the completion of an FOA.

Third-party priority and other clauses

Famor should pay particular attention to the terms in the granting instruments and other project documents that may affect the process of the farm-out, such as priority rights of the host countries or third parties (e.g. right of first refusal and Area of Mutual Interest (AMI) clauses).

In addition, prior to negotiations, Farmor must:

- **Conduct internal due diligence**: to prepare for any due diligence enquiry by Farmee;
- **Understand the tax implications of the transaction**: understand in advance the tax implications of various structures for the farm-out, in particular where the tax costs exceed the benefits of the farm-put, in order to minimize the adverse tax-related consequences to the extent possible during the negotiations.
- **Impose duties and restrictions on Farmee**: specify the duties and restrictions, such as an equity payment, that Farmor must impose on Farmee.

Conclusion

An FOA involves complex issues such as **evaluation of past costs, governmental approval, and reassignment due to Farmee' s default**. The terms cover an extensive range of contents for a long time span, which greatly tests the comprehensive competence and creativity of the negotiation teams of both parties. Although industry associations such as AIEN and AMPLA provide relatively complete model contracts, they only represent the start of drafting and negotiating a transaction agreement for the parties. Both parties need to formulate transaction documents based on the project' s commercial arrangements and applicable laws, and have them reviewed by a professional team.

Thanks to intern Xie Zixuan for her contribution to this article.

DECOMMISSIONING CONTRACTS AND TYPICAL PRACTICES IN INTERNATIONAL OIL AND GAS TRANSACTIONS

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Offshore oil and gas projects begin with the acquisition of exploration licenses and end with the full performance of decommissioning obligations. Decommissioning constitutes an important part of oil and gas project development. At present, with the continuous improvement of the environmental protection laws and regulations in host countries and maturing of an increasing number of early projects, the operators are facing increasingly stringent decommissioning obligations. This article will introduce the decommissioning obligations, key contractual clauses and different national/industry model agreements, and provide preliminary suggestions on how operators can deal with the risks associated with decommissioning obligations.

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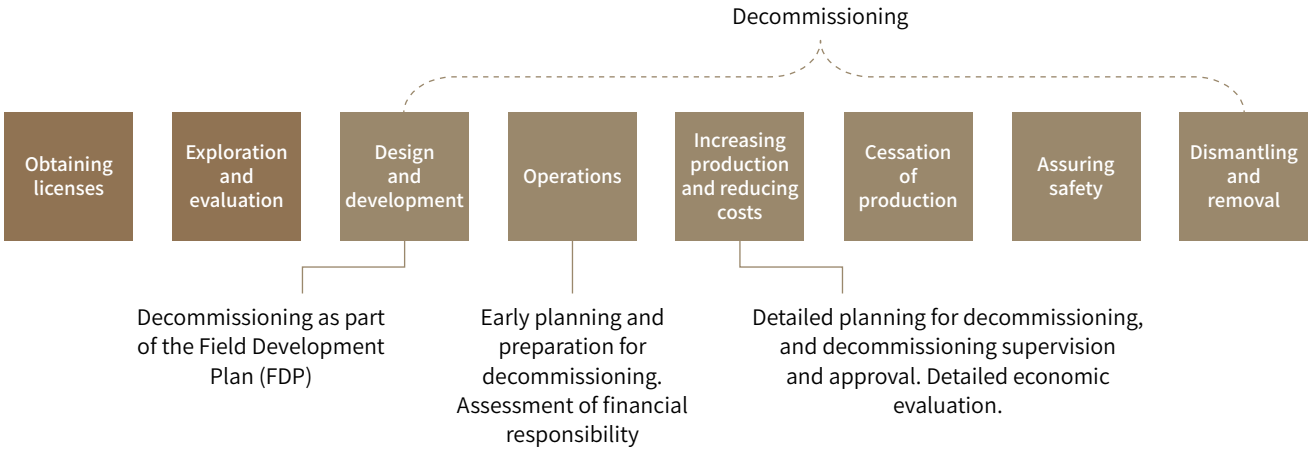
I. Stages and types of decommissioning

In general, decommissioning refers to the process of dismantling, disposing or reusing offshore oil and gas facilities upon regulatory approval when the facility cannot meet the purpose of production operations. It mainly involves waste management with the aim of restoring the ocean and seabed to their pre-operational state. The nature and location of facilities, regulatory requirements and operator preferences all influence the specific method of decommissioning.

As seen in the figure below, decommissioning is not a process limited to the final stage of dismantling and removal, but **throughout almost the whole life of an oil and gas project**. Decommissioning of production platforms includes, in order, design, installation and operation, post-operation, shutdown, isolation from oil reservoirs (plugging and abandonment), cleanup of superstructures and pipelines, isolation of pipelines, dismantling and removal of superstructures, conduit racks and subsea equipment/pipelines, removal and disposal/recovery, and monitoring.



Decommissioning can be briefly divided into abandonment in situ, abandonment not in situ, and serving a subsequent new use.

- **Abandonment in situ**: leaving the abandoned facilities in situ after they have been disposed of as required, or turning over some of the facilities at the original installation place for disposal.
- **Abandonment not in situ**: partially or totally dismantling the abandoned facilities and towing/carrying them away from the original place for offshore disposal after they have been disposed of as required.
- **Serving a subsequent new use**: using the abandoned facilities for other purposes after they have been renovated.

II. Special terms of the decommissioning contract

(I) Commercial arrangements

A decommissioning contract usually refers to normally a contract entered into between an owner (or operator) and a prime contractor for the removal of offshore oil or gas facilities and transportation of such facilities onshore. Most of the decommissioning costs are paid in accordance with such contract.

Similar to the EPIC (Engineering, Procurement, Installation and Commissioning) contracting model widely used in oilfield development, most oil companies prefer to enter into an EPRD (Engineering, Preparation, Removal and Demolition) contract with the prime contractor. The prime contractor may subcontract portions of a project to contractors in specialized areas if necessary.

For the operator, the EPRD model has the advantage of not having to be involved in the management of different subcontractors. For the prime contractor, however, this mode means that it has to be responsible for the actions of its subcontractors, accompanied by uncontrollable risks. For this reason, the prime contractor may protect its commercial interests by entering into “back-to-back” clauses with its subcontractors. For some operations such as onshore dismantling and disposal, the prime contractor usually tends to avoid relevant liabilities, therefore the operator has to contract directly with the specialized contractor.

(II) Force majeure

Given potential third-party interference (e.g. environmental protests), the contractor may extend the scope of Force Majeure to include "protesters' impeding of the performance of decommissioning through practical actions, public protests, petitions or litigation".

The decommissioning contract may also provide that the owner shall pay a standby rate to the contractor for the duration of a force majeure event. If the the duration of force majeure event exceeds the agreed period, either party is entitled to terminate the contract. Similar to a construction contract, parties to a decommissioning contract have a notification obligation in case of a force majeure event.

(III) Liquidated damages

Liquidated damages are usually set based on estimated losses suffered by the operator due to delay. However, if decommissioning has been delayed for several years, it may not be practical to require substantial payments for each overdue day. As with all liquidated damages clauses for construction delay, the decommissioning contract shall clearly specify maximum liquidated damages incurred due to overdue work and confirm that liquidated damages are the sole and exclusive economic remedy for the operator in case of a delay.

(IV) Pricing

Most operators wish to control costs on a lump sum basis (rather than on a time and materials basis), which transfers the price risk to the contractor. Therefore, in order to assess and manage such risk, the contractor may conduct due diligence on the project to clarify the scope of work prior to bidding.

(V) Acquisition of title

In a decommissioning contract, the title to a facility usually comes with the corresponding responsibility, and therefore, the operator wants to transfer such title to a third party at the earliest opportunity. In most cases, the contractor for offshore decommissioning work prefers not to take ownership of a facility, while the onshore recovery/disposal contractors may take such ownership directly from the oil and gas company.

(VI) Division of liability

In a decommissioning contract, the parties will usually specify a mechanism for risk distribution. A common practice is to provide reciprocal unlimited compensation for safety incidents to personnel and damage to property. In case of an accident, the parties do not need to conduct detailed fact investigation for liability distribution or incur any costs of litigation. The risk of physical damage to facilities also falls under the consideration of a liability clause. If the facilities have residual value, the contractor may seek to cap its risk exposure in a corresponding indemnity clause.

With respect to the environmental risk of decommissioning, the operator will normally be responsible for pollution from the oil wells, and the contractor contamination from vessels. However, it is not clear which party will bear the risk of contamination from the topsides of the production platform. The division of responsibility for such event depends on negotiations between the parties. One of the currently feasible schemes is for the operator to assume the portion higher than a specified amount, while the contractor will bear the primary responsibility but will not be fully responsible for the contamination incident.

(VII) Termination clause

If the operator unilaterally decides to terminate the decommissioning contract, the contractor will normally be entitled to reimbursement for all work performed, materials purchased, and the cost of vessels and equipment used. However, if the operator chooses to terminate the decommissioning contract at an early stage of contract performance (e.g. before the contractor mobilizes the vessel), the contractor may not be fully compensated. Liquidated damages for unilateral termination are usually determined through negotiations.

III. Practice of decommissioning in China and the UK

China' s existing laws and regulations have a series of provisions on the decommissioning system, and the

relevant legislation is improving. The UK decommissioning system is more stringent than others in the world, especially in terms of decommissioning program, operation and guarantee. The following introduces the legal framework related to decommissioning in China, and briefly compares the more stringent international decommissioning systems with the UK as a reference.

(I) China

1. Overview of the legal and regulatory systems related to decommissioning

The table below shows the laws and regulations currently in force in China on decommissioning.

Chinese laws and regulations on decommissioning	
Laws	Civil Code (2021) Environmental Protection Law (2015) Law on Prevention and Control of Water Pollution (2018) Law on the Prevention and Control of Environmental Pollution Caused by Solid Wastes (2020)
Administrative regulations	Administrative Regulations on the Prevention and Treatment of the Pollution and Damage to the Marine Environment by Marine Engineering Construction Projects (2018) Regulations on the Control over Dumping Wastes into Sea Waters (2017) Regulations on the Administration of the Environmental Protection in the Exploration and Development of Offshore Petroleum (1983)
Department rules	Interim Provisions on the Administration over the Disposal of Decommissioned Offshore Oil & Gas Production Facilities (2010) Measures for the Implementation of the Regulations on the Administration of Environmental Protection in the Exploration and Development of Offshore Petroleum(2016) Notice on Further Strengthening the Management of Environmental Impact Assessment in the Oil and Gas Industry (2019) Interim Measures on the Administration over the Disposal of Decommissioned Offshore Oil Platforms (2002) Measures on the Administration of Enterprise Income Tax on Decommissioning Expenses of Offshore Oil & Gas Production Facilities (2011)

2. Work schedule for decommissioning

The operator shall submit a written application for decommissioning to the national marine authority 90 working days before the cessation of the production operation of the facility, and may conduct the decommissioning only after obtaining the approval document. Before the decommissioning, the operator should prepare an implementation plan and submit it to the national energy authority for filing.

The table below shows the reference timeline for the decommissioning of offshore oil and gas fields in China.

Before development	after three years of production	Before decommissioning OPERATION	after termination of production
1. Prepare an **overall development plan**. 2. Prepare a **preparatory plan for the decommissioning** of facilities, and submit it to the competent state energy, finance and taxation authorities for filing. 3. Prepare and submit a **marine environmental impact statement to the marine administration department** for examination and approval, and submit the statement to the environmental protection administration department for filing, and accept its regulation	The **preparatory plan for the decommissioning** may be modified.	1. **Submit a written application for decommissioning** to the national marine authority 90 working days before the cessation of the production operation of the facility, and may conduct the decommissioning only after obtaining the approval document. 2. Prepare the **implementation plan for the decommissioning of facilities** and report it to the national energy authority for filing.	Decommissioning operations shall commence within one year from the date of termination of production. 1. Prepare an **environmental protection scheme for demolition** when demolishing the relevant facility and take necessary measures to prevent pollution and damage to the marine environment. 2. An organisation which needs to dump waste shall submit a **written application** to the state marine administration department and shall only dump the waste upon examination and approval and **issuance of a permit by the department**.

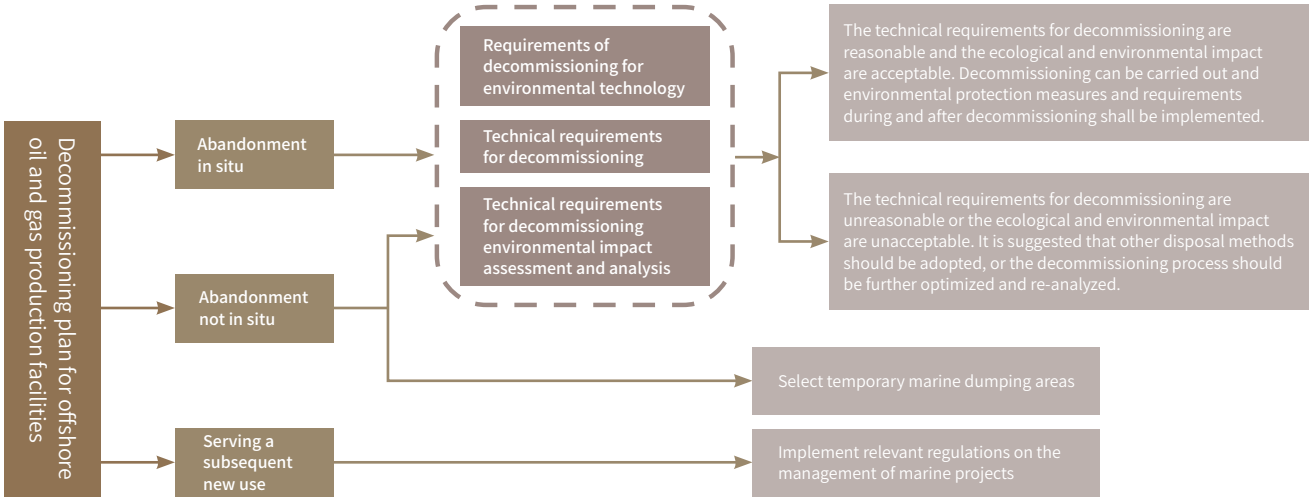
3. Provisions on decommissioning costs

Decommissioning costs refer to the special expenses incurred by each investor in the offshore oil and gas field to assume the responsibility and obligation of decommissioning oil and gas production facilities for the abandonment, removal, landfill, clean-up and ecological restoration of oil wells and related facilities and the preliminary preparation.

Offshore oil and gas field investors shall bear the responsibility and obligation of decommissioning facilities in proportion to their investment, and withdraw decommissioning costs as special funds for environmental protection and ecological restoration. Offshore oil and gas field decommissioning costs shall be on a monthly basis by adopting the production method or the average annual method, and the withdrawal method once determined shall not be changed anymore. The decommissioning costs borne by investors in Chinese-foreign cooperative oil and gas fields shall be recorded in the joint account book and may be recovered in the oil contract.

4. Latest legislative developments

The *Environmental Protection Technical Requirements for Decommissioning of Offshore Oil and Gas Production Facilities (Draft for Comment)* released on November 30, 2021 is the latest legislative development on decommissioning in China, which includes the following main chapters: definition of terms, general requirements, technical requirements for decommissioning, technical essentials for ecological and environmental impact assessment of decommissioning, environmental protection measures and monitoring plans. The diagram below shows the decommissioning management process based on the latest regulations.



Flowchart for the decommissioning management of offshore oil and gas production facilities

(II) The UK

The decommissioning of offshore oil and gas facilities in the UK is regulated by international conventions, the EU legislation and the UK domestic legislation. The UK has oil and gas regulatory bodies with clear functions and responsibilities, such as the Oil and Gas Authority, the Department for Business, Energy and Industrial Strategy and the Offshore Petroleum Regulator for Environment and Decommissioning.

1. Introduction of legal regulatory frameworks

(1) International conventions

International conventions		
1	United Nations Convention on the Law of the Sea, 1982	The state parties to this Convention are required to ensure that abandoned or disused offshore installations or structures located in their exclusive economic zones are **removed (not dumped)** and to control marine pollution.
2	Guidelines and Standards for the Removal of Offshore Installation and Structures On the Continental Shelf and In the Exclusive Economic Zone, 1989 (IMO Resolution A.672 (16))	Member governments are obligated to remove or partially remove abandoned or disused offshore installations or structures on their continental shelves or in their exclusive economic zones.
3	Convention on the Prevention of Marine Pollution by Dumping of Wastes and Other Matter, 1972 (the London Convention) and the London Protocol, 1996	The London Convention aims to control all sources of marine pollution, and imposes the requirements of prohibition of dumping, special permit and general permit according to the degree of damage caused by marine pollution sources. The 1996 London Protocol has similar objectives to the London Convention, but contains more stringent restrictions.

International conventions		
4	Convention for the Protection of the Marine Environment of the North-East Atlantic, 1992	"Dumping at sea" does not include leaving in situ abandoned offshore installations or offshore pipelines, in whole or in part. The *1998 OSPAR Decision 98/3 on the Disposal of Disused Offshore Installations* clarifies the prohibition of dumping in maritime areas and the retention in whole or in part of abandoned offshore installations. It is important to note that the above Decision **does not cover** pipelines. There are currently no international guidelines for the decommissioning of pipelines.

(2) The EU legislation

The EU legislation		
1	Waste Framework Directive, 2008	• The EU does not have a specific framework for the decommissioning of offshore installations. The Waste Framework Directive reflects the general principles of the aforementioned conventions and applies to waste brought to land for disposal. According to case law, this Directive applies to offshore areas.
2	EU Waste Shipment Regulation (1013/2006)	• It applies to any cross-border shipment of waste.

(3) The UK domestic legislation

The UK domestic legislation		
1	Petroleum Act, 1998	• The 1998 Petroleum Act regulates the decommissioning of offshore oil and gas installations and pipelines on the UK continental shelf. • The Secretary of State has the power, by notice, to require specified entities to submit a costed decommissioning scheme for specified offshore oil and gas installations and pipelines. Each entity submitting the scheme is **jointly and severally liable** for such scheme to ensure that it is implemented.
2	Implementation of the general permit regime of the Convention for the Protection of the Marine Environment of the North-East Atlantic and the London Convention	• Part II of the Food and Environment Protection Act 1985 provides for a general licensing system for the release into the sea of certain sediments to meet the relevant obligations under the Convention for the Protection of the Marine Environment of the North-East Atlantic and the London Convention. • The above Act does not specifically address offshore installations, but applies to marine structures.
3	The Guidelines for Decommissioning of Wells (2018)	• The Guidelines set out the relevant well abandonment requirements.

IV. Embodiment and connection of decommissioning in joint operating agreements

The joint operating agreement (JOA) generally does not specify decommissioning. In many host countries, the oil and gas legal system is just composed of mineral law or licensing system, without a well-developed basic legal framework for decommissioning. Thus, there is no institutional provision for JOAs' reference.

Compared to other industry standard templates, the model JOA of Oil & Gas UK (OGUK) is the first to treat decommissioning as a special phase of oil well operations. The Association of International Petroleum Negotiators (AIEN) followed this trend in the 2012 version of its Model JOA. Other model JOAs have also evolved, though few have touched on decommissioning-related content.

(I) General principles

The jurisdiction in which the oil and gas assets are located determines the basic content of the JOA (including its governing law), as the decommissioning activities must comply with the standards of relevant national and international laws. In addition, the JOA should clarify whether the parties are required to provide a specific guarantee for the performance of the decommissioning obligation on or after the signing date.

The decommissioning terms in a JOA should normally reflect the laws and regulations of the host country regarding decommissioning. Since the relevant legal provisions may expose the parties to punitive liability under specific circumstances, the parties are more inclined to agree on more specific terms for the decommissioning obligations in their JOA. For example, the decommissioning provisions of the *UK Petroleum Act*, amended in 1998, are considered more onerous because a wide range of stakeholders can be required by the government to bear the full costs of asset decommissioning.

(II) Decommissioning provisions in the Model JOA

As mentioned above, OGUK' s Model JOA is ahead of other industry models to provide for decommissioning. It provides that an operator must submit a decommissioning plan to the operating committee at least one year before providing the plan to the government.

The 2012 version of AIPN' s JOA, however, requires the operator to submit with the draft development plan an estimated decommissioning work plan and budget (WP&B) together with reasonably necessary supporting materials. The draft development plan must be revised at least one year prior to the date when the operator expects to fund-raise for decommissioning costs.

(III) Provisions on decommissioning security

As described above, to ensure that the parties bear the high decommissioning costs pro rata, apart from entering into a decommissioning security agreement, the parties may agree in the JOA on the provision of decommissioning security within a certain period of time. For instance, the parties may agree that the transfer by one party of its interest under the JOA is conditional on the transferee assuming the relevant decommissioning obligations of the transferor. Similar arrangements may be made between the transferor and transferee in share transfer agreements, exploration rights grant agreements or other relevant transfer documents.

Decommissioning security usually takes the form of parent company guarantee, letters of credit furnished by banks, or remittance of funds to a specific account or trust fund. In theory, the JOA could stipulate that all parties shall agree on an estimate of the decommissioning costs at the time of the conclusion of the JOA and provide the necessary guarantee for bearing their respective proportions of such costs. However, this is impractical because the parties are

usually unable to determine the best technical solution for the decommissioning of relevant assets and facilities at the time of contracting, thus affecting their cost estimates.

V. Decommissioning risks and the countermeasures

In addition to the relevant legislation and regulatory regime for decommissioning, at least five key factors should be considered to determine the most appropriate decommissioning scheme and avoid the related legal risks: **potential impact on the environment, potential impact on human health and safety, technical feasibility of the decommissioning plan, the economic impact** and **public concern**. The specific decommissioning risks and the possible measures to be taken are as follows:

(I) Regulatory risks of decommissioning and the countermeasures

Prior to project exit, a party shall fully understand the legal requirements of the host country, communicate with the government in advance under the provisions on the procedures and standards for decommissioning as specified in the project contract when necessary, and obtain the approval of the relevant government before the decommissioning is implemented.

(II) Approval risks and the countermeasures concerning the decommissioning plan

- Strictly comply with the requirements of the regulators of the host country during the preparation of the decommissioning plan, and fully consult with stakeholders from the technical and legal perspectives to avoid affecting the subsequent approval process.
- The operator should preliminarily discuss with the regulators the form and timing of the decommissioning plan two to three years or longer before the planned suspension of production;
- The operator should collect relevant data to prepare the documents in advance, which include three parts: a draft consultation proposal of the regulatory authority, a public consultation publicly released by the operator, and a statutory consultation with parties potentially affected by the decommissioning plan; and
- The decommissioning plan should be submitted after the operator and the regulator have agreed on its final version.

(III) Approval risks and the countermeasures concerning the delayed or phased decommissioning plan

If the operator decides to postpone or phase the decommissioning, it must inform the regulator immediately and provide detailed explanations of the decommissioning scheme. The operator may not implement the decommissioning plan until the approval of the regulator has been obtained.

(IV) Decommissioning security risks and countermeasures

When allocating decommissioning responsibilities, the operator should sign a decommissioning security agreement with stakeholders in a timely manner to specify their respective decommissioning responsibilities. At the same time, the renewal or release of the decommissioning security should be properly handled to avoid retroactive liability of the stakeholders of the decommissioning security (such as the parent company).

(V) Risks of decommissioning operations and countermeasures

It is recommended that the operator sign an EPRD decommissioning contract with the main contractor. The main contractor can further subcontract to specialized subcontractors to complete related work such as onshore dismantling and waste disposal. In addition, the operator should follow up on the potential risks and liability sharing that may arise from the decommissioning, including the loss and residual value (if any) arising from the dismantling of production devices, the environmental impact and liability (e.g. oil leakage) that may be caused by the dismantling operation and the liability for third parties, and make timely response to any legal safeguard.

(VI) Tax reimbursement of decommissioning costs and the countermeasures

In order to secure the interests, once an oil and gas fields suspend production, the operator should promptly communicate with the government of the host country about the tax refund related to the decommissioning costs.

(VII) Ruse of facilities to be decommissioned and the countermeasures

The government of some host countries, such as the UK, and the oil and gas industry are currently considering the feasibility of reusing oil and gas infrastructure for carbon capture, utilization and storage (CCUS). Once the policy is in place, the government of host countries could relieve the original owners of the infrastructure of all or part of their decommissioning responsibilities, thus prompting the participants in oil and gas projects to shift to CCUS projects.

Conclusion

Despite the continuous scientific and technological breakthroughs, such as the recovery of oil production, an increased number of oil and gas fields are entering the end of their production cycle. In addition, host countries continue to improve their legal regimes on decommissioning regulations to better deal with mature oil and gas assets and cope with the pressure from NGOs. Under the current situation, oil and gas companies are facing technical, financial, legal and social challenges related to decommissioning obligations. It is hoped that this article will provide a preliminary reference for participants in oil and gas projects. Oil and gas companies, as project operators, should plan ahead and maintain communication with regulators of host countries to keep updated on decommissioning requirements.

Thanks to intern Ji Haoran for his contribution to this article.

A DISCUSSION ON THE LEGAL ASPECTS OF COMMERCIAL LAUNCH FROM THE INTERNATIONAL PERSPECTIVE

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In recent years, driven by Starlink, a satellite internet constellation operated by SpaceX, the world has seen a surge in the development of low earth orbit (LEO) constellation programmes. According to the development plans of the world' s major LEO satellite internet companies, SpaceX and Boeing in the US plan to launch 12,000 and 2,956 satellites respectively; UK company OneWeb intends to launch 1,980 satellites; the Canada-based company Telesat plans to launch over 1,600 satellites; the South Korean company Samsung aims to launch 4,600 satellites; and Yaliny from Russia strives to launch 135 satellites. The limited satellite communication bands and orbital resources are facing almost unlimited growth demands.

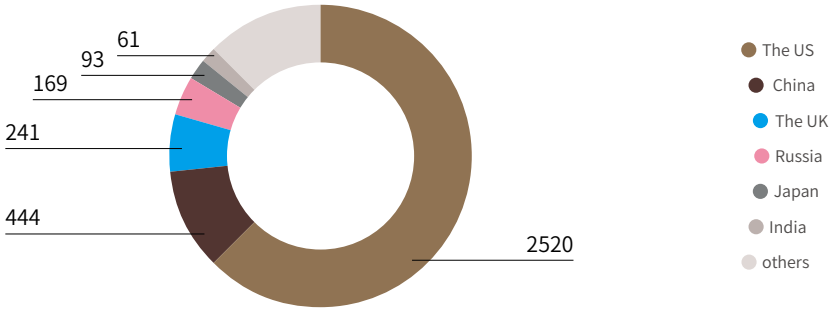
In China, the National Development and Reform Commission has formally included the satellite internet in the "new infrastructure" concept along with other communication network infrastructures such as 5G, IoT and industrial internet since April 2020. Satellite internet service has thus been upgraded to a national strategic emerging industry and has become an important part in China' s development of a space and sky integrated information system. Accordingly, it is very important to bring the "catfish effect" of space commercialisation into play. In the face of lengthy approval process and vast quantities of applicable laws and contract documents, most enterprises are still hesitant to get involved in this emerging industry. This article will briefly introduce the relevant international practices of the US and Russia, the traditional powers in space, in launch licensing, and the contractual framework and key mechanisms for commercial launches, the most vital link of the satellite internet industry chain, in combination with past experiences, with a view to providing useful references for enterprises involved in the development of the satellite internet.

I. Background overview

Undoubtedly, the US, Russia and China are leading the world' s commercial satellite manufacturing and launching services market, both

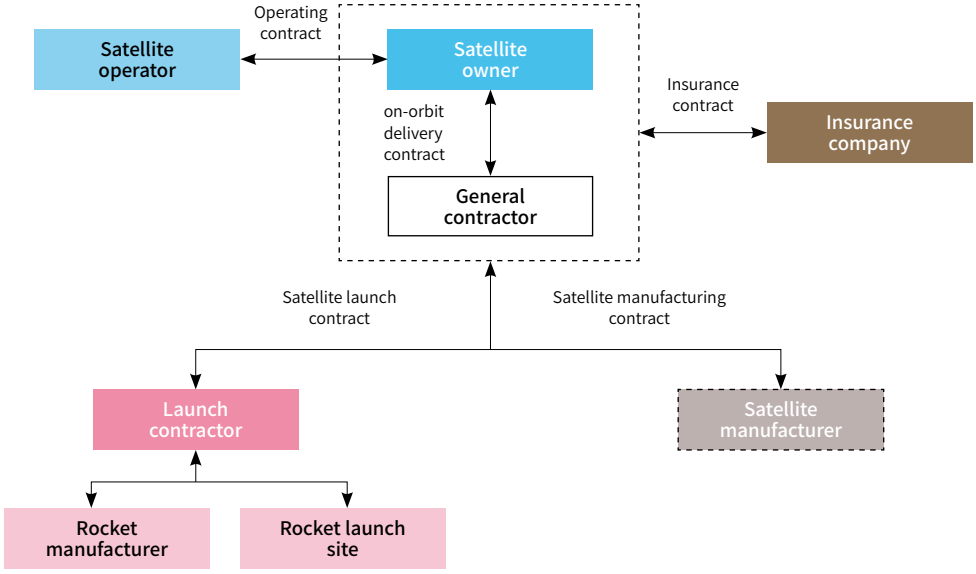
in terms of technology and market share. China' s satellite internet industry, however, is still in urgent need of rapid development. There is still a huge gap between China and the US in technical aspects such as reusable rocket, multiple satellites on a single rocket, or in terms of commercialisation. From the number of satellites in operation, as of 30 April 2021, the US has up to 2520 satellites in orbit, representing half of the the world' s total. China, in the second place, has only 444 satellites in operation. The number of satellites in orbit in various countries is shown in the chart below:

The number of satellites in orbit by country



Note: Data includes satellites operated by each country in conjunction with other countries

The satellite internet industry chain covers the particularly satellite manufacturing, launch, ground equipment manufacturin, satellite operations and services, among which satellite manufacturing and launching are particularly critical. As shown in the following diagram of the main transaction framework for commercial satellite launches, in practice, a satellite owner may outsource the satellite manufacturing and launch to different specialised contractors. Alternatively, a satellite owner may also turn to the "turnkey" service model under which the on-orbit satellite will be delivered by a general contractor. Moreover, due to the differences in technology and resource endowment of various countries, commercial satellite launch is prominently international. The satellite owners, satellite manufacturers, launch contractors, rocket launching sites and even satellite operators in the chart below may all be located in different countries, which complicates the legal regulation and transaction practices for satellite launch.



II. A brief comparison of the US, Russian and Chinese commercial satellite launch licensing systems

Commercial satellite launch is a key link in the satellite internet industry chain. How to find a convenient "space shuttle" for hundreds or even thousands of satellites under the satellite internet constellation programme is a practical problem to be addressed urgently for the rapid development of the commercial satellite launch industry. However, as commercial satellite launch involves the use of outer space and may affect a third country, it is regulated by various international treaties, including the *Treaty on Principles Governing the Activities of States in the Exploration and Use of Outer Space, including the Moon and Other Celestial Bodies* (the Outer Space Treaty), the *Convention on International Liability for Damage Caused by Space Objects* (the Liability Convention) and the *Convention on Registration of Objects Launched into Outer Space* (the Registration Convention).

In accordance with the aforementioned treaties, the government of the launching country shall be absolutely liable to pay compensation for damages caused by its space object on the earth' s surface or to aircraft in flight. The launching state, which is broadly defined in the Liability Convention, means (i) a state which launches or facilitates the launching of space objects; (ii) a state that launches space objects from their territories or facilities. Thus, if a satellite launch is a cross-border project, there may be far more than one launching state, all of which are absolutely jointly and severally liable for the damage, regardless of whether they are the state of registry. For this reason, while gradually opening up commercial satellite launches, countries have also formulated strict rules regarding the registration of space objects, the licensing of the use of satellite radio frequencies, the qualification of rocket and satellite manufacturing, the licensing of space activities, import and export controls, etc., so as to meet their obligations under international law and the necessary requirements on technology, security, environmental protection and confidentiality. The following is a brief introduction to the satellite launch licensing system with prominent differences among countries, taking the US, Russia and China as examples.

(I) The US launch licensing system

The US launch licensing system is set out in the *Commercial Space Launch Act and the Commercial Space Transportation Regulations* (CSTR), among others. In accordance with the latest amendments to the CSTR, by the *Streamlined Launch and Reentry License Requirements*, which took effect on 21 March 2021, launch contractors are required to obtain a vehicle operator licence from the Federal Aviation Administration (FAA) for one or more launches or reentries of the same or family of vehicles.

The issuance of rocket operation license is subject to a rigorous review procedures. Prior to formal application, the launch contractor must consult with the FAA first, which will advise on compliance and preparation of application materials in the context of the specific situation of the project. Upon completion of the pre-application consultation, the launch contractor will proceed to the formal application process and will be subject to a policy review, payload review, public safety review, maximum probable loss (MPL) determination, environmental review, etc. The FAA will review, from the compliance and technical aspects, whether an application may affect the public health and safety, property safety, national security, diplomatic interests or international obligations of the US, and environmental protection. In addition, the FAA will also review the information provided by the applicant related to the launch and/or reentry of the rocket in order to reasonably determine the maximum possible loss (MPL) to persons or property resulting from the launch or reentry, including: (1) damage to third parties and (2) damage to government property, government personnel and nearby operators. If the applicant meets the application conditions and submits a complete application package, the rocket operation license will generally be issued within 180 days after the application is accepted. Then, the FAA may modify and adjust the MPL at any time based on additional information obtained. The launch contractor shall purchase liability and property insurance equivalent to the MPL to the upper limit determined by law during the specified time period before the launch, or otherwise prove its sufficient compensation capacity by providing special funds or fund certificates of jointly managed accounts and other means.

(II) Russian launch licensing system

Russia does not provide for a separate licence for rocket launch. Pursuant to the *Federal Law on Licensing Specific Types of Activities*, the *Federal Law on Space Activities* and the *Regulations on Licensing of Space Activities*, a licence for space activities is required from Roscosmos for the provision of services related to rocket launches and spacecraft entering the orbit, as for other space activities such as satellite manufacturing.

The *Regulations on Licensing of Space Activities* therefore stipulated more principled application requirements, including having (1) facilities and premises required for hygiene, epidemic prevention, fire protection, equipment, technical documentation, etc. necessary for carrying out the licensed activity; (2) sufficient number of specialists with the appropriate academic and other qualifications to meet the service demand (no less than 5 persons); (3) a quality monitoring system; and (4) qualifications to use state secrets to complete services (if applicable). Theoretically, if an applicant meets the aforementioned conditions and provides truthful and sufficient application documents, Roscosmos will issue the licence within 45 working days after accepting the application, and list the applicant's right to engage in rocket launching services in the license annex. As it is difficult to quantify the above application conditions, however, there is a high degree of uncertainty as to whether a private entity can obtain the space activity license for launch services. From the perspective of market practice, launch services in Russia are still mainly provided by Roscosmos and its affiliates. In terms of liability insurance, under Article 25 of the *Federal Law on Space Activities*, satellite owners, satellite operators, satellite manufacturers or launch contractors are obliged to purchase third-party liability insurance for commercial satellite launches.

(III) China' s launch permit system

In accordance with the *Interim Measures on the Administration of Permits for Civil Space Launch Projects* promulgated in 2002, the commercial satellite launch requires a permit for civil space launch project issued by the State Administration of Science, Technology and Industry for National Defence (SASTIND, formerly known as the Commission of Science, Technology, and Industry for National Defence). Unlike the US and Russian regulations, the launch permit in China is a special permit for a specific project rather than an approval of the qualification of the launch contractor. The launch either within China, or outside China by a launch contractor entrusted by a Chinese satellite owner, shall be subject to a launch permit from the SASTIND for which an application is submitted through the provincial administration of science, technology and industry for national defence.

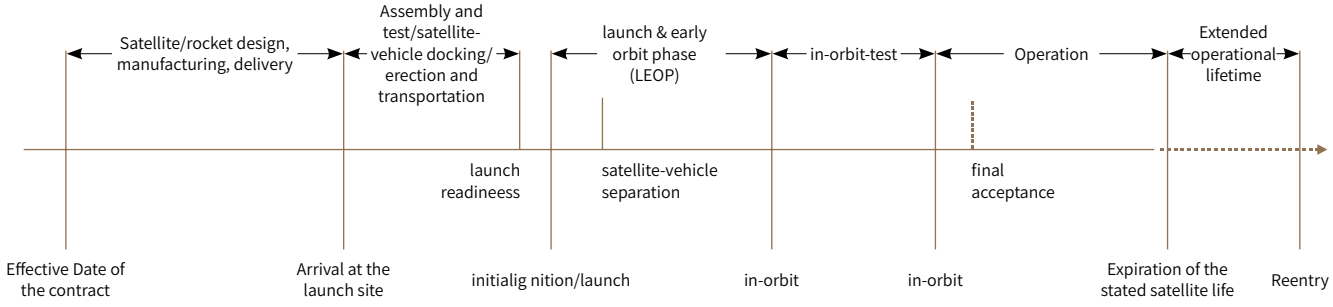
In principle, the applicant for the civil space launch project license is the general contractor of the project (including the launch contractor). The satellite owner may also be the applicant if there is no domestic general contractor. The applicant should submit an application for a launch permit to the SASTIND nine months before the scheduled launch month of the project, after completing technical coordination with the launch site and other parties and developing the launch and flight outline. In accordance with the *Interim Measures on the Administration of Permits for Civil Space Launch Projects*, the applicant shall meet the following conditions: (1) complying with national laws and regulations and maintaining state secrets; (2) the project will not endanger national security, harm national interests or violate national foreign policy and international conventions concluded and in force; (3) the project will not cause irremediable danger to the health, safety or property of the public due to gross negligence or intentional acts; (4) having relevant licensing documents; (5) having necessary technical strength, economic power and complete technical documents and providing corresponding application materials. The SASTIND shall complete the examination and approval within 30 days from the date of receiving the application materials.. In addition, the general contractor may, as the case may be, need to submit relevant materials to the Equipment Development Department of the Central Military Commission for special review. After obtaining the permit and passing the special examination, the permit holder will purchase the third party liability insurance and other relevant insurances for the launch of space objects as the necessary preconditions for the space objects to leave the factory and enter the launch site.

III. Contractual framework and key mechanisms for commercial satellite launches

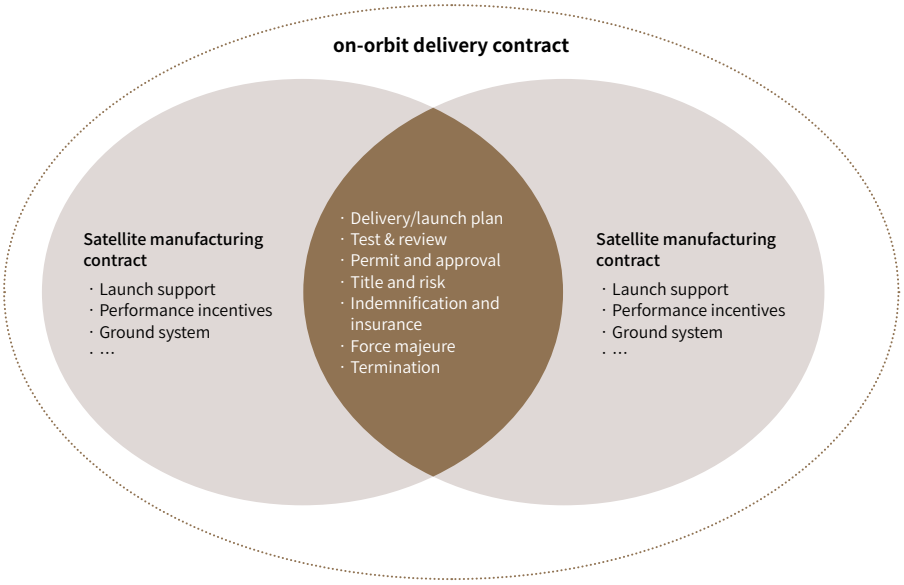
(I) Contractual framework

As illustrated in the main transaction framework above, depending on the expertise of the satellite owner and commercial concerns, there are two types of contract structures in practice: firstly, the satellite owner outsources the satellite manufacturing and launching to different professional contractors to operate commercial satellites on their own; secondly, the satellite owner chooses the commercial satellite on-orbit delivery mode by signing a "turnkey" contract with a general contractor who will be responsible for manufacturing the commercial satellite and launching it into orbit (also known as a satellite on-orbit delivery contract).

Under the two modes, the following key milestones throughout process of the commercial satellite from manufacturing to recycling shall be considered in designing and drafting the contract to specify corresponding rights and obligations of both parties.



Accordingly, under the multi-contract structure where the satellite manufacturing and launch services are purchased respectively, the terms and mechanisms of the two contracts need to be converged and coordinated.



The commercial satellite project is complex and integrated. Therefore, the contract is intended to specify the rights and obligations of both parties, and their relationship from the accounting perspective. Furthermore, it is necessary to supplement more details in the technical annexes to the contract, especially technical annexes on the scope of work, technical requirements and test plans. The contract and its annexes should be coordinated in terms of defined terms and mechanisms.

(II) Key mechanisms

Below is a brief introduction to the title and risk transfer, assessment and acceptance mechanism, performance and quality assurance mechanism, indemnification and insurance mechanism in the satellite on-orbit delivery contracts.

1. Title and risk transfer

The title and risk transfer clause is an important mechanism for determining the ownership of the deliverables and the allocation of risk for damage and loss between the parties. In general, unless otherwise agreed in the contract, the title transfer and the transfer of risk take place at the same time. The title and risk transfer may also be set separately depending on the commercial concerns and bargain power of the parties in a particular project.

In satellite on-orbit delivery contracts, the contractor' s deliverables are broadly divided into two categories: (i) spacecraft consisting of satellites and rockets; and (ii) other deliverables such as civil works, equipment and software that primarily constitute the satellite' s ground-based measurement and control, application and communication systems (ground system).

The high risk of loss of spacecraft often takes place between the intentional ignition and the scheduled orbit. While contractors tend to set the risk transfer node as far ahead as possible, title and risk of the spacecraft in a typical on-orbit delivery contract are generally transferred from the contractor to the owner at the time of intentional ignition (when the launch instruction is received by the rocket and the propellant starts to flow to the first stage engine of the rocket) in accordance with the risk allocation principle of "risk to be borne by the party best able to manage it". In the event of a launch termination (generally when the rocket' s first stage engine are shut down prior to lift-off after the terminated ignition, the take-off contact is not closed and the launch pad is declared to be safe), title and risk of the spacecraft will be transferred back to the contractor until the next launch. In some projects, depending on the bargain power of both parties, the ownership and damage risk transfer nodes of spacecraft may be put behind, e.g., after the final acceptance of the on-orbit testing. In such a case, compared with the transfer of ownership and risk at the time of intention ignition, the contractor essentially assumes a greater risk, and the contract price often increases accordingly.

Since the ground systems need to be tested together with the on-orbit satellite and during the test they are mainly operated by the contractor, title and risk of the ground systems are generally transferred to the satellite owner upon receipt of the ground systems by the owner. This is similar to the common practice of construction contracting. It should be noted that, depending on the complexity of the ground systems and their relevance to the on-orbit satellite, some projects also take the satellite on-orbit testing as a prerequisite for the acceptance of the ground systems.

2. Testing and acceptance

In general, in addition to the essential final acceptance of the satellite, including the in orbit test, an on-orbit delivery contract may also set other interim milestones, including a preliminary design review, critical design review, mechanical test, thermal test, shipment readiness review, flight readiness review, and launch readiness review. This will help the contractor to recover the contract price by milestone, while placing higher requirements on the contractor to manage the project schedule.

It should be noted that although the on-orbit delivery contract also covers the design, manufacturing and delivery of the rocket, the core of the acceptance mechanism under the contract lies in the successful launch of the satellite into the specified orbit and the testing of the satellite' s performance. Therefore, in spite of the complexity of the design, manufacturing and delivery of rockets, and routine process such as factory inspection and shipment readiness review, the key part is the launch readiness review which takes place after the rocket has arrived at the launch site and completed the final assembly and adaptation of the satellite. This is a key milestone in any satellite launch contract (whether a turnkey or a multi-contract structure).

After the launch readiness review, the assessment of the satellite' s performance is focused on the on-orbit test after the satellite has been successfully launched into its scheduled orbit. During this phase, the contractor will test whether the satellite' s effective communications capability reaches the parameters indicated in the contract (also known as the nominal communications capability). Available communications capability is generally reflected in the sum of the "transponder years" (defined as the shortest of the stated satellite life, the satellite' s fuel life or the operating life of a serviceable transponder) for each serviceable transponder or the transponder expected to be serviceable. In general, the contractor, in order to mitigate the performance risk of the satellite, may tend to agree in the contract that if the satellite reaches the minimum communications capacity other than its nominal communications capacity, the satellite owner should still accept the satellite on orbit. However, the owner is entitled to make a corresponding deduction from the contract price.

3. Performance and quality assurance

Due to the technical difficulty and high costs, it is generally unlikely to replace and repair satellites after they pass acceptance and encounter on-orbit operation failure. As a result, commercial satellite contracts usually do not provide similar mechanisms for repairing defects such as warranty periods and defect notification period in general engineering contracts. However, this does not mean that the satellite owner has no way to procure the contractor to design, manufacture and launch a satellite with stable performance within its stated satellite life. Accordingly, commercial satellite contracts typically set a certain proportion of performance incentives in the contract price. The operating life and performance incentive fees of satellites will generally be calculated from the time of on-orbit acceptance. In some projects, we also see that some contracts distinguish between the on-orbit acceptance and the final acceptance, and the main difference between the two concepts is that after the on-orbit acceptance and before the final acceptance, the satellite owner will also evaluate the satellite' s performance during a complete eclipse period. The distinction, however, will not affect the calculation of the operational lifetime of the satellite and the performance incentives from the time of on-orbit acceptance. In general, the distinction may help the contractor to reduce the proportion of the balance payment and recover the contract price as early as possible.

In the interest of the satellite owner, the performance incentives may be allocated to each period (e.g. a quarter) of the stated satellite life and paid by assessing the effective communications capability of the satellite during each period until the end of the stated satellite life. Depending on the commercial claims and negotiating position of the parties, it may also be considered to agree on whether the satellite owner is required to pay the contractor performance incentives beyond the contract price for satellites that have exceeded their service life. In addition, we have seen very pro-contractor performance incentive fee mechanisms in some projects. For instance, the satellite owner shall pay the contractor the contract price including the performance incentives after final acceptance, and re-assess the satellite' s effective communications capability within one year of final acceptance. Only when the effective communications capability falls below the rated capability will the contractor be required to return the performance incentive fee previously received pro-rata to the satellite owner.

4. Indemnification and insurance

Indemnification obligation of the parties is a relatively common clause in contracts involving on-site execution and complex responsibilities for interfaces. In principle, one party needs to indemnify the other party against the loss caused by its own act or omissions, or by the matters for which such party bears the risk.

Given the technical complexity and high risk of the satellite launch project and the difficulty in finding out the cause of responsibility, the indemnification clauses of commercial satellite contract have their own characteristics from the perspective of facilitating the transaction. In many project contracts, the obligation of one party to indemnify the other party is often restricted to the third party claims against the indemnified party. Further, to appropriately simplify the risk sharing mechanism between the parties, the satellite owner and contractor generally undertake to waive claims for damage to their own (including subcontractors') personnel or property caused by the other party in its launch activities or at the launch site, even if such damage is caused by the other party' s intention or gross negligence.

Similarly, in light of the high risks and potential huge losses associated with commercial satellite projects, commercial satellite contracts should contain more detailed insurance provisions, including mutual waiver of claims. As described above, launching States, in accordance with their obligations under international laws such as the Outer Space Treaty and the Liability Convention, further require commercial satellite launching agencies or satellite owners to purchase third-party liability insurance for satellite launch through domestic legislation to cover, during and after satellite launch (generally for one year), the damage to persons and property of third parties on the surface of the Earth caused by objects falling from rockets or satellites, as well as damage to persons and property in the aircraft in flight. In addition, a commercial satellite contract will also generally require the satellite owner or contractor to purchase other industry-specific insurance, such as insurance for rocket/satellite pre-launch, satellite launch and initial operation, and satellite on-orbit insurance. The provisions such as the inception of insurance coverage, insured amount and insurance incidents of these insurance policies shall also be taken into consideration together with the risk allocation mechanism of the commercial satellite contract. For example, as mentioned above, the risk of damage and loss of the spacecraft is generally transferred to the satellite owner at the time of the intentional ignition. Therefore, the inception of insurance coverage will generally be connected to the intentional ignition regardless of which party is responsible for purchasing the satellite launch and initial operation insurance.

Conclusion

Satellite communication is expected to be widely applied in the 5G/6G era. Some institutions predict that the estimated scale of domestic industry driven by LEO satellite will reach RMB 400 billion. The enterprises in the industry are facing vast opportunities in both the domestic and international markets. Commercial satellite launch, however, involves very high thresholds in approval and licensing, numerous downstream subcontractors, complex contract mechanisms and long implementation periods. In the case of cross-border transactions, this is especially true as they not only challenge the contract negotiation and project management capabilities of enterprises, but also place higher requirements on the international vision, commercial thinking and expertise of lawyers. Looking at the global market, companies such as SpaceX, Boeing, Airbus, and Amazon have rushed to invest into the LEO satellite sector in recent years. As tens of thousands of LEO satellites are expected to be launched into the space in the next five years, the competition for LEO satellite orbit and spectrum resources will intensify. We hope that, with the gradual implementation of China' s LEO satellite constellation plan, the commercial satellite industry will grow rapidly and steadily in the country.

Thanks to intern Liu Yifan for the contribution to this article.

INSIGHT INTO FUTURE CASH FLOW AND PRODUCT FLOW FINANCING MECHANISMS IN THE MINING SECTOR FROM A COMMERCIAL LAW PERSPECTIVE

Fan Duoling (Grace)

Introduction

In the mining sector that has always had a huge financing demand, international mining companies are raising development and working capital through a variety of channels. A common channel is equity or quasi-equity financing, including syndicated loans, bonds and other possible sources (including equipment financing).

While traditional bank debt and capital market bond issuances still play a significant role in mining financing, the mining sector is diversifying its overseas financing channels, especially at the early stage of projects. For example, in addition to financing from equity investments such as M&A, farm-in arrangements (investments by non-operator minority shareholders) and joint venture arrangements for project exploitation, which are familiar to players in the mining industry, royalty financing and metal streaming financing are also becoming more mature and favored by the international market.

Royalty financing and metal streaming financing are available to mining companies at the feasibility and production stages of a bankable project. Under these two financing methods, negotiations over the financing quantityare usually based on the reserves of minerals. Of course, different asset host countries have different reserve certification standards, and therefore negotiation and valuation considerations may vary[1]. For mining companies, in the initial stages of a project, future cash flow financing may be more attractive than other equity financing methods diluting the equity. This article will focus on these more diversified financing methods and introduce more flexible transaction options.

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[1] According to geological confidence, mineral resources can be divided into: measured mineral resources, indicated mineral resources and inferred mineral resources. According to geological confidence and other correction factors, ore reserves are subdivided into proven minerals and probable minerals.

I. Royalty financing

In the mining sector, mining royalty refers to the right purchased from a mining company to obtain a fixed proportion of future revenues from mineral products extracted from the relevant mineral project. While conducting comprehensive due diligence on mineral resources, investors do hope that they can invest at a discount based on the future profit confirmed by both parties. So, how does one define future value? The most common methods are based on: (1) gross revenue (which has the highest certainty); (2) net revenue (i.e. profits); (3) net smelter balance (gross revenue less a proportionate share of mining and transportation costs, i.e. cash flows net of operation and capital costs); or (4) a proportion of physical mining products.

From a mining company' s perspective, royalty financing usually lasts throughout the life cycle of the mineral resource development. This means that the company' s future sales of mineral resources (or taking on new equity investment) will be subject to its obligation to pay royalties. A key issue is to ensure that the royalty interest flows with the project and binds the future owner of the mineral resource, which also protects against the risk of insolvency. In some jurisdictions, a royalty holder may register its royalty interest with the appropriate authority, giving it priority over other creditors and making the registration binding on the purchaser of the mining title. However, such registration of royalty interests, which is not a common international practice, is subject to the law of the jurisdiction where the ownership of the project is located. If, under the legal framework of the relevant jurisdiction, the royalty interest is not an interest in land, the royalty holder will generally seek a security interest in or a lien on the mining title associated with the royalty interest.

Typically, the key terms negotiated in a royalty financing agreement include:

- Percentage of the royalty interest;
- Calculation method (including discounts on future cash flows);
- Purchase price of the royalty interest;
- Type of mineral or mining product/by-product associated with the royalty interest;
- Mine site from which a product is extracted and the royalty interest is paid;
- Whether and how payment obligations are secured;
- Whether the royalty interest is bundled up with the underlying premises and the relevant rights to be transferred; and
- Whether a right of first refusal of the royalty interest is arranged.

II. Metal streaming financing

Under a metal streaming financing mechanism, investors make upfront payments to a mining company for the right to purchase a fixed proportion or quantity of future production of specific mining projects.

The metal streaming financing mechanism originated from large North American gold companies. The subject of the metal stream may be minerals produced in the project or by-products of the mining operation, such as precious metals produced in base metals operations (e.g. gold produced from copper operations). Industrial investors may participate in such financing arrangements to access a portion of the upstream mineral resources. Such a structure is typically designed to ensure that the interests of the project operator are aligned with those of the company acquiring the metal

stream interest. Therefore, the subject of the metal streaming arrangement represents only a small proportion of the expected total production of the project.

In a metal streaming financing transaction, the investor usually undertakes to purchase with cash an agreed proportionate share of future products at the lower of the agreed fixed price or the market price at the time of delivery. Therefore, the investor would normally make an upfront payment and then pay the predetermined price for the actual production. The upfront payment may constitute a security deposit, i.e., if the future sales at the fixed price are lower than the market price, the difference may be credited to the deposit. Generally, the remaining deposit at the end of the term should be repaid by the mining company, which can also hedge the risk of poor performance of the mineral project.

Typically, the key terms negotiated in a metal streaming financing agreement include:

- Amount of the upfront payment;
- Fixed price and the term;
- Percentage of the product to be purchased; and
- Manner of delivery of the product and the allocation of risk.

Since no rights and interests in project properties typically arise under the metal streaming mechanism, if there are no security interests or liens, the metal stream investor will be in the same priority of payment as other unsecured creditors. If the purchaser of the mining project does not agree to sell the product to the metal stream investor on the same terms, the investor can only file a claim. As a result, the investor will generally consider claiming a miner' s guarantee on the underlying project to protect its interests to a certain extent.

The tax and accounting treatment is a key consideration when arranging a metal streaming mechanism, which is subject to the laws of the jurisdiction in which the project is located or the jurisdiction in which the arrangement is enforceable.

III. Financing based on future cash and product flows

Financing based on future cash and product flows is attractive to mining companies. First, compared with traditional debt, this financing method does not require the payment of interest, which benefits mining companies that lack the revenue to meet their debt service obligations prior to and during the development of a project. Second, although this type of financing indirectly reduces shareholder returns as total revenues decline, it does not dilute shareholders' equity and ownership. In addition, mining companies have no obligation to pay or deliver products before production and only need to complete payments if they have any revenue or any product (which, depending on the structure of the different transactions, may hurt the profitability of the project). Moreover, such financing signifies that external industry experts recognize the potential of the mining projects funded this way.

In addition, from a legal perspective, such financing is generally flexible in contract terms, and requires limited documentation (usually only the financing agreement and any associated guarantee or lien), which can be agreed upon and signed relatively quickly. Such mechanism is less contractual than traditional debt instruments, with little agreement on default matters (including no financial covenants and no penalties for development delays). In short, after the investor has done due diligence on the project and confirmed the valuation, it needs to share the risks of the project extraction and the price fluctuations of commodities with the mining company. The investor has no direct control over the management or operation of the project, so its due diligence will focus on the technical strength of

the project, the ability of the management team (formed on an ad hoc basis or for the project), political risks, and other factors that may affect the investor' s ability to achieve a stable, long-term return on its investment.

While the above financing arrangements are attractive to mining companies, they are also challenging.

For example, it is often difficult for a mining company' s management to determine the true cost of a royalty interest (i.e. the loss in the value of future cash flows), especially in the early stages of a project. Mining companies are also exposed to the risk of actual royalty payments significantly exceeding their initial valuation and, as a result, they must consider their future funding needs. In addition, a secured royalty interest or metal stream mechanism may add complexity to the transaction when negotiating with bank financiers that would normally require a senior lien or security status. Nonetheless, domestic and foreign banks familiar with mining finance typically do not mind secured concessions of priority (usually perceived as industry confidence in projects). The mining company should ensure that the financing mechanism does not limit its ability to raise secured financing in the future and should agree at the outset on the order of payment among creditors for either the royalty holder or the metal stream interest holder. Under a future financing arrangement, the royalty equity should be treated as operating costs in the cash flow waterfall, but future financiers may require the royalty holder to take an inferior position.

Conclusion

Considering the challenges faced by the global mining industry, it grows more important than ever before for the management of mining companies to comprehensively assess the financing costs and be flexible with the impact of current and future alternative financing sources. At the initial stage of a project, a mining developer may have sufficient reasons to avoid diluting equity by selling strategic equity in a mining project or a royalty interest, but the loss of future revenue and the introduction of a joint venture partner may have a significant impact on future financing. Similarly, it is not optimal for mining companies to rely solely on syndicated loans as a single source of funding. Therefore, in practice, flexibility in commercial and legal terms requires the accurate judgment and cooperation of each professional on the project team according to the actual situation.

HOW CHINESE COMPANIES PROTECT THEIR OVERSEAS INVESTMENTS IN THE FACE OF RAIDS AND UNRESTS

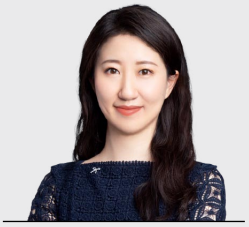
Su Chang, Li Zhenghao

Introduction

On 21 December 2021, the Indian Income Tax Department carried out dawn raids on certain foreign controlled mobile communication & mobile handset manufacturers, including those controlled by Chinese companies, and their associated persons in India on the ground of suspected tax evasion.[1] Mass protests and demonstrations, triggered by a price rise of liquefied natural gas, took place in Kazakhstan at the beginning of 2022. The Kazakh president accepted the government' s resignation on 5 January and declared a nationwide state of emergency.[2] Against the backdrop of rising trade protectionism and unilateralism and an increasingly complex international landscape, Chinese companies should actively take legal actions to protect their legitimate rights and interests in overseas investments. When suffering losses due to a foreign government' s acts or receiving unfair treatment in a foreign jurisdiction, a Chinese investor can use the relevant international investment agreement (investment agreement) signed by China to safeguard its rights and interests by initiating an international investment arbitration against the host state.

I. Protecting legitimate rights through investment agreements: from the perspective of the China-India BIT and the China-Kazakhstan BIT

International investment arbitration refers to an international arbitration initiated by a foreign investor against the host government, claiming the host government' s breach of its treaty obligations and seeking monetary compensation from the host government pursuant to a bilateral or multilateral investment agreement. In comparison with domestic litigation, international investment arbitration can effectively



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[1] https://pib.gov.in/PressReleasePage.aspx?PRID=1786625; https://world.huanqiu.com/article/4673n8urgSL
[2] http://www.news.cn/world/2022-01/06/c_1128239567.htm

avoid local protection and has many advantages in arbitration procedure and award enforcement. In comparison with commercial arbitration, investment arbitration often has more extensive social impact and can be used as a powerful means for investors to exert pressure on the host government to seek reconciliation and settlement compensation. In recent years, we have seen a rapidly growing number of international investment arbitration cases. According to the 2021 Annual Report issued by the International Centre for Settlement of Investment Disputes (ICSID), a total of 332 ICSID cases were administered in FY2021.[3]

There are a number of requirements for initiating an investment arbitration based on an investment agreement, including: covered investment and investor, the host state' s breach of relevant obligations under the investment agreement, the host state' s consent to arbitration, and pre-arbitration procedures. The key requirements are set out in the analysis below concerning the recent events in India and Kazakhstan.

(I) Covered investment and investor

Only an "investor" protected by investment agreements may obtain compensation from foreign governments by initiating investment arbitration. In general, investment agreements stipulate the definition of covered "investment" and "investor". For example, Article 1 of the China-India bilateral investment treaty (BIT) defines "investor" as "any national or company of a Contracting Party" and "investment" as "every kind of asset established or acquired, including changes in the form of such investment", including but not limited to: shares in and stock and debentures of a company and any other similar forms of participation in a company; and rights to money or to any performance under contract having a financial value. Therefore, the subsidiary established by a Chinese company in India constitutes an "investment" protected by the China-India BIT. If any breach of the Indian government in violation of the investment agreement results in damage to that "investment", the Chinese company will be entitled to claim compensation under the China-India BIT.

Similarly, according to Article 1 of the China-Kazakhstan BIT, the investment of a Chinese investor protected by the China-Kazakhstan BIT includes not only the subsidiary established by the Chinese company in Kazakhstan, but also the such company' s claims to money or to any performance of economic value enjoyed by way of contract.

(II) Potential breach of relevant obligations under investment agreements

An investment agreement provides for the host state' s investment protection obligations, including fair and equitable treatment (FET), full protection and security, most-favoured-nation treatment, expropriation and compensation, war clause and etc. Depending on the specific circumstances of the event in question, the acts of the host state may be suspected of breaching the relevant provisions of the investment agreement entered into with China.

1. The Indian raids

- **Breach of the FET clause**: Article 3 of the China-India BIT requires that the Indian government accord "fair and equitable treatment" in the territory of India to the investments and returns of the Chinese investors. In the current investment arbitration practice, common acts that are found by arbitral tribunals to constitute a breach of FET include: arbitrary or discriminatory treatment, denial of justice, violation of due process, lack of transparency in the host state' s laws or procedures, and breach of the investor' s reasonable expectations. The Indian government may be suspected of breaching the FET clause if the raids are clearly discriminatory and do not comply with the due process or transparency requirements.

[3] See ICSID' s 2021 Annual Report at p28, available at:https://icsid.worldbank.org/sites/default/files/publications/ICSID_AR21_CRA_bl1_web.pdf.

- **Breach of the expropriation clause**: Article 5 of the China-India BIT stipulates that investments of investors of either contracting party shall not be nationalised, expropriated or subjected to measures having effect equivalent to nationalisation or expropriation in the territory of the other contracting party except for public purposes in accordance with the law on a non-discriminatory basis and against fair and equitable compensation. This article covers both direct and indirect expropriation. In general, direct expropriation refers to compulsory transfer or unconditional taking of ownership of property while indirect expropriation refers to measures that have the effect of direct expropriation without the transfer of property rights. The Indian government may be suspected of "indirect expropriation" of the Chinese enterprises' investments in India if it ultimately imposes high "punitive" taxes or fines on Chinese enterprises for unjustified reasons.

2. The Kazakh unrest

- **Breach of the war clause**: In accordance with Article 4(3) of the China-Kazakhstan BIT, in case of investment losses caused by war, state of emergency, civil unrest and other similar circumstances, the Kazakh government shall not treat the Chinese investors less favourably than domestic or third-country investors in terms of compensation for losses or other relevant measures. The Kazakh government may be suspected of breaching the war clause if the relevant measures taken in response to the unrest are clearly discriminatory against the Chinese investors.

(III) Consent to arbitration

To initiate an international investment arbitration, an investor needs to first prove that the host state has consented to the submission of the investment dispute to international arbitration under the relevant investment agreement. The scope of consent to arbitration is broad under the China-India BIT. Under Article 9 of the said BIT, an investor may initiate an arbitration to resolve "[a]ny dispute…in relation to an investment". Therefore, Chinese investors affected by the Indian government' s measures may submit for arbitration a relatively wide range of matters, including disputes arising from the breach of the FET clause or the expropriation clause as stated above.

Article 9 of the China-Kazakhstan BIT, however, limits the scope of consent to arbitration to any dispute in relation to the amount of compensation for expropriation. Therefore, to initiate an arbitration against the Kazakh government for wrongful acts in response to the civil unrest, a Chinese investor needs to first address the issue of the Kazakh government' s "consent to arbitration", i.e. to prove that the dispute involves the amount of compensation for expropriation.

II. Recommendations for Chinese companies to invest overseas

Given the complex and changing international situation, the setbacks of economic globalisation, the changes in international trade and investment rules, the rise of trade protectionism, and the continued evolution of the COVID-19 pandemic, we advise that Chinese companies seeking overseas investment or those having already gone global take the following measures:

First, when investing abroad, Chinese companies can use overseas investment insurance to reduce their risks. Overseas investment insurance covers losses incurred in overseas investments due to political risks such as expropriation and war in the host state. The Chinese companies can obtain financial compensation from the insurer in the event of any covered risks.

Second, when deciding on investment and transaction structures, Chinese companies should consider whether they can enjoy the investment protection provided by the investment agreement and seek to obtain the

highest level of treaty protection by planning investment structures and changing the nationality of investors. The China-Kazakhstan BIT, for example, lacks the so-called common "full protection and security" clause under which the host state is required to provide basic security for foreign investors' investments in the event of civil war, unrest, etc. Therefore, if the investment destination is a politically unstable country, Chinese investors should plan investment structures in such a way that their investments are protected by the relevant investment agreement, including the full protection and security clause. In addition, we also advise that Chinese investors consider whether the relevant investment agreement contains the denial of benefits clause. Such clause may prevent an investor from seeking treaty protection and render the abovementioned indirect investment unfeasible. Therefore, Chinese investors are recommended to seek professional legal advice and make a thorough assessment when determining their investment plans.

Third, when determining the level of protection provided by an investment agreement, Chinese companies should consider whether the agreement allows for international investment arbitration and whether there are restrictions on the initiation of investment arbitration. The absence of international investment arbitration or the existence of relatively more restrictions in the investment agreement may limit the possibility for Chinese enterprises to defend their rights through investment arbitration. For example, the China-Kazakhstan BIT only stipulates that investors may submit disputes involving the amount of compensation for expropriation to an arbitral tribunal. Given the relatively limited scope of protection, Chinese companies are recommended to make maximum use of their bargaining power to include international investment arbitration as the dispute resolution method and also relevant investment protection clauses in the investment contract with the host government. These clauses will ensure Chinese companies' right to international investment arbitration when they are unfairly treated by the host government in their overseas investments.

Thanks to intern Qiao Qiya for her contribution to this article.

COUNTRY SNAPSHOTS

ANALYSIS OF THE "EXTREME SANCTIONS" AGAINST RUSSIA FROM THE US, EU AND OTHER COUNTRIES AND THE RESPONSE OF CHINESE COMPANIES

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Introduction

Since the escalation of the Russia-Ukraine conflict on 21 February 2022, the US, EU, and some other countries have successively launched an unprecedented series of export controls and economic sanctions in sectors of critical importance to the Russian economy, including national defence, energy, finance, trade, telecommunications and transportation. These extreme sanctions have further aggravated geopolitical risks and will bring more uncertainty to the already fragile global supply chain system due to the influence of the pandemic.

Based on the current international situation, this article will analyse the latest sanctions against Russia imposed by the US, EU and other countries, discuss their potential impacts on Chinese companies, and provide some recommendations on how to respond properly.

I. Previous and latest sanctions against Russia from the US, EU and other countries

(I) Previous sanctions against Russia

Economic sanctions are a core tool of the US foreign policy. Although the current round of sanctions against Russia is severe, most of the measures have been applied in Iran, China and even Russia before. Since the outbreak of the Crimea crisis in 2014, most US Congress members are concerned about Russia' s geostrategic intention in the Eurasian Plate. As such, the US imposed rounds of economic sanctions on Russia, including banning Russian banks from bond transactions and loans, and banning exploration and technical cooperation with Russian energy companies; freezing the assets of Russian officials, banning the issuance of visas to them and freezing their internet accounts; revoking the business licences of relevant Russian companies, cancelling high-tech export licenses and implementing arms embargo; and repeatedly blocking the Nord Stream 2. These sanctions are more of a political statement than an economic attack.

(II) Characteristics and measures of the current sanctions against Russia

With the escalation of the Russia-Ukraine conflict, the US has recently issued two executive orders and ten related determinations against Russia, and is also introducing sanctions regulations against Russia. The sanctions are unprecedented in scale, frequency and scope of deterrence. The wide range of sanctions imposed in concert with its allies makes the US economic sanctions "extreme" in the context of this conflict.

Unlike most mechanisms for implementing sanctions against specific targets, these sanctions are more directly stated about what they are intended to achieve, namely to cut off Russia' s banks from processing payments through the US financial system, cut off more than half of Russia' s high-tech imports, restricting Russia' s access to vital technological inputs, atrophying its industrial base, and ultimately undercutting Russia' s strategic ambitions to exert influence on the world stage.

The sanctions that are the most visible and also the most likely to have a full impact on the Russian economy include:

1. Removing Russia from financial tools and financial markets

According to the US White House statement dated 26 February 2022, the leaders of the European Commission, France, Germany, Italy, the United Kingdom, Canada and the US decided to exclude certain Russian banks from the SWIFT messaging system, which meant that Russia was completely blocked from the financial markets of Western countries and some Russian financial institutions could not normally conduct cross-border transaction communication and clearing, and could not obtain new foreign exchange through bonds and corporate financing. Specifically, for example:

- The UK announced that Russian state-owned enterprises and private companies in key areas are prohibited from financing in the UK financial market.
- The EU prohibits the listing and provision of services in relation to shares of Russian state-owned entities on EU trading venues, the acceptance of deposits exceeding certain values from Russian nationals or residents, as well as

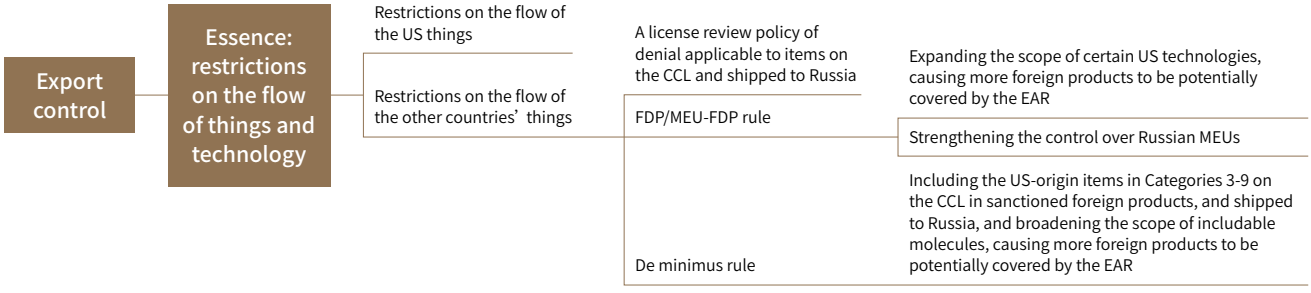
the selling of euro-denominated securities to Russian clients by the EU Central Securities Depositories.

- a full ban of the provision of crypto-asset wallet, account or custody services to Russian persons and residents, regardless of the total value of those crypto-assets
- The US prohibits its financial institutions from participating in the markets for bonds issued by the financial services sector of Russia;
- Japan prohibits the issuances and transactions of new Russian sovereign debt in the Japanese market; and
- Canada prohibits its citizens from dealing Russian sovereign debt.

The prohibitions on the Russian central and other selected banks are reportedly related to the security and use of Russia' s international reserves of more than USD 600 billion. The possible impact of such restrictive measures is therefore also of great concern to the international community. The above sanctions will deal a heavy blow to the import and export trade, international payments and foreign exchange of Russian banks.

2. Cutting off Russia' s import from key supply chains

In terms of the multi-sectoral US sanctions, export controls have become an important tool to restrict foreign access to US-related items in a broad sense. In addition to the economic sanctions described above, the US Department of Commerce' s Bureau of Industry and Security (BIS) has also implemented a sweeping series of comprehensive and stringent export controls to maximise restrictions on the development of Russian defence, aerospace and maritime sectors. The controls are intended to cut off access of key sectors of Russia' s industrial base to any key US-related items, including semiconductors, computers, telecommunications, information security equipment, lasers and sensors, in order to undercut its strategic influence on the Eurasian arena. Recent additional measures include:



- The EU will prohibit the sale, supply, transfer or export of certain specific refined oil products and technologies to Russia and impose restrictions on the provision of related services. The prohibitions are aimed at hitting the oil industry by making it impossible for Russia to upgrade its refineries. The EU will also ban the sale of all aircraft, spare parts and equipment to Russian airlines and the provision of insurance, reinsurance and maintenance services in relation to these goods and technologies.
- The UK announces punitive new restrictions on trade and export controls against Russia' s hi-tech and strategic industries to crack down on its electronics, telecommunications and aerospace companies.
- The energy, telecommunications and aviation industries on which the Russian economy depends will be prevented from upgrading.

- The EU will be prohibited to provide maritime transport and to provide technical assistance, brokering services or financing or financial assistance, related to the maritime transport to third countries of crude oil (as of December 2022) or petroleum products (as of February 2023) which originate in or are exported from Russia.
- The EU is extending the import ban on steel products that either originate in Russia or are exported from Russia. Further import restrictions are also imposed on wood pulp and paper, cigarettes, plastics and cosmetics as well as elements used in the jewellery industry such as stones and precious metals, that altogether generate significant revenues for Russia. The sale, supply transfer or export of additional goods used in the aviation sector will also be restricted.
- The prohibition to provide architectural and engineering services as well as IT consultancy services and legal advisory services to Russia.

II. Impacts of US and EU sanctions on Chinese companies in Russia

(I) Import and export trade

According to the data of the US Department of Commerce, in 2020, US exports to Russia totalled $4.9 billion, a 15.6% decrease from 2019; US imports from Russia totalled $16.8 billion, a 24.3% decrease.

US-Russia import and export data for 2020			
US exports to Russia	US$4.9 billion	US imports from Russia	US$16.8 billion
Commodities	Percentage	Commodities	Percentage
Machinery & mechanical appliances	30.20%	Minerals	52.90%
Chemicals, plastics, leather products	22.40%	Stone, glass & semiprecious metals	15.40%
Transportation equipment	20.30%	Base metals	10.30%

In 2020, of the USD 4.9 billion in US exports to Russia, 2.9% (about USD 142.1 million) were subject to a BIS licensing requirement, and about 10% (USD 490 million) were exported under No License Required with an ECCN. One of the key important changes in the amendments to the US Export Administration Regulations (EAR) is the increased licensing requirements on items controlled under Categories 3-9 on the Commerce Control List (CCL). A license review policy of denial applies to these items. It is quite different from the US Department of Commerce' s previous license policies of denial of presumption and case-by-case review. Therefore, the EAR amendments will also have a direct impact on Russian imports of US items. In view of the stricter licensing review situation in the Russian market, the amendments may also significantly reduce the previously applicable license exceptions. Due to the small volume of direct US exports to Russia, the direct impact of the corresponding supply interruption in this field on the Russian market is also relatively limited.

In 2020, China' s imports from the US amounted to approximately USD 124.6 billion, while China' s exports to Russia in the same year amounted to nearly USD 67.5 billion. Of these exports, some were produced in China, some may be produced using US technology (or software, equipment, etc., here and below), and still some may be produced

and sold to China by other countries but contain US technology and ultimately be exported to Russia. The amended foreign direct product (FDP) rules will generally affect Russia in terms of these products exported from China. The US also restricts Russia' s access to any items related to the US to the greatest extent by FDP, including US-origin products, US direct exports and foreign direct products subject to the EAR under the FDP rules, thus minimising the flow of US items into the Russian market.

Licensing statistics and forecasts for US export to Russia for 2020				
License requirements	Specific license requirements	Percentage	US$ millions	Potential impacts of the increased licensing requirements
License required	BIS license	1.30%	1.421	A license review policy of denial applicable to items in CCL Categories 3-9
	BIS license exception	1.60%		License exceptions are expected to be significantly reduced in accordance with the stringency of the review policy
No license required	No license required with an ECCN	10.10%	4.9	A license review policy of denial applicable to items classified in an ECCN in CCL Categories 3-9

(II) Banking & finance

On 26 February 2022, the leaders of the European Commission, France, Germany, Italy, the United Kingdom, Canada and the US issued a joint statement, committing to ensuring that several "selected" Russian banks are excluded from the SWIFT international settlement system. According to the joint statement, the latest measures undertaken will ensure that these banks are disconnected from the international financial system and "harm their ability to operate globally". As of 27 March 2022, 466 financial institutions in Russia were SWIFT members. These measures mean that Chinese companies in Russia may be prevented from secure and effective messaging with banks abroad through any Russian banks, and thus from cross-border payment and clearing.

(III) Supply chain disruption

According to foreign media reports, global wafer makers, including TSMC, have halted sales to Russia. Major European and American semiconductor manufacturers have expressed their willingness to comply with the applicable regulations and act in accordance with government measures. GlobalFoundries, a chip manufacturer headquartered in Malta, New York, and Intel, headquartered in Santa Clara, California, have suspended deliveries of their products to Russia. As more companies are following suit, Chinese companies in Russia are at risk of supply chain disruption.

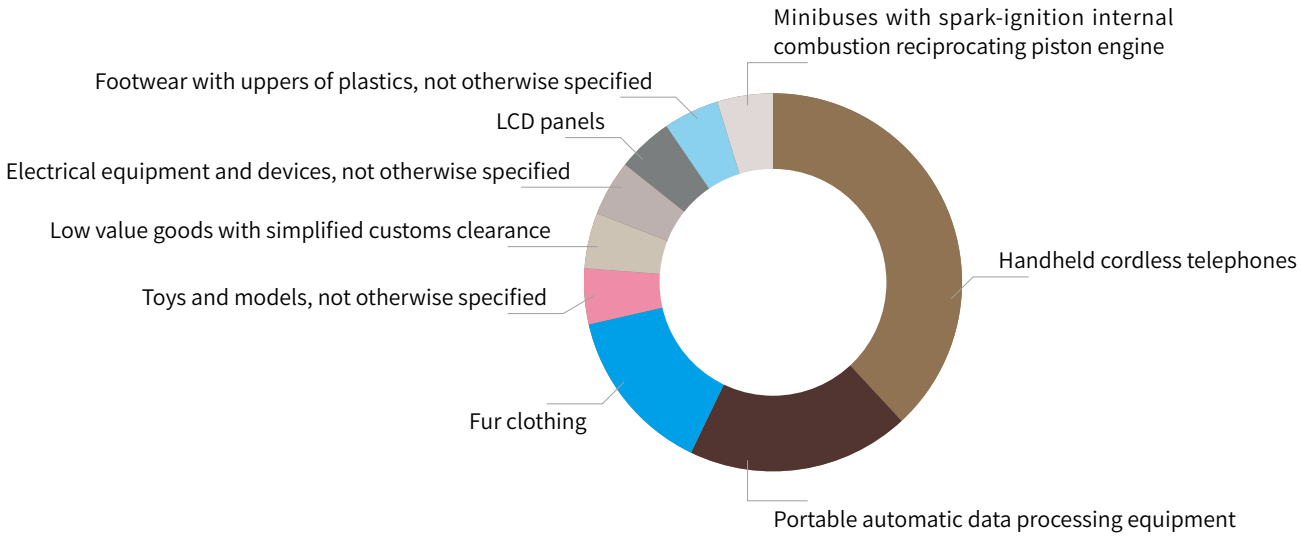
III. Impacts of US and EU sanctions on Chinese companies not located in Russia but having business with Russia

(I) Chinese exporters

According to the latest data recently released by China' s Ministry of Commerce, the trade volume of goods between

China and Russia reached USD 146.87 billion in 2021, and China remained Russia' s largest trading partner for the 12th consecutive year. Among the exports to Russia in 2021, the top 20 include hand-held cordless telephones, automatic data processing equipment, fur clothes, toys, electrical equipment, LCD panels, minibuses, compressors, valves and lighting fixtures.

China' s export to Russia (value in USD)



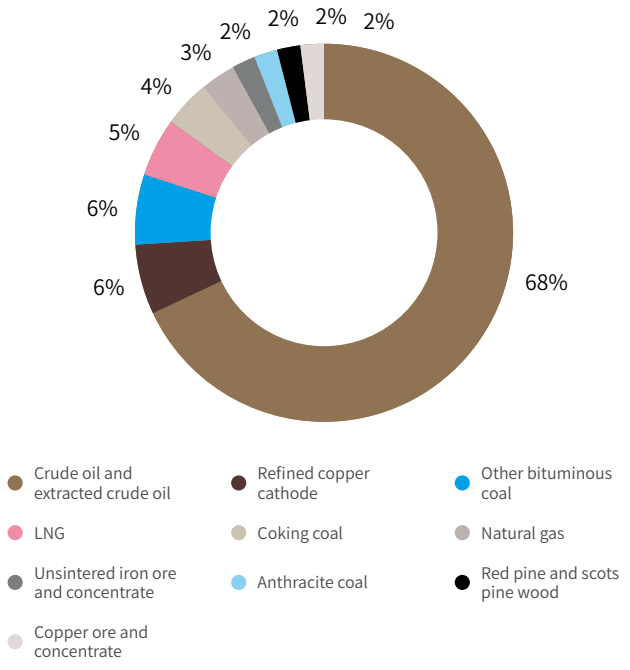
According to the chart above, China' s exports to Russia may include products produced with specific US technology and subject to the FDP rules, such as chip products. Taking the eighth top export of LCD panels as an example, the LCD industry chain is broadly divided into three categories: raw materials and equipment, production and manufacturing, and terminal products. Most Chinese manufacturers are at the midstream (i.e. LCD assembly and production). Since 2018, China has become the region with the largest production capacity for large-size LCD panels across the world. These panels are applied in TVs, monitors, laptops, smartphones and tablets. Although panels have seen an increasingly high localisation rate, they are basically processed with imported materials, which highlights the fact that China' s insufficient control of upstream core technologies. For example, polarizers and colour filters, whose costs account for nearly 50% of the total cost of panels, present certain technical barriers to China. The Japanese and Korean companies are dominant in the market. For the LCD glass alone, the US-based Corning occupies nearly half of the market share. In addition, the LCD panel production requires measuring, testing and other equipment, which is basically provided by the Japanese and Korean suppliers.

For the components of the LCD modules, chips, for example, cannot break the US export controls (or the FDP rules) described above for the Chinese exporters. Even if the shipment is knowingly destined for Russia, the items are probably not allowed to be exported to Russia if the incorporated chips are manufactured using US-origin technology (e.g. EDA software controlled under 3D991) and they are not EAR99 items.

(II) Chinese importers

China' s top 10 imports from Russia in 2021 include crude oil, natural gas, coking coal, iron ore, precious metal ores and pine and fir wood, as shown in the chart in below:

China' s imports from Russia (value in USD)



China' s import data on energy reflects that oil and natural gas are important commodities imported by China from Russia. Although the above sanctions mainly target the US, requiring the US not to import/invest in energy products such as oil and natural gas originating in Russia, Chinese enterprises should pay attention to:

- Whether a US nexus exists. A Chinese company may also be affected by the related sanctions if it has a US nexus, for example, if its conduct leads to a US person' s participation or investment in energy imports in violation of any ban; and
- A Chinese company is still at risk of sanctions if it deals with a SDN-listed entity although the Chinese company does not have any US nexus but has materially assisted in the transaction and it is a significant transaction.

IV. General response of Chinese companies

In the context of the Russia-Ukraine conflict, the US sanctions against Russia are frequently updated and diversified, with different control rules in different areas. Therefore, Chinese companies should take into account the application and implications of the related regulations while ensuring their business interests. They need assistance from professionals in carefully identifying risks and prudently responding to them.

(I) Risk assessment in specific business areas

As mentioned above, sanctions against Russian financial institutions have existed for a long time, and the risk of sanctions and export controls against companies other than financial institutions has recently expanded. To maintain normal business operations and corporate reputation, both companies and financial institutions should fully assess the potential risks.

Financial institutions: Since the Crimea crisis in 2014, the US has launched rounds of economic sanctions against Russia. Due to their important role in financing and other aspects, financial institutions are often targeted in the first round of sanctions. Chinese banks and other financial institutions should already have some understanding of the previous US economic and other controls and sanctions against Russia and have gradually developed their own countermeasures.

Non-financial institutions: Non-financial Chinese companies used to face less risk of US controls and sanctions and thus usually lack core competencies in compliance procedures, corporate governance, risk assessment, etc. Especially for Chinese enterprises involving dual-use items, it is crucial to understand the relationship between the sanctioned Russian entities and the global supply chain, upstream and downstream partners, and Know Your Customer (KYC) when facing key concerns regarding regional controls and sanctions from the US, the EU and other countries. It helps stabilise business operations and growth to conduct due diligence on partners and counterparties and remain aware of the sanctions lists and informed of the situation of partners and counterparties.

Therefore, the core is the identification of the risks of the actual business, including but not limited to risk identification of import and export items, confirmation of the blacklist of upstream and downstream partners, the identification of the risks of countries/regions and industry sectors in which the transaction is carried out. In addition, the business and legal risks should be considered in the business scenarios.

(II) Continued attention to the development of controls and sanctions

Chinese companies with business in Russia, especially companies and financial institutions that have established close trade and cooperative relations with Russia, should pay special attention to the controls and sanctions against Russia, to avoid the risk of being sanctioned due to their provision of material assistance or facilitation for any sanctioned Russian entity or transaction.

In view of the ever-changing international landscape, the export controls and economic sanctions are constantly changing. An accurate analysis and forecast of the international situation and the regulations and policies of the countries in which the companies operate help proactively adjust their strategic planning and get prepared to respond properly. The analysis and research of the international situation and policies are not purely legal issues, but more related to political, diplomatic and other issues.

(III) Response depending on the sector and actual situation

The US sanctions against Russia involve a variety of targets, including government agencies and officials, and Russian entities in key industries. Accordingly, Chinese companies in different sectors should pay attention to different risks and develop different strategies to address them.

For enterprises investing and financing in Russia, they should review the sanctions lists of the target companies, and assess the risk of investment and financing based on whether the target companies are included and the sanctions stated in a specific sanctions list. For example, non-US persons may be subject to sanctions if they enter into a significant transaction with or provide substantial assistance to SDN-listed entities. Sanctions may also be triggered if non-US persons assist in or facilitate transactions under some regulations.

As for shipping companies, the US is well aware of the dependence of international shipping trade on the US financial system and the US dollar. The OFAC' s shipping due diligence focuses specifically on providing guidance to: shipowners, operators, brokers, ship chandlers, flag registries, port operators, shipping companies, freight forwarders, classification service providers, commodity traders, insurance companies and financial institutions. Therefore, shipping enterprises should know their customers and counterparties, monitor the ships throughout their lifecycle, carry out supply chain due diligence, and understand the industry information, including that of shipowners and shipowners' clubs.

(IV) Industry alliance and professional counselling

Given the normalisation, diversification and complexity of the regulatory and sanction measures from the US, EU and other countries, Chinese companies should have considerable resources and technical skills, including industry resources and matching legal service resources, to make a proper judgement and respond effectively. In this regard, we recommend that relevant enterprises establish a corresponding local industry compliance alliance with their peers in the industry and other entities associated with their Russian business to strengthen cooperation with professional institutions in compliance response. They should conduct regular seminars on the same functional departments of the industry and the industry chain, and engage compliance experts to carry out legal risk assessment and professional counselling. While reducing their compliance burden, these recommended measures will also help the Chinese companies understand relevant legal risks in depth and identify specific risk management and compliance solutions.

This article only analyses in principle the risks and impacts of the controls and sanctions in the context of the Russia-Ukraine conflict as well as the strategies to deal with them. In practice, companies in different sectors and at different stages of the industry chain may face varying risks and should develop different response strategies. If you have any questions, please feel free to contact us for further analysis and potential solutions in the light of your actual situation.

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IMPACT AND ANALYSIS OF WESTERN ECONOMIC SANCTIONS AGAINST RUSSIA ON THE ENERGY AND NATURAL RESOURCE INDUSTRIES

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As the Russia-Ukraine conflict simmers, major **Western countries** or organizations (Western Countries) led by the US have imposed a series of severe economic sanctions against Russia. By summarising the major economic sanctions issued by the US as of 3 March 2022, and the economic sanctions imposed against Russia during the Crimean crisis in 2014, this article briefly analyses the potential impact on the future compliance and transactions of Chinese energy and natural resource companies for relevant enterprises' reference. [1]

I. Major economic sanctions imposed by Western Countries

In this round of economic sanctions, the US has imposed sanctions on specific targets (including entities and individuals) based on the Specially Designated Nationals and Blocked Persons List (SDN List) and non-SDN sanctions.

(I) Economic sanctions after the Ukraine crisis and the Crimean crisis

The US imposed a series of sanctions on Russia following the outbreak of the Crimean crisis in 2014. Although its adverse impacts are far less than the Ukraine crisis, the related sanctions have not been lifted so far and most Western economic sanctions are superimposed under their regulatory system. Therefore, the sanctions related to the Crimean crisis and the current sanctions in the Ukrainian crisis together constitute a complete system of US sanctions against the Russian economy.[2] In this article, we also sort out the major sanctions related to the Crimean crisis to present a comprehensive picture:

[1] This article was published on 3 March 2022.

[2] "Russia-Related Designations", https://home.treasury.gov/policy-issues/financial-sanctions/recent-actions/20220225_33.

Ukraine Crisis (2022)	Crimean crisis (2014)
(1) Imposed sanctions on Nord Stream 2 AG and its corporate officers. (2) Imposed full blocking sanctions on Russia' s two major financial institutions Vnesheconombank (VEB) and Promsvyazbank and their subsidiaries. (3) Imposed sweeping sanctions on 20 Russian elites and their family members, including the Russian President and Foreign Minister. (4) Expanded sovereign debt prohibitions to restrict US individuals and corporations from participation in secondary markets for new debts issued by the Central Bank of the Russian Federation (Central Bank), the National Wealth Fund of the Russian Federation (National Wealth Fund), or the Ministry of Finance of the Russian Federation (Ministry of Finance). (5) Added the Russian Direct Investment Fund (**RDIF**) and two RDIF-affiliated entities to the SDN List. (6) Prohibited US persons from engaging in new debt of longer than 14 days maturity or new equity of the 11 sanctioned entities listed in Directive 3 (mainly large Russian state-owned financial institutions, energy and infrastructure enterprises). (7) Prohibited US financial institutions from (i) opening a correspondent account or payable-through account for two major Russian banks Sberbank and VTB Bank and three other important financial institutions; and (ii) processing transactions involving any such entities or their property or interests in property. (8) The Central Bank, the National Wealth Fund, and the Ministry of Finance were added to the Non-SDN Menu-Based Sanctions List (NS-MBS List).	(1) As of 2019, a total of 665 entities or individuals have been sanctioned through the SDN List, including two major Russian energy companies (Rosneft and Novatek). (2) Imposed sanctions on Sberbank, Russia' s largest bank, and Rostek, a military enterprise, restricting their financing in the US financial markets. (3) Imposed secondary sanctions on Russian oil and gas companies' deepwater, shale and natural gas export pipeline projects, restricting their access to sophisticated oil and gas exploration and production technologies (Note: *Special technology exports are subject to export control regulations, which need to be analysed according to the export control framework*).

(II) US sanctions against investment and financing activities of Russian entities and individuals

This round of US sanctions is based primarily on a sanctions order on Russia signed by US President Joe Biden on 15 April 2021 (Executive Order 14024[3] (EO)), which grants the US Department of the Treasury the authority to designate targets to sanctions. In addition to the Primary Sanctions on sanctioned Russian entities and individuals, *any transaction that evades or avoids, has the purpose of evading or avoiding, causes a violation of, or attempts to violate any of the prohibitions set forth in this order is prohibited*. The foregoing wording actually leaves sufficient room for maneuvering in the actual implementation of sanctions. In addition, non-US entities trading with the sanctioned targets also risk exposure to potential Secondary Sanctions (i.e., sanctions against non-US entities and individuals not associated with the US).

Based on the EO, the Office of Foreign Assets Control (OFAC) of the US Department of the Treasury has issued the following directives on economic sanctions against Russia:

Directive 1A[4]

- Prohibited US financial institutions and their overseas branches from participating in the secondary market for transactions in Russian sovereign debt denominated in any currency, including sovereign debt issued by the Central Bank, the National Wealth Fund and the Ministry of Finance;

[3] "Executive Order 14024", https://www.federalregister.gov/documents/2021/04/19/2021-08098/blocking-property-with-respect-to-specified-harmful-foreign-activities-of-the-government-of-the.

[4] Russia-related Designations; Issuance of Russia-related Directive 1A and General Licenses; Publication of new and updated Frequently Asked Questions", https://home.treasury.gov/policy-issues/financial-sanctions/recent-actions/20220222;

- OFAC issued the No.1 directive on 15 April 2021, prohibiting US financial institutions from participating in the primary market for Russian sovereign debt transactions.[5]

Directive 2[6]

Prohibited US financial institutions from

- Opening or maintaining a correspondent account or payable-through account for the listed Russian financial institutions (mainly involving Sberbank and 25 Sberbank foreign financial institution subsidiaries); and
- Processing transactions involving any such entities or their property or interests in property.

Directive 3[7]

Prohibited transactions in new debt and new equity of sanctioned entities of maturity exceeding a specified period by US persons or within the US (a total of 13 companies in the financial, oil and gas, and telecommunications sectors are currently under sanctions, effectively blocking large Russian enterprises' access to US financing).

Directive 4[8]

- Froze the assets of the Central Bank, the Ministry of Finance and the National Wealth Fund, and prohibited transactions with them;
- General License No. 8A provides a general license[9] for transactions related to energy, i.e., no special OFAC license is required for energy-related transactions.

Consistent with the EO, in addition to the Primary Sanctions on sanctioned Russian entities and individuals, any transaction that evades or avoids, has the purpose of evading or avoiding, or leads to a violation of, or attempts to violate any of the above directives is prohibited. Non-US entities that deal with the targets of sanctions also risk exposure to potential Secondary Sanctions. Despite a freeze on the assets of all targets of sanctions in the US, the EO also prohibited the provision or acquisition of any aids, articles or services for the sanctioned targets. Therefore, non-US entities and individuals may also be at risk of Secondary Sanctions if they assist or cause a US entity or individual to violate any EO.

Although General License No. 8A issued by OFAC provides a general license for energy-related transactions, **the Bureau of Industry and Security (BIS) under the US Department of Commerce will, *through export controls on oil and gas extraction equipment, impose restrictions on technology exports that would support Russia's refining capacity over the long term***[10], according to a statement issued by the US White House on March 2, local time. Meanwhile, according to the White House, reducing global energy supply is not in line with the strategic interests of the US and its allies and partners (therefore, energy payments have been set aside in the relevant financial sanctions), but the US and its allies and partners share common strategic interests in degrading Russia's status as a leading energy supplier and these actions will help further that strategic goal. Since BIS has not yet released details on the implementation of export controls targeting oil refining, we will continue to follow up.

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[5] "Directive 1 under Executive Order 14024", https://home.treasury.gov/system/files/126/sovereign_debt_prohibition_directive_1.pdf .

[6] "US Treasury Announces Unprecedented & Expansive Sanctions against Russia, Imposing Swift and Severe Economic Costs", https://home.treasury.gov/news/press-releases/jy0608.

[7] "Directive 3 under Executive Order 14024, Prohibitions Related to New Debt and Equity of Certain Russia-related Entities", https://home.treasury.gov/system/files/126/new_debt_and_equity_directive_3.pdf.

[8] "Directive 4 under Executive Order 14024, Prohibitions Related to Transactions Involving the Central Bank of the Russian Federation, the National Wealth Fund of the Russian Federation, and the Ministry of Finance of the Russian Federation", https://home.treasury.gov/system/files/126/eo14024_directive_4_02282022.pdf.

[9] "General License No. 8A Authorizing Transactions Related to Energy", https://home.treasury.gov/system/files/126/russia_gl8a_1.pdf.

[10] "Fact Sheet: The United States Continues to Impose Costs on Russia and Belarus for Putin's War of Choice", https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/02/fact-sheet-the-united-states-continues-to-impose-costs-on-russia-and-belarus-for-putins-war-of-choice/.

(III) Other major Western economic sanctions

Country/Organisation	Major economic sanctions
EU	• Planned to implement a package of sanctions against Russia, including a ban on the import of goods from non-government-controlled areas of Donetsk and Luhansk (Sanctioned Areas), restrictions on trade and investments related to certain economic sectors, freezing of Russian assets in the EU, and sanctions on Rossiya Bank, Promsvyazbank PJSC and VEB; and • Switzerland: adopted the EU sanctions package against Russia, freezing the assets of relevant Russian individuals and institutions in Switzerland, and prohibiting Swiss companies from doing business with the targets of sanctions.
UK	• Imposed sanctions on VTB, Russia' s second largest bank and eight other financial institutions; and • Prohibited UK individuals and entities from providing financial services for the Central Bank, the Ministry of Finance, and the National Wealth Fund.
Canada	• Imposed a ban on transactions in the non-government controlled areas of Sanctioned Areas, and prohibited Canadians from engaging in certain transactions and activities in these areas; and • Imposed new bans on direct and indirect transactions of Russian sovereign debt and sanctions on two important Russian financial institutions.
Australia	• Prohibited Australian individuals and entities from doing business with the following banks: Bank Rossiya, Promsvyazbank PJSC, IS Bank, Joint Stock Company Genbank and the Black Sea Bank for Development & Reconstruction; and • Imposed severe economic sanctions in Sanctioned Areas, prohibiting trade in the transport, energy, telecommunications, and exploitation of oil, gas and mineral reserve sectors.
Japan	• Prohibited the Russian government from issuing and circulating new sovereign bonds in Japan; and • Imposed sanctions on Promsvyazbank PJSC, VTB Bank, and the Central Bank, and froze their assets.

(IV) SWIFT sanctions

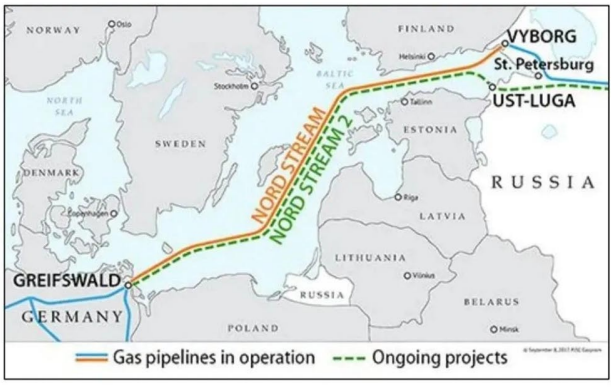
On February 26, the US, the UK, the EU and other countries issued a *Joint Statement on Further Restrictive Economic Measures*, announcing that several major Russian banks would be removed from the Society for Worldwide Interbank Financial Telecommunication (SWIFT) international settlement system. SWIFT is the most important information exchange platform and financial infrastructure for global financial institutions' settlement of transactions. Removing Russia from the SWIFT system effectively cuts Russia off from the global banking system, making it impossible to conduct international settlements, which may paralyse its financial system. Therefore, SWIFT sanctions will be one of the strongest financial sanctions the West can impose on Russia.

Up to now, Western Countries are still jointly formulating the final sanctions package, and have not yet released the specific list of Russian banks subject to sanctions. Given the high dependence of European countries on Russian energy (for example, about 40% of Europe' s gas supply comes from Russia) and **the current global restraint on sanctions in the energy sector, we conclude that exceptions to SWIFT sanctions may apply to the sector**. We will keep an eye on this and explain in more detail the implications and impact of the SWIFT system on the energy and natural resources industries in our presentations on big energy deals in the future.

II. Impact of economic sanctions against Russia on the energy and natural resources industries and suggestions for response

(I) Nord Stream 2 AG plans to file for bankruptcy

Nord Stream is an offshore gas pipeline system from Russia to Germany, consisting of two pipelines from Vyborg to Greifswald (Nord Stream 1) and two pipelines from UstLuga to Greifswald (Nord Stream 2). Nord Stream 1 is owned and operated by Nord Stream AG (majority owned by Gazprom) and Nord Stream 2 by Nord Stream 2 AG, a wholly owned Swiss subsidiary of Gazprom. The Nord Stream 1 pipeline was commissioned in November 2011[11], and the Nord Stream 2 pipeline has been waiting for the final permit from regulators since its completion in September 2021.



Source: Gazprom, edited by CRS.

Nord Stream 2 AG was previously on the SDN list. According to OFAC' s 50 Percent Rule, Nord Stream 2 AG' s subsidiaries and assets will also be subject to the same sanctions. The German government also announced to suspend the approval process of the Nord Stream 2 gas pipeline. After being included in the SDN list, Nord Stream 2 AG has laid off most of its employees and plans to initiate bankruptcy liquidation proceedings.

Although Nord Stream 2 AG is registered in Switzerland, its biggest stakeholders are Germany and Russia. Since Germany has previously set out a roadmap for a full withdrawal from nuclear and coal energy, its demand for natural gas will increase in the short term. At present, the disposal mode of the completed Nord Stream 2 pipeline remains unclear, but it is foreseeable that the current developments will further lead to Europe' s increasing dependence on the US for energy supplies.

(II) International energy giants to discontinue operations in Russia

As Western economic sanctions continue to aggravate, international energy giants, including Equinor and Shell, have issued public statements about their intention to pull out of their operations in Russia.

[11] "Russia-EU gas pipeline delivers first supplies", https://www.ft.com/content/51ea636e-0a14-11e1-8d46-00144feabdc0.

Energy companies	Action statement
Equinor	• On 28 February 2022, Equinor announced in a statement that its Board of Directors has decided to stop new investments into Russia, and to start the process of exiting Equinor' s Russian joint ventures. • Equinor has been in Russia for over 30 years and entered a cooperation agreement with Rosneft in 2012. Equinor' s cooperation with Rosneft includes the North Komsomolskoye heavy oil and gas field in Western Siberia and the North Danilovsky development project in Eastern Siberia.
Shell	• On 28 February 2022, the Board of Shell announced its intention to exit its joint ventures with Gazprom Neft and related entities, including - Its 27.5% stake in the Sakhalin-II liquefied natural gas facility (an integrated oil and gas project located on Sakhalin Island where Gazprom holds 50%, Mitsui 12.5%, and Mitsubishi 10%); - Its 50% stake in the Salym Petroleum Development N.V. (a joint venture with Gazprom Neft that is developing the Salym fields in the Khanty Mansiysk Autonomous District of western Siberia), and - Its 50% stake in the Gydan energy venture (a joint venture With Gazprom Neft to explore and develop blocks in the Gydan peninsula, in north-western Siberia. The project is in the exploration phase, with no production). • Shell also intends to end its involvement in the Nord Stream 2 pipeline project (Shell is one of five energy companies which have each committed to provide financing and guarantees for the project).

None of the above-mentioned international energy companies has proposed specific exit plans, but the relevant exits will undoubtedly affect their oil and gas assets. We will also continue to follow up on the exit of other international energy companies from their operations in Russia. Exxon Mobil, Shell, Total Energies and Japanese companies have investments in Russia' s upstream oil and gas sector. If the relevant assets were to be frozen, confiscated or put under other radical restrictions, a more severe crisis would ensue. The economic sanctions against Russia could cause significant losses to EU member states and change the future energy landscape in Europe and even the world. Europe is the main export destination for Russian oil and gas. The two are highly interdependent in the energy sector. In other words, Europe needs Russian energy to satisfy its needs and Russia needs the European energy market. In 2020, about 48% of Russian oil exports flowed to the European market; EU member states collectively imported about 152.65 billion cubic meters of gas from Russia, accounting for 38% of the EU' s total imports. The escalating Russia-Ukraine conflict spurred the production of relevant substitutes. About 60% of US liquefied natural gas (LNG) exports went to the European market in January 2022.

(III) Recommended actions for Chinese energy and natural resource enterprises

Chinese energy and natural resource enterprises are advised to take the following actions in a timely manner to identify and prevent potential compliance risks:

1. Sort out existing Russia or Ukraine-related projects

The relevant Chinese enterprises should sort out existing projects involving Russia or Ukraine, especially the partners and banks involved in transactions. As this round of economic sanctions involves a slew of banks and other financial

institutions, the settlement capacity and liquidity of the US dollar will be greatly restricted. Meanwhile, considering the payment for trade with Russia in the wake of financial sanctions, it is necessary to keep an eye on the possible SWIFT sanctions in the future, and deal with transactions in related fields in a timely manner.

2. Adjust existing/future energy project partners and supply chains by taking account of economic sanction risks

In response to the economic sanctions imposed by the West on Russia and Ukraine, Chinese energy and natural resource enterprises need to focus on the screening of upstream, midstream and downstream partners and supply chains for future investment projects from the perspective of compliance. OFAC' s 50 Percent Rule states that all entities and individuals on the SDN List and entities owned 50 percent or more in the aggregate by one or more blocked persons are considered blocked. This means it is necessary to see if your partners involve sanctioned targets. As the screening of offshore entities is often faced with high difficulties and compliance costs, it is recommended that a risk alert mechanism be established and compliance risks be identified based on the following:

- Reviewing whether the place of incorporation/principal business region of the transaction parties involves any sanctioned jurisdictions;
- Analysing potential sources of raw materials (mainly analysed under the export control laws of relevant exporting countries, but may also constitute a nexus to economic sanctions), distribution of major assets, etc.;
- Understanding the compliance controls of upstream, midstream and downstream partners (e.g., if a single partner imposes higher requirements for economic sanctions compliance, such as compensation mechanisms linked to audit entitlements, it is recommended that the same entitlements, as well as compensation mechanisms, be implemented throughout the supply chain whenever commercially possible).
- Closely tracking enterprises' financial settlements involved in the supply chain and the source and flow of materials; and
- Establishing a compliance system for economic sanctions in sensitive areas and regularly testing the accuracy of the compliance risk identification system.

3. Closely monitor trading accounts and fund flows

As this round of sanctions highlights the importance of capital security, enterprises need to pay close attention to and sort out the flow of funds for existing projects. We recommend enterprises to:

- agree on the obligation of Russian partners to cooperate with the fulfillment of the obligation in completing cross-border payments, and set mandatory requirements for decentralized management of funds;
- establish a non-US jurisdiction mezzanine structure or account and dynamically recover or delegate cash flows while ensuring the dual needs of project operating capital demand and investment security; and
- take entities outside Russia as the investment target entities of Russia-related projects in light of project situations, and arrange for the transfer of funds outside Russia as much as possible to settle payments in non-US dollar currencies, and fund project operating companies through overseas investment platforms, so as to minimise the flow of funds within Russia.

4. Control project risks in a specific energy sector involving economic sanctions compliance obligations

Overseas partners of Chinese energy and natural resource enterprises in sanctioning countries may take relevant covenants on sanctions, anti-corruption and compliance (meeting or avoiding certain specific behaviours for a certain period of time) as an important prerequisite for reaching cooperation. Our experience shows that in past transactions, energy enterprises may also prevent and control compliance risks through representations & warranties (showing the compliance status at a specific time), i.e., as of a specific time (usually the execution date, the closing date or the implementation date of an order in a block trade), energy enterprises will be deemed to have made true and accurate representations of compliance (statements of past and present facts, not of ongoing or future conditions) if they satisfy their partners' or their own compliance requirements. By contrast, a compliance covenant with respect to sanctions may require ongoing compliance within the term of a contract, meaning that Chinese enterprises may be under an obligation to keep abreast of compliance developments.

In addition, overseas partners may even require to supplement stricter compliance commitments to the agreements being performed, i.e., each agreement signed by a Chinese enterprise becomes a covenant on economic sanctions compliance, and failure to meet the then-applicable compliance requirements during the contract term will result in breach of the covenant obligation and affect the certainty of the partnership, and the partner may, in accordance with the agreement, claim or even terminate the agreement for breach of the covenant obligation. Some parties may even propose unified retroactive applications of the provisions with respect to economic sanctions in the existing contracts.

It is recommended that enterprises should prevent the above risks and negotiate in the following ways:

- Specifying the scope of economic sanctions compliance, improving the certainty of compliance work, and avoiding the assumption of excessive compliance obligations as the parties in a cross-border cooperation relationship are usually subject to shared jurisdiction due to the global layout of most energy enterprises;
- Specifying the specific obligations of both parties in respect of economic sanctions compliance, such as the scope and frequency of information disclosure, and the availability of a mechanism for third-party review;
- Specifying their own compliance obligations, subjecting the identification of violations of economic sanctions to the judgment of an objective third party rather than the subjective judgment of either party and establishing obligation standards similar to other contractual obligations to mitigate their own obligations as much as possible;
- In alignment with the requirements imposed on Chinese energy-related enterprises by their overseas partners, Chinese energy and natural resource enterprises also need to protect themselves from potential economic sanctions by constraining their upstream and downstream partners, including the imposition of "back-to-back" constraints on third parties; and
- Establishing sound communication channels with upstream exploitation and middle and downstream partners in respect of economic sanctions compliance, and reaching consensus on major risk points.

5. Prepare alternative financing schemes for Russia-related projects

Given the sweeping blockade on the Russian financial system, the planned fund inflows from Western counties, in particular, are bound to be severely affected. Therefore, Chinese energy enterprises should make proper preparations and design alternative international financing schemes for Russia-related projects accordingly, instead of relying solely on traditional financing channels.

Western countries continue to impose sanctions against Russia as the Russia-Ukraine conflict further spirals downward. We will continue to keep a close eye on the progress of the relevant sanctions and further share the analysis and suggestions on responding to relevant sanctions for the energy and natural resource industries.

Thanks to Interns Xie Zixuan and Ji Haoran for their contribution to this article.

GUIDELINES FOR CHINESE ENTERPRISES DOING BUSINESS IN RUSSIA TO IDENTIFY AND CONTROL RISKS IN THE CONTEXT OF THE RUSSIA-UKRAINE CONFLICT

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Introduction

Since the outbreak of the Russia-Ukraine conflict, in-house counsels of Chinese enterprises have been working overtime every day to collaborate with business departments in dealing with unexpected risks and thorny issues related to Russian projects.[1] From the standpoint of enterprises, it is obviously very necessary to make early risk assessment and formulate emergency plans. This article provides a summary of western countries' sanctions against Russia and Russia' s countermeasures. Based on our hands-on experience and the hot topics we have collected recently, it further analyses the risk identification methods corresponding to each stage of their Russia-related business development and puts forward some preliminary suggestions on how to respond to such risks.

I. Overview of the sanctions against Russia and Russia' s countermeasures

(I) The latest statistics

Since Russia announced the recognition of the Donetsk People' s Republic and the Lugansk People' s Republic on 22 February 2022, the Russia-Ukraine conflict intensified, and the US, EU and their followers have successively announced comprehensive sanctions against Russia. As of 23 March 2022, they have announced a total of 186 sanctions against Russia, and the total number of new Russian entities on various sanctions blacklists has exceeded 1000. In response, Russia has successively released a series of countermeasures, including the Unfriendly Countries List, since 23 February 2022. In addition, there has been a strong call in Russia for proposals to nationalise the assets of enterprises from unfriendly countries. Given the complexity and uncertainty of the conflict, overseas enterprises have begun to re-evaluate their business risks in

[1] This article was released on 24 March 2022.

Russia. Several well-known European and American IT, automobile and energy enterprises have recently reportedly decided to withdraw from Russia.[2]

(II) Classification of sanctions against Russia

The sanctions issued by many countries against Russia on various legal bases target "**people**", "**property**" and "**objects**" (as shown in Figure 1). **First, the sanctions targeting "people" are mainly aimed at cutting off the channels for Russian people to conduct foreign transactions**. The main measures adopted are to include Russian officials, oligarchs, enterprises, financial institutions and other entities in various sanction lists, and then enjoin or restrict their citizens, enterprises and other entities from carrying out economic and trade activities with those on the sanction lists and Russian related personnel from entering their country. **Second, the sanctions targeting "property" are mainly aimed at cutting off Russia' s external financial channels**. The sanctioning countries impede the flow of money and trade between Russia and the rest of the world, for example, by restricting or prohibiting Russian companies and other entities from using the US dollar as the settlement currency, or by removing some (currently seven) Russian banks from the SWIFT system[3]. **Third, the sanctions targeting "objects" are mainly aimed at cutting off Russia' s import supply chain**. The sanctioning countries have restricted or enjoined the export of advanced commodities, technologies and software (especially involving military end-users and for military end-uses) as well as the finished products produced by using such technologies as tools (especially sensitive technologies and electronic products) to Russia, thus comprehensively affecting Russia' s domestic market as well as its scientific and technological R&D and national defence building capabilities. As far as the current US export control policy towards Russia is concerned, Russia may face the same situation as Cuba, Iran, DPR of Korea and Syria in the future.

Figure 1. Schematic diagram of classification of sanctions against Russia

[2] Quoted from "More and more European and American giants are leaving Russia" (see https://wallstreetcn.com/articles/3653116 for reference).

[3] SWIFT, the Society for Worldwide Interbank Financial Telecommunications, is one of the most important financial communication networks in the world. With members including more than 11,000 financial institutions, exchanges, and enterprises operating in over 200 countries, SWIFT is almost the exclusive provider for cross-border payment messaging services. SWIFT does not transfer funds, but instead sends and receives transaction instructions among banks. The payment and transfer of funds are mainly realised

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(III) Russia' s countermeasures

Russia has introduced a series of countermeasures. **First, it has issued a list of countries and territories that commit unfriendly actions against Russia**[4], limiting the currency of debt service and related transactions. For foreign creditors from the listed countries and territories, the Russian debtors may repay the foreign exchange debts with rubles, and the Russian entities are required to obtain the approval of the Government Commission on Monitoring Foreign Investment for all their transactions and business with the enterprises and citizens of the listed countries and territories. **Second, it has implemented export controls**, including restricting Russia' s supply of steel products to Europe, stopping the supply of rocket engines to the US, and temporarily banning the export from Russia of foreign-made medical equipment imported from countries that joined the sanctions against Russia. **Third, it restricted the use of foreign exchange**. Russian individuals and companies are prohibited from remitting foreign currencies abroad to repay loans or from transferring foreign currencies into their foreign accounts, and 80% of the foreign exchange income obtained by Russian exporters from January 1, 2022 will be compulsorily settled.

In addition, according to media reports, although the EU requires leasing companies to take back about 515 planes leased to Russian aviation enterprises by March 28, they cannot do so due to restrictions such as the closure of airspace. The Russian Ministry of Industry and Trade has also proposed to ban timber exports to the EU and the US, and compiled a list of foreign companies whose assets may be nationalised. Additionally, the Russian Federation Council proposed to introduce an accelerated procedure for the sale of property of companies from unfriendly countries. As of 15 March 2022, Russia has successively announced a sanction blacklist, including Biden and 12 other US officials, as well as 313 Canadian citizens, including Prime Minister Justin Trudeau, Minister of Foreign Affairs Mélanie Joly, and Minister of National Defence Anita Anand.

in the clearing and payment system, which is the most important infrastructure for the flow of cross-border funds nowadays. In short, SWIFT is almost indispensable for international clearing. According to the data of the Russian National SWIFT Association, currently about 300 or more than half of the total number of Russian financial institutions are members of SWIFT, which makes Russia the second largest user of SWIFT after the United States. Russian financial institutions currently conduct foreign exchange transactions around the world worth USD 46 billion per day, of which more than 80% are denominated in US dollars; Russian financial institutions account for about 1.5% of the 4,200 messages transmitted on SWIFT every day. The exclusion of seven Russian banks from SWIFT obviously obstructed the funds and trade flows between Russian entities and the rest of the global economy. Although it is still possible to conduct cross-border payment and settlement in Russia on a one-to-one basis or by connecting other financial institutions to the SPFS system, the convenience and applicability will undoubtedly be greatly reduced. It is expected that the cross-border payment and trade in Russia will shrink, which will further affect the economic development of Russia.

[4] As of 23 March 2022, the list approved by the Russian government includes the US, Canada, EU countries (a total of 27 countries), the UK (including Jersey, Anguilla, British Virgin Islands and Gibraltar), Ukraine, Montenegro, Switzerland, Albania, Andorra, Iceland, Liechtenstein, Monaco, Norway, San Marino, North Macedonia, as well as Japan, Republic of Korea, Australia, Micronesia, New Zealand, Singapore and China' s Taiwan region.

II. Risks of secondary sanctions faced by Chinese enterprises

(I) Introduction to secondary sanctions

The US economic sanctions can generally be divided into "primary sanctions" and "secondary sanctions" depending on US' s jurisdiction over related transactions. The primary sanctions apply to transactions with a US nexus, most commonly including involvement of a US person, US financial institution, US dollars, or US originating goods. A violation of primary sanctions will occur if a foreign person uses or acts through any US person or entity to facilitate a transaction that violates sanctions and causes a US person or entity to violate the sanctions. The Office of Foreign Assets Control (OFAC) of the US Department of the Treasury may hold the foreign subject criminally and civilly liable. **Secondary sanctions are mainly applicable to transactions without a US nexus, and generally include two types of situations**. First, non-US entities are prohibited from carrying out, participating in or supporting violations of human rights or undermine regional peace and stability, and other key activities prohibited by US sanctions programs (such as knowingly engaging in projects involving military invasion, etc.). Second, non-US entities are prohibited from providing support to certain persons subject to sanctions such as asset freeze (e.g., conducting normal transactions with those included in the Specially Designated Nationals and Blocked Persons List (SDN List)). Certain characteristics of secondary sanctions can be seen in the US regulations on sanctions against Russia, such as *Countering America's Adversaries Through Sanctions Act* and Executive Order 14024 (material support clause).

(II) Risks of secondary sanctions faced by Chinese enterprises

The US secondary sanctions are not new to Chinese enterprises. Since the escalation of the China-US trade war in 2018, the US, taking advantage of its economic dominance, has frequently applied secondary sanctions to restrict economic exchanges between Chinese enterprises or individuals and enterprises in the target countries subject to US sanctions. The US secondary sanctions generally consist of trade sanctions, investment sanctions and financial sanctions. **In terms of means of implementation of the sanctions, the most typical and commonly used means is to indicate "subject to secondary sanctions" or "secondary sanctions risk" in the SDN List published by OFAC, in addition to setting the provisions on secondary sanctions in relevant executive orders on sanctions**. In general, if Chinese enterprises carry out transactions with the enterprises included and so indicated in the SDN List, they may be added to the SDN List on the grounds of violating economic sanctions, resulting in serious impacts such as freezing of their assets and bank accounts in the US, or being investigated for corresponding legal liabilities.

In addition, **in accordance with the relevant EU sanctions regulations, any legal person, entity or body from a third country with any business done in whole or in part within the EU is generally required to comply with EU sanctions regulations**.[5] That is to say, if a third-country enterprise conducts business in the EU, it may be subject to the jurisdiction of the EU if it engages in transactions with Russia, and thus may be subject to the EU economic sanctions policies. For example, a Chinese bank will be deemed to have violated the EU sanctions laws if it provides financing to an EU client in connection with a sanctioned transaction.

(III) Practical difficulties for Chinese enterprises to prevent and control risks of secondary sanctions

Given the close economic and trade cooperation between China and Russia and the penetrating effect of US economic sanctions, Chinese enterprises are faced with high sanctions risks and find it difficult to prevent and control such risks in practice.

[5] COUNCIL REGULATION (EU) No 833/2014, Article 13, This Regulation shall apply: (e)to any legal person, entity or body in respect of any business done in whole or in part within the Union. (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014R0833&qid=1647337446167).

1. China-Russian cooperation presents high risks of secondary sanctions

Russia is China' s important strategic partner, and the two sides have close cooperation in trade. According to the statistics released by the General Administration of Customs of the PRC on 14 January 2022, the trade volume between China and Russia in 2021 increased by 35.8% year-on-year to USD 146.887 billion[6]. The cooperation between the two sides mainly focuses on key areas such as energy and finance, and involves many large Russian financial institutions, presenting high risks of secondary sanctions. The risks of secondary sanctions imposed by the US against Russia under relevant sanctions regulations are mainly concentrated in energy, finance and other fields. The US has restricted the cooperation between third-country persons and sanctioned persons in Russia by including the main entities in relevant industry in sanction lists such as Sectoral Sanctions Identifications List (SSI List) and SDN List, thus exerting extreme pressure on Russia' s key economic industries.

2. SDN and SSI Lists have wide coverage with strong penetration effect

In accordance with the Revised Guidance on Entities Owned by Persons Whose Property and Interests in Property Are Blocked and the OFAC' s answers to related Frequently Asked Questions (FAQs), the "50% Rule" applies to the SDN and SSI Lists. Any entity owned 50 percent or more individually or accumulatively by one or more blocked persons under SDN or SSI List is considered blocked under the said list and will be subject to the relevant sanctions even if it is not designated on the relevant sanction lists (as shown in Figure 2). In addition, US sanctions generally do not reach the superior entity. However, if the parent company is aware that its subsidiary engages in activities in violation of US sanctions policies or knowingly instructs its subsidiary to do so, it shall bear the liability for violations together with its subsidiaries.[7] The 50% Rule expands the scope of sanctions and imposes higher compliance requirements, requiring enterprises to accurately identify the equity structure of the counterparty.

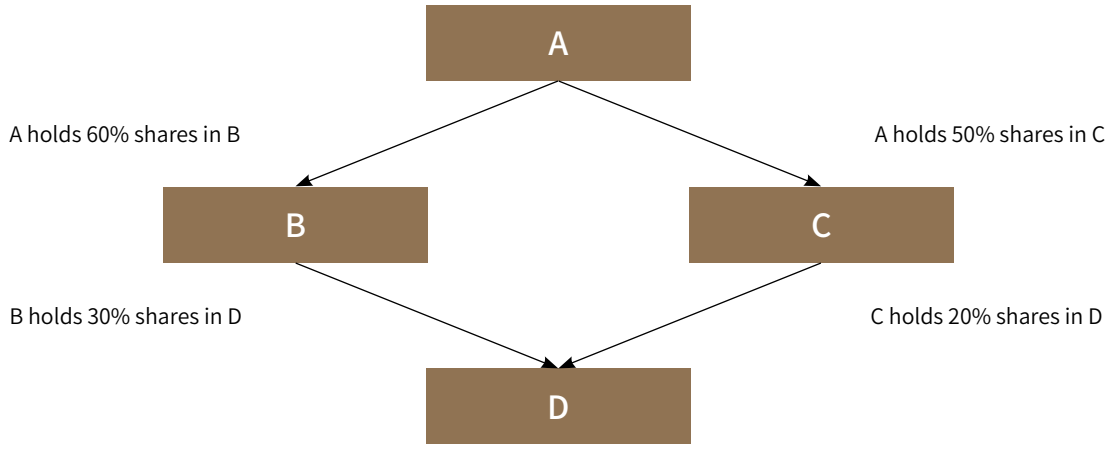

Figure 2. Example Diagram of "50% Downward Penetration Rule"

[6] "China-Russia trade volume amounted to USD 146.887 billion in 2021", quoted from MOFCOM' s official website (http://petersburg.mofcom.gov.cn/article/jmxw/202201/20220103237286.shtml).

[7] https://www.federalregister.gov/documents/2020/12/15/2020-27517/notice-of-department-of-state-sanctions-actions-pursuant-to-executive-order-13846-of-august-6-2018

In Figure 2, as A, a person on the SDN List, holds 50% or more shares in B and C respectively, B and C are automatically subject to sanction. D is also automatically sanctioned because it is owned 50% in the aggregate by B and C.

To judge whether there is a risk of secondary sanctions, Chinese enterprises are advised to comprehensively and carefully examine relevant sanctions regulations, administrative orders, FAQs and punishment cases based on the actual situation of their business to be carried out and the results of blacklist screening.

3. Continuous attention to the risk of secondary sanctions is necessary with the update of sanctions-related laws

From the US' use of secondary sanctions against foreign countries in the past, the US will adjust relevant policies at any time according to the needs of attacking the countries subject to sanction. Taking its recent sanctions against Russia as an example, the US officials have repeatedly called on and forced Chinese enterprises to strictly abide by US sanctions against Russia in order to prevent China and other relevant countries from carrying out related transactions with Russia, thus offsetting or weakening the effect of US and other western countries' sanctions against Russia. **In this context, it is not ruled out that the US may further strengthen the secondary sanctions applicable to enterprises in third countries such as China in the future**.

III. Secondary sanctions risk assessment process and compliance measures

With the escalation of sanctions against Russia by the US and other western countries, Chinese enterprises should avoid a partial risk response. They are advised to comprehensively assess the secondary sanctions risks of existing and new business from the perspectives of "people", "property" and "objects" involved in US sanctions.

(I) Carrying out blacklist screening to determine the risk level of trading counterparties and trading restrictions

The blacklist is a vital tool for the US to carry out sanctions, **especially under the current Russia-Ukraine conflict. The US, the EU and other countries have included nearly 1,500 Russian entities in the sanction lists**. Therefore, Chinese enterprises should screen blacklist risk as an important compliance prerequisite before carrying out any business activities in Russia. In practice, however, the blacklists involve various countries and types, and there is a large number of business partners. Given the ongoing changes in the two aspects, it is not realistic to rely solely on manual screening.

In such cases, we recommend Chinese enterprises to adopt digital compliance solutions in their blacklist screening. A digital compliance solution refers to a complete set of solutions designed to integrate risk identification, automatic disposal and expert intervention by using legal technology in the form of information-based system, in order to implement the compliance systems. **Blacklist screening is only an integral part of the solution. Subsequently, enterprises can implement closed-loop deployment according to their localisation requirements, to achieve the connection with business systems of partners such as customers and suppliers. By employing the information technology, enterprises are able to complete automatic screening and early warning of blacklists at all times, thus greatly improving the efficiency and accuracy of screening**.[8]

[8] KWM Institute: Preliminary Analysis of the Automatic Screening of the Sanction Blacklists - From the Perspective of the Information Technology Compliance Development in Response to US Export Control and Economic Sanctions (https://mp.weixin.qq.com/s/bu-azsDcSQEl1XB4wrfhmA);
KWM Institute: Export Control Compliance: Analysis of Solutions to Information Technology Compliance Control (https://mp.weixin.qq.com/s/2xiYFQqMYAUpmh7-0F_hmA).

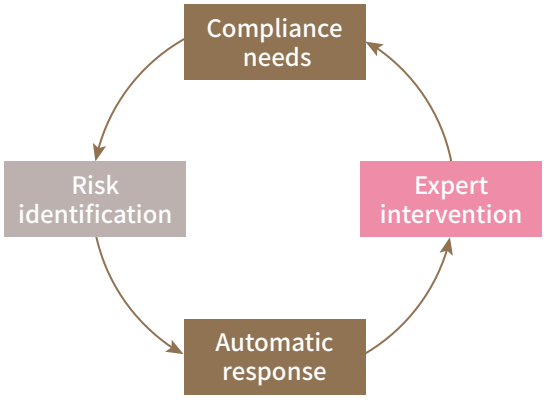

Figure 3. Digital Legal Compliance Solution

(II) Sorting out capital channels and assessing capital safety

Financial institutions are the core hub of transaction settlement. Once a sanctioned bank is involved in the relevant transactions, or financial institutions of a third country (such as an overseas intermediary bank involved in a remittance route) believes that there is sanctions risk in the transaction, the assets may be frozen and property losses may be caused. **An enterprise shall figure out the transactions involving sanctioned financial institutions and assess the impact of relevant sanction measures on specific transactions**. Meanwhile, an enterprise should identify whether the fund route of transactions involving Russia involve financial institutions of a third country, determine the currency involved, project background, transaction parties, etc., and assess the impact on the enterprise if the financial institution of a third country takes freezing measures.

(III) Assessing the risk of illegal transfer of related controlled items

Under the current Russia-Ukraine conflict, western countries cut off the import supply chain on which Russia' s key industries depend and restrict the development of Russia' s key fields and industries by restricting or prohibiting their domestic enterprises from exporting advanced commodities, technologies and software (collectively, the items) to Russia (especially when military end-users and military end-uses are involved). The EU and other countries have relatively weak extraterritorial effects in terms of export control, and most of them take control measures such as refusal or revocation of export licenses. The US Export Administration Regulations (EAR), however, has strong extraterritorial effect, basically applicable throughout the entire lifecycle of controlled items. The EAR not only focuses on US-origin items, but also provides for jurisdiction over products produced in foreign countries involving US items. Specifically, it covers foreign-made products with US-origin controlled content exceeding the de minimis levels, and foreign products subject to the EAR under the Foreign-Direct Product (FDP) rules.

1. Judgment of De minimis level

In accordance with Section 734.3 of the EAR, foreign-made products with US-origin controlled content exceeding the de minimis level shall be subject to the EAR. Due to the new licensing requirements imposed by the US on Russia, US-related items from Categories 3 to 9 of the ECCN on the Commerce Control List (CCL) require a license for export, re-export or transfer (in country) to Russia. As a result, the percentage of US-origin controlled content in the de minimis level has been significantly increased, resulting in products that previously may not have met the de minimis level have become subject to the EAR under the new rules. For example, ECCN 5A991 (generally electronic devices, such as mobile phone components) did not require a license for exports to Russia in the past, i.e. molecules need not be included in the de minimis level. **Under the new license requirements, a license is required for exports to Russia, and molecules should be included in the judgment of de minimis level. If it exceeds the de minimis level, it means that the product is subject to the EAR, and further judgment on ECCN is needed to determine whether it is necessary to apply for an export license for exports to Russia**.

2. Impact of FDP rules

In accordance with § 734.3 of the EAR , foreign products are subject to the EAR if they meet the direct product rules. Under the Russia-Ukraine conflict, the US provides for Russia and Russia-military end user FDP rules in § 734.9 of the EAR to expand restrictions on exports of US-related products to Russia. Specifically:

New Russia FDP rule: The US established the Russia FDP rule in order to limit Russia' s ability to acquire certain foreign products, that is, foreign products whose export destination is Russia are subject to the EAR if they fall into the following two situations: (1) foreign products are directly produced or developed by US-origin "technology" or "software" specified in any ECCN in product groups D or E in Categories 3 to 9 of the CCL; (2) the plant or major component of a plant that produces or develops foreign products is a direct product of US-origin software or technology classified by the aforementioned ECCN in the CCL. The Russia FDP rule is not applicable if the foreign-produced item is designated EAR99.

New Russia-Military End User FDP rule: The new rule is stricter, mainly including the following two situations: (1) foreign products are directly developed or produced by US-origin software or technology specified in any ECCN in product groups D or E of the CCL; (2) the plant or major component of a plant that produces foreign products is a direct product of US-origin software or technology specified in the aforementioned CCL. In addition, if the transaction party is an entity with a footnote 3 designation in the Entity List, or it is understood that the direct products will be used in the manufacture or development of any parts, components or equipment manufactured or purchased by one of the above entities, a license is required even if ECCN is EAR99 and the application willbe reviewed with a presumption of denial.

The above-mentioned Russia and Russia-Military End User FDP rules have greatly expanded the control scope of US products. A license is required for almost all foreign products subject to the EAR based on the FDP rules if they are exported to Russia. The US adopts a policy of "Presumption of Denial" for such license applications, making it difficult for non-US enterprises to be licensed for export of any US-related products to Russia. **Therefore, Chinese enterprises need to check whether their products are directly developed and designed based on US software or technology or whether they use equipment produced based on US software or technology according to the FDP rule. If necessary, they need to focus on the US nexus to determine whether they need to apply for a license and whether they may export their products to Russia so as to avoid being punished for violating relevant export control policies**.

IV. Carrying out systematic risk assessment, and taking differentiated response measures

Western countries are currently imposing a wide range of sanctions against Russia in various means. In addition, according to news released after US President Biden meeting with leaders in European allies and other countries on March 24, western countries will implement a new round of joint sanctions against Russia in the next stage. Nevertheless, **Chinese enterprises are not recommended to adopt a "one-size-fits-all" stop strategy for all Russian-related businesses. Instead, they should carefully analyse the potential secondary sanctions risks according to specific type of business, and anticipate the possible risk scenarios according to the actual development stage of the business. In addition, they should formulate differentiated risk control measures**. Below, we will specifically provide relevant risk prevention and response suggestions in a scenario-based manner from the horizontal and vertical perspectives respectively.

(I) Horizontal: focusing on the risk prevention and response for economic sanctions and export control

1. Economic sanctions

If the Russian transaction partner of a Chinese enterprise is an entity on the sanctions blacklists of the US, Europe and other countries, the Chinese enterprise is advised to carefully assess which blacklist the entity is on, the specific restrictions of the blacklist and whether there are secondary sanctions risks. Then, the company should determine whether the transaction can proceed or what additional compliance preconditions need to be attached based on the assessment results, and timely include the necessary contract clauses.

In addition, it is suggested that blacklist screening should be carried out for all possible financial institutions (including but not limited to the receiving bank, intermediary bank, paying bank, issuing bank, and honouring bank) so as to judge whether there is any risk of capital freezing or other obstacles in the transfer of funds.

· **Risk scenario**

Taking US economic sanctions as an example, the risks are mainly from (i) inaccurate identification of the US nexus, and (ii) incomplete analysis of the effectiveness of secondary sanctions. For example, a Chinese enterprise confirms through preliminary blacklist screening that its partner is a SDN-listed entity but is not subject to secondary sanctions. Then the company concludes that it can continue to carry out transactions with the partner. The company, however, may end up at risk of being subject to secondary sanctions because it did not further confirm the specific provisions on the sanction programs or executive orders .

· **Response recommendation**

First, the Chinese enterprise should first fully communicate with the partner and suspend relevant business if the partner is found blacklisted. Second, the company should comprehensively sort out the applicable sanction regulations to examine and evaluate whether there are relevant provisions on the effectiveness of secondary sanctions, and seek advice from external counsels if necessary. Third, the company should develop a bottom-line thinking, keep an eye on the latest development of sanctions, and anticipate potential major risks based in combination with the characteristics of the project. In addition, it should sign relevant supplementary agreements with the partner upon negotiation when necessary.

2. Export control

It is recommended to assess risk based on the export control measures implemented by various countries against Russia. The following is an analysis of the risks and responses by taking the US export control against Russia as an example.

(1) Risks from direct resale of US controlled items to Russia and responses to such risks

· **Risk scenario**

If Chinese enterprises directly resell US controlled items to Russia, it will most likely need to apply to the US for a license, which is difficult to obtain in practice. If the item is transferred to a Russian entity, the Chinese enterprise will be at a risk of being punished for violating the US export control laws.

· **Response recommendation**

First of all, blacklist screening should be conducted for the transaction partner. If the partner involves Russian military subjects, almost all US items cannot be exported, and the transaction should be suspended. Second, if the partner is not a restricted subject, the ECCNcorresponding to the US item and its end use should be further identified to determine whether a license is required and whether a license exception is applicable. Finally, if the license is required and the license exception is unapplicable, the transaction should be suspended unless the license is obtained.

(2) Risks from US content in products traded with Russia and responses to such risks

· **Risk scenario**

If the proportion of the fair market value of the US content (including US-origin components) contained in a Chinese enterprise' s products to be sold to Russia reaches the limit requirement (25% for Russia), the finished products produced by the Chinese enterprise will still be subject to the EAR. It is necessary to further identify the ECCN of such finished products, so as to determine whether a license is required for export to Russia. In reality, the risk that an export license may not be obtained shall be fully anticipated.

· **Response recommendation**

First, the de minimis level should be calculated for products containing US content. Second, the ECCN classification and confirmation of end-use information shall be conducted for products exceeding the level to determine whether a license is required. Third, whether the transaction can be continued shall be comprehensively judged based on the results of the aforesaid risk identification.

(3) Risks from products involving the FDP rule and responses to such risks

· **Risk scenario**

If a Chinese enterprise uses US controlled tools (including equipment, software and technology) in its production process, the products processed with such tools may be deemed as items subject to the EAR under the FDP rule. The Chinese enterprise may risks violating the US export control requirements if it exports such products to Russia or Russian military subjects without a license.

· **Response recommendation**

Firstly, it is necessary to sort out the US controlled tools needed in the production process. Secondly, blacklist screening should be conducted on the Russian partners as there are great differences between general Russian civilian subjects and Russian military end users under the FDP rule. Thirdly, a comprehensive judgment should be made on whether the transaction can be continued based on the above screening results. For example, if the traded product is manufactured with US software, technology or equipment, and involves military end users, the transaction shall be terminated immediately.

(II) Vertical: focusing on the characteristics of each stage of Russian business (from the access to business opportunities to the closing of the transaction) to develop common and differentiated response measures

1. Opportunity access and contract signing

Risk factors

- Partner
- Item
- Industry
- Financial institution
- Compliance clause

Response measures

- **Conduct blacklist screening.** When obtaining business opportunities, blacklist screening should be conducted on partners (including but not limited to customers, suppliers, freight forwarders, banks, carriers, and end users) to identify any sanctions risks involved. In addition, it is also necessary to verify such key information of the partners as place of registration, main place of business, officers, and shareholding structure, to determine whether they involve high-risk industries, regions, or subjects that may be subject to sanctions. The risk information research and investigation work is also necessary.
- **Identify controlled items and transfer risks.** In the business communication, an assessment should be made on items involved in the transaction which are controlled by the US, Europe and other countries to avoid illegal transfer of controlled items.
- **Assess the risks from industry background and financial institutions.** Focus shall be put on the project background, purpose, guarantor, financial institution, ultimate beneficiary and other transaction partners and supporting third parties, as well as on the currency of funds, transfer route, category of item, technical composition, transport route, etc., to determine whether there is any sanction risk. For projects involving sanctions, the transaction party, capital channel, currency, etc. should be reasonably planned to avoid Europe and US nexus.
- **Set risk emergency response or resolution clauses.** Representations and warranties, breach clauses, and exit mechanisms with respect to compliance obligations in economic sanctions and export control shall be included in the contract, provided that the requirements of Chinese countermeasures shall not be violated.

2. Performance and dissolution of the contract

Risk factors

- Partners are blacklisted.
- Relevant items are strictly controlled.
- Compensation is required for breach of contract.
- Asset loss is incurred after termination.

Response measures

- Rolling blacklist screening on the partners should be conducted during the performance of the contract. Once the partners are found included in the sanction blacklist of western countries or the countermeasure list of Russia , prompt communication should be made with the clients subject to sanctions to confirm the relevant situation, timely verify the impact on the existing projects or transactions, and initiate emergency response plans as needed.
- The localisation alternatives for US and European contents in goods, technologies and software related to Russian projects should be quickly developed. In addition, the stock of goods can be appropriately increased based on needs.
- If Chinese enterprises reasonably foresee the major potential risks that may lead to their own liability for breach of contract, they should request to suspend the transaction, and negotiate with the partners to add necessary clauses or sign supplementary agreements in time so as to avoid being held liable for breach of contract by the other party in the future.
- Chinese enterprises should keep abreast of the latest developments in Western sanctions and Russian counter-sanctions. For Chinese enterprises that have subsidiaries in the US, Europe and other countries, they shall also pay close attention to the relevant bills in Russia on the restriction of the departure and withdrawal of foreign capital or the proposed nationalisation of assets, and timely request their overseas subsidiaries to formulate necessary emergency plans.

3. Settlement and repayment of loans

Risk factors

- Relevant financial institutions are blacklisted.
- It' s infeasible to settle in USD and EUR.
- Exchange rate change causes financial loss.
- The third party financial institutions does not cooperate in the settlement.
- Payment of compensation is delayed.

Response measures

- If a Russian financial institution used in the project is included in the sanction list, the relevant financial service contract may be suspended, and solutions such as change of repayment method, currencies and channels may be adopted according to the results of subsequent risk assessment.
- The risk clauses covering settlement method, settlement bank, and settlement period should be re-evaluated. Based on the evaluation results, the Chinese enterprises may consider changing to a Chinese-funded bank or using RMB for settlement to avoid subsequent contract disputes or relevant exchange rate risks.
- In addition to strictly complying with the sanctions regulations against Russia, some US and European financial institutions may choose not to provide any financial services involving Russia based on their own compliance policies or values. In this regard, the necessary risk assessment should be carried out in advance and, if necessary, measures may be changed to reduce the fund settlement risk.
- Taking the payment of imported goods by a Chinese enterprise as an example, it shall be clearly stipulated that the Chinese enterprise has fulfilled its payment obligation once the remittance is completed at the paying bank, and if the seller receives the payment at a later date or fails to receive the payment due to reasons in connection with intermediary bank or receiving bank, the seller shall not require the Chinese enterprise to pay interest on the delayed payment or assume other liability for compensation.

4. Production equipment and technical raw materials

Risk factors

- Use of US controlled production equipment
- The proportion of US content in the products exceeded the level

Response measures

- For the production equipment involving US items, it is necessary to comprehensively judge the transaction party and whether the US Russia and Russia-Military End User FDP rules are applicable. If the FDP rules apply to the product, a license must be required, otherwise there is a risk of violating the requirements of US export control if the product is exported to Russia or Russia' s military entities without a license.
- If a product contains US technology or raw materials, the de minimis level should be recalculated to determine whether the product is subject to the EAR. If the proportion of US content is beyond the level, a further ECCN classification is required to determine whether a license or an exception is required to avoid export control risks.

5. Transfer of shares and sales of assets	
Risk factors	**Response measures**
• The counterparty is blacklisted • The consideration or ownership cannot be actually retrieved after closing of share transfer and asset sales. • Disposal of assets involving US controlled items leads to violation of export control requirements.	• Blacklist screening should be carried out on trading counterparties (including but not limited to contributors, guarantor, and financial institutions) to the share transfer and asset sales in order to avoid the risks of triggering sanctions. • Chinese enterprises should assess whether there is any restriction on share transfer and asset sales under Russia' s anti-sanction policies, with the focus on whether there may be any major risks after the closing, such as the failure to get back the consideration or ownership, and include relevant risk resolution clauses in the agreement if necessary. • If the assets to be sold may involve items subject to the EAR, a risk assessment shall be made in advance and an export license shall be obtained if necessary. If an export license cannot be obtained at the moment, it is recommended to suspend disposal until subsequent confirmation or the license is obtained.

Finally, Chinese enterprises must pay attention to the fact that the sanctions laws and regulations of the US, Europe and other countries usually explicitly prohibit all acts of circumventing sanctions. As stipulated in Section 4 of US Executive Order 14024, which imposed sanctions on Russia, any act taken with the intention of evading the executive order and in violation of the sanctions regulations is prohibited.[9] As mentioned above, if a Chinese enterprise, in order to evade the sanctions against Russia, changes the transaction party as its subsidiary and instructs such subsidiary to complete the transaction on its behalf, such act may be deemed as an evasion of sanctions, that is, the Chinese enterprise provides material support to the sanctioned target through its subsidiary. The Chinese enterprise will thus be punished due to its violation of sanction regulations.

V. Developing a long-term compliance control system in response to sanctions

With the normalised development of the game between China and the US, Chinese enterprises should, referring to OFAC risk assessment rules,[10] establish a long-term compliance control mechanism in response to sanctions in advance, so as to timely identify and dispose of sanction risks in time. **First, a sanction risk assessment mechanism shall be established to improve the compliance risk database**. Chinese enterprises should analyse the size and characteristics of sanction risks they face in their own business from the three dimensions of "people", "property" and "objects". They should also judge the effect of the existing compliance control measures from the three aspects of "timeliness", "accuracy" and "comprehensiveness". By comparing the inherent risks and control measures, Chinese enterprises should evaluate the effectiveness of the existing compliance mechanism and timely improve the compliance risk database. **Second, automatic blacklist screening should be conducted regularly**. With the gradual expansion of the scope of sanctions imposed by the US and Europe and the increasing diversity of sanctions measures, blacklist screening system has become an important tool for enterprises to prevent and control sanctions risks. Enterprises should select customised blacklist screening schemes according to their own business characteristics and

[9] See https://www.federalregister.gov/documents/2021/04/19/2021-08098/blocking-property-with-respect-to-specified-harmful-foreign-activities-of-the-government-of-the

[10] See framework_ofac_cc.pdf (treasury.gov) for compliance framework; and FAQ risk matrix.doc (treasury.gov) for risk matrix.

establish an automated screening mechanism that can cover the whole business process. **Third, internal control should be strengthened and graded control of persons on the sanction lists should be exercised**. For enterprises with large business volume and many branches, it is necessary to carry out graded control of persons on the sanction lists to enhance the efficiency of business development. **Fourth, full attention should be given to the changes in sanctions imposed by various countries and Russia' s countermeasures**. Chinese enterprises may designate personnel or hire lawyers to carry out long-term tracking and research on sanction policies, identify sanction risks in advance, and timely optimise graded control measures. **Fifth, personnel training and internal audit of compliance should be enhanced**. Chinese enterprises may strengthen their staff' s awareness of risk prevention through inviting external experts to give lectures, conducting internal knowledge competitions and issuing operational guidelines. They should also carry out regular internal audits of the effectiveness of sanction compliance, and timely check and fill the gaps.

VI. Anticipation of investment in Russia and recommendations for business strategic planning

With the gradual escalation of sanctions against Russia by Europe, the US and other countries, Russia will gradually implement its own countermeasures. There will be more risks of uncertainty in the future sanctions involving Russia. **First, a growing number of countries imposed sanctions against Russia, with the synergy effect of sanctions measures gradually increased**. Since the US announced sanctions against Russia on 21 February 2022, the EU, the UK, Australia, Japan and other countries have adopted various sanctions measures, gradually forming synergy effects, further reducing Russia' s ability to counter sanctions and making it increasingly difficult to deal with sanctions risks by changing currencies and taking advantage of overseas shell companies. In the face of the multilateral and complex nature of the Russia-related sanctions, the enterprises of a third country are advised to carry out cross-jurisdictional sanctions compliance risk assessment and disposal in light of their actual business conditions. **Second, Chinese enterprises will be faced with the dilemma of compliance with the expansion of Russia' s countermeasures**. In order to cope with the extraterritorial effect of the US secondary sanctions, Russia may further expand and strengthen its countermeasures, which will cause Chinese enterprises to face the dilemma of compliance conflicts. The in-house counsels may be requested for some solutions or countermeasures beyond legal advice. **Third, issues arising from the Russia-Ukraine conflict need to be carefully judged**. The fluctuations in international crude oil prices and the restructuring of the global supply chain caused by the sanctions against Russia seem to provide new business opportunities for the enterprises of third countries. The Chinese enterprises, however, should effectively control the risks in business expansion. In particular, when planning to carry out proposed medium and long-term investment projects in Russia, the Chinese enterprises are recommended to, at least at the present stage, adopt a prudent response strategy.

Conclusion

The conflict between Russia and Ukraine may be eased in the near future, but the confrontation between sanctioning countries and Russia will not end anytime soon. The risk prevention and control involving Russia-related sanctions is characterized by high timeliness, cross-jurisdictions, and serious consequences of violations. Improper response may cause a devastating blow to the overseas business of enterprises. We suggest that Chinese enterprises timely introduce digital compliance management tools, and with the assistance of the think tank team formed by external counsels and experts, prudently and accurately assess the potential risks of Russia-related business, formulate effective countermeasures as soon as possible, and create business value through compliance management.

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OVERVIEW OF INVESTMENT IN RENEWABLE ENERGY PROJECTS IN SPAIN, GERMANY AND VIETNAM

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With global warming, the concept of green development has become a global consensus. Many countries have introduced policies to encourage the development of renewable energy industry, and initiated or deepened electricity system reform. Under this background, renewable energy technologies are developing continuously, and opportunities are emerging for investment in renewable energies such as wind and solar energy around the world. Renewable energy policies of various countries are changing, such as the gradual elimination or discontinuation of tariff subsidies. Thus, potential investors need to clearly understand the relevant risks and challenges before investing. In addition, in today' s anti-globalisation trend, investors also need to pay more attention to the foreign investment screening regime of the target location in order to protect their legitimate investment rights and interests.

This article focuses on the foreign investment screening regime, renewable energy project approvals and renewable energy subsidies in Spain, Germany and Vietnam for your reference.

I. Renewable energy projects in Spain

Spain has formulated its emission reduction plan for 2021-2030 to implement the EU' s goal of "reducing greenhouse gas emissions by at least 55% below the 1990 levels by 2030".

In order to complete this plan, relevant Spanish government departments will further introduce policies to promote the development of renewable energy industry. Furthermore, Spain is deepening the energy sector reform, and renewable energy is becoming increasingly important in the Spanish energy structure, which brings new development opportunities for renewable energy companies.

(I) Foreign investment screening regime

1. Relevant EU regulations

In March 2019, the *Regulation (EU) 2019/452 of the European Parliament and Council establishing a framework for the screening of foreign direct investments into the EU* (the Regulation) was published and implemented from 11 October 2020. The Regulation aims to create a targeted and transparent foreign investment screening framework for EU member states to ensure that the EU can effectively safeguard its core interests while opening up to the outside world. With the implementation of the Regulation, the European Commission was granted access to information, the right to provide comments and the power to adopt delegated acts. This actually strengthened the review of foreign investments.

On 25 March 2020, the European Commission issued the *Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe' s strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation)* (the Guidance) on 25 March 2020, providing further guidance for the specific implementation of the Regulation in order to protect critical EU assets and technologies from control by foreign investors during the market turmoil caused by the COVID-19 pandemic.

It should be noted that the Regulation and the Guidance do not have a mandatory binding force for EU member states. EU member states may decide, to a certain extent, independently and autonomously whether to implement the foreign investment screening mechanism and the specific content of the mechanism, and decide whether to adopt the recommendations provided by the European Commission and other EU member states on specific screening cases. Therefore, an investor intending to invest in an EU member state specifically needs to investigate whether the country has adopted and established the above foreign investment screening regime and the specific contents of the regime.

2. Relevant Spanish regulations

The Royal Decree 664/1999 of 23 April 1999 on foreign investment, (the Spanish Foreign Investment Law), the most important Spanish foreign investment legislation, allows for the complete free movement of capital. Under the Spanish Foreign Investment Law and other relevant regulations, foreign investments, except from tax havens or involving national security, require no approval of any government agency, but only a post-investment filing with the Directorate-General for International Trade and Investments (Dirección General de Comercio e Inversiones, DGCOMINVER) under the Spanish Ministry of Industry, Trade and Tourism.

The Royal Decrees 8/2020 and 11/2020 (collectively, the Decrees) enacted in March 2020 introduce emergency special measures for foreign investment after the outbreak of the COVID-19 pandemic. The parts of the Decrees relating to foreign investment screening are mainly based on the Regulation and reproduces some provisions of the Regulation, changing the previous loose regulation of foreign investments in Spain. In accordance with the Decrees, a transaction requires prior review by the DGCOMINVER and approval by the Spanish Cabinet if it meets all the following three conditions:

(1) The investor is a non-EU or non-EFTA entity, or an EU or EFTA entity ultimately controlled by a non-EU or non-EFTA entity (i.e. a non-EU or non-EFTA entity directly or indirectly controls more than 25% of the investor' s equity or voting rights, or otherwise exercises direct or indirect control over the investor);

(2) The foreign investor holds no less than 10% of the equity of the Spanish company or acquires control of the Spanish company after the transaction; and

(3) The investment is in sensitive industries (including critical infrastructure, key technologies, critical material supplies, and information confidentiality), or the identity of the foreign investor is sensitive (including the investor is directly or indirectly controlled by foreign governments, carries out an investment or activity in another EU member state that may affect national security, public order and public health, or is related to serious risks of engaging in criminal or illegal activities affecting national security, public order or public health).

Although the Decrees are temporary measures in response to the state of emergency and will become ineffective one month after the government declares the lifting of the state of emergency, the validity of the above policies may be extended by issuing a Spanish Royal Decree.

It should also be noted that the Decrees do not replace the Spanish Foreign Investment Law (which still regulates foreign investments in Spain). For example, if foreign investors intend to invest from a tax haven or in activities directly related to the national defence of Spain, the investor must still obtain approval from the relevant governmental authorities in accordance with the provisions of Spanish Foreign Investment Law.

	Before the outbreak of COVID-19	Since the outbreak of COVID-19
Main laws and regulations	Spanish Foreign Investment Law	Spanish Foreign Investment Law and the Decrees
Foreign investment screening	Except for special circumstances, foreign investments are only subject to a post-investment filing with the DGCOMINVER.	The special investments are still subject to approval in accordance with the Spanish Foreign Investment Law. Projects that meet the three conditions set forth in the Decrees are also subject to review by the DGCOMINVER and approval by the Spanish Cabinet.

Table 1: Foreign investment screening before and after the outbreak of COVID-19 in Spain

(II) Project approval

The Spanish energy sector is highly regulated and has a complex regulatory system. Prior to investing in specific projects, the investor should investigate and understand the specific regulatory requirements that may be applicable to the proposed project.

1. Competent authorities

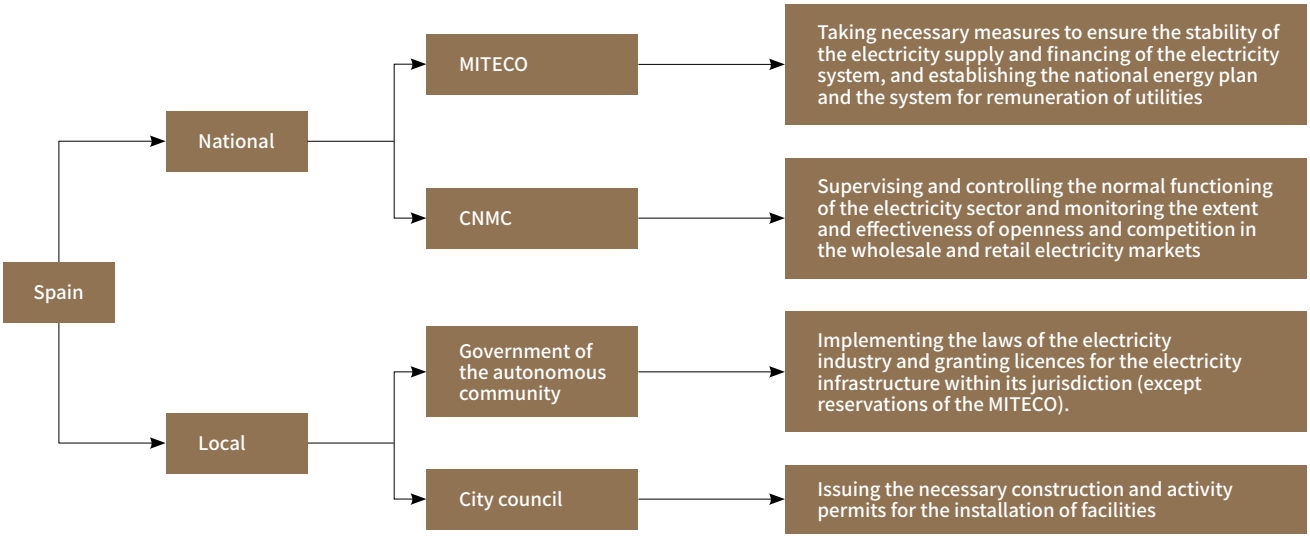

Figure 1: Competent authorities of electricity industry in Spain

The Ministry for the Ecological Transition and the Demographic Challenge (Ministerio para la Transición Ecológica y el Reto Demográfico, MITECO), the major national regulator of the electricity sector, is responsible for taking necessary measures to ensure the stability of electricity supply and financing of the power system, and establishing a national energy plan and a system for the remuneration of facilities. The National Markets and Competition Commission (Comisión Nacional de los Mercados y la Competencia, CNMC) is responsible for supervising and controlling the normal functioning of the power sector, and monitoring the extent and effectiveness of opening and competition in the wholesale and retail electricity markets.

The government of the autonomous community is in charge of implementing the national laws on the power industry and granting licences for the electricity infrastructure within its jurisdiction unless such licensing is reserved by MITECO. The city council is in charge of issuing the necessary construction and activity permits for the installation of facilities.

2. Project approval

The construction, commissioning and operation of renewable power generation facilities in Spain require the relevant permits or authorization in advance. Relevant legislation includes but is not limited to: (i) Law 24/2013, and Royal Decrees 1955/2000 and 413/2014; (ii) Decree 21/2013, and (iii) the regulations of the autonomous community or the city council where the project is located. Specifically:

(1) For new renewable energy projects, major permits required for construction and operation include but are not limited to environmental assessment, grid access and connection permit, prior administrative permit, project construction permit, project use permit, urban municipal permit, environmental municipal permit, and public asset occupation permit.

(2) For existing renewable energy projects, (i) in the case of asset acquisition, projects authorized by an autonomous community also require the authorization of the autonomous community for the transfer (the

specific authorization procedures are subject to the specific autonomous community' s policies); and (ii) in the case of equity acquisition, relevant laws do not explicitly require government authorization for indirect transfer of project facilities (including equity transfer). In our experience, the governments of some autonomous communities, including the Comunidad de Castilla y León, have requested governmental authorization for indirect transfers within the autonomous community.

The above are only the main approvals for renewable energy projects. For a specific project, the investor needs to engage a Spanish counsel to analyse specific circumstances of the project.

(III) Subsidies for renewable energy projects

In order to establish a more competitive market, encourage renewable energy enterprises to improve their technology and management capabilities, and reduce the cost of electricity, EU member states are gradually eliminating direct subsidies and instead providing indirect subsidies by auctions and other methods to renewable energy companies that can generate electricity at lower costs. This is also the case with Spain' s renewable energy subsidy policy.

The Spanish government provides subsidies for renewable energy projects, including special subsidy and economic subsidy for power generation facilities. Special subsidy, as a direct subsidy, was last provided by the Spanish government in 2017.

The economic subsidy for power generation facilities is an indirect subsidy. Through this mechanism, the Spanish government wants to compensate the difference between the sum of the costs and reasonable profits of renewable energy generators and the actual price in the electricity market. The CNMC announced the mechanism of economic subsidy for power generation facilities in 2013, which will be updated every six years. In 2020, the CNMC announced the updated six-year economic subsidy mechanism for power generation facilities. Under the updated subsidy mechanism, renewable energy companies can participate in auctions, and the winner will receive a subsidy equal to the difference between the auction price and the actual market price.

The Spanish government has published its auction plan for the period 2020 to 2025, as shown in the table below:

		Minimum power capacity (MW)					
		2020	2021	2022	2023	2024	2025
Wind Power	Increase	1000	1500	1500	1500	1500	1500
	Total	1000	2500	4000	5500	7000	8500
Photovoltaics (PV)	Increase	1000	1800	1800	1800	1800	1800
	Total	1000	2800	4600	6400	8200	10000

Table 2: Spain' s auction plan for wind power and PV for 2020-2025

The first auction in January 2021 achieved a transaction for approximately 3,000 MW of installed capacity, with each renewable energy company being awarded a tariff ranging from EUR 14.89 MW/h - EUR 28.9 MW/h.

II. Renewable energy projects in Germany

Germany is currently in the energy transition phase. The German Coal Commission announced in January 2019 that all existing coal-fired power plants would be phased out by 2038. In this context, Germany expects that 55-60% of electricity will come from renewable energy in 2035, and the proportion of renewable energy will reach 80% in 2050.

(I) Foreign investment screening regime

As an EU member state, Germany has established its own foreign investment screening mechanism, and has submitted relevant materials on its foreign investment review mechanism to the European Commission in accordance with the Regulation.

The Foreign Trade and Payments Act and its supporting Foreign Trade and Payments Ordinance are the most important foreign investment regulations in Germany. The Foreign Trade and Payments Act aims to reduce restrictions on foreign economic activities, but also reserves the power of the German government to intervene in certain circumstances, such as to safeguard national security and foreign policy interests. In 2020, the Foreign Trade and Payments Act and the Foreign Trade and Payments Ordinance were amended to further strengthen the regulation of foreign investment in Germany.

Foreign investors may invest in Germany through establishment of new businesses, purchase of shares, and mergers and acquisitions in industries other than those explicitly prohibited by law. The German foreign investment screening laws provide for two different screening procedures: cross-sector review and sector-specific review.

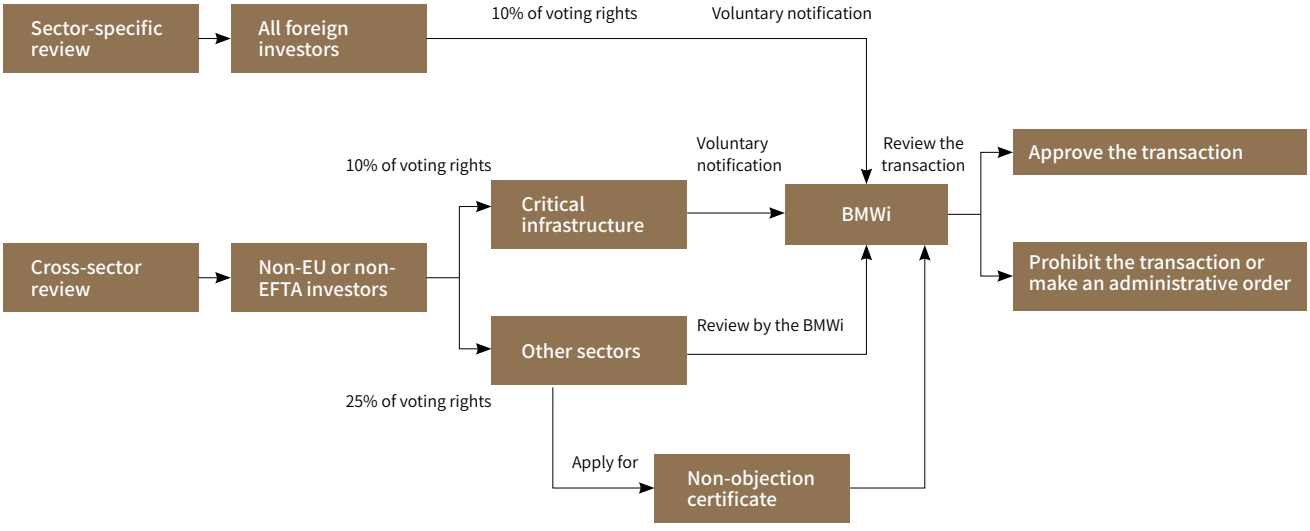

Figure 2: Foreign investment review process in Germany

1. Cross-sector review

(1) If a non-EU or non-EFTA investor acquires more than 10% of the voting rights in a German target company operating in the sector of critical infrastructure specified in the Foreign Trade and Payments Ordinance, both parties to the transaction are obliged to notify the acquisition to the German Federal Ministry for Economic Affairs and Energy (Bundesministerium für Wirtschaft und Energie, BMWi) for its review.

(2) If a non-EU or non-EFTA investor acquires more than 25% of the voting rights in a German target company operating in a section other than critical infrastructure specified in the Foreign Trade and Payments Ordinance, the parties are not obliged to notify the acquisition to the BMWi. The BMWi may initiate a cross-sector review process ex officio. Therefore, investors may apply to the BMWi for "a non-objection certificate" in advance in order to obtain legal certainty for the transaction.

2. Sector-specific review

The sector-specific review applies to M&As in defence and other security-sensitive industries that may pose a potential threat to public security in Germany. When a non-German investor acquires 10% or more of the voting rights of a German target company engaged in special industries, the investor is obliged to notify the BMWi and obtain its approval.

(II) Project approval

1. Competent authorities

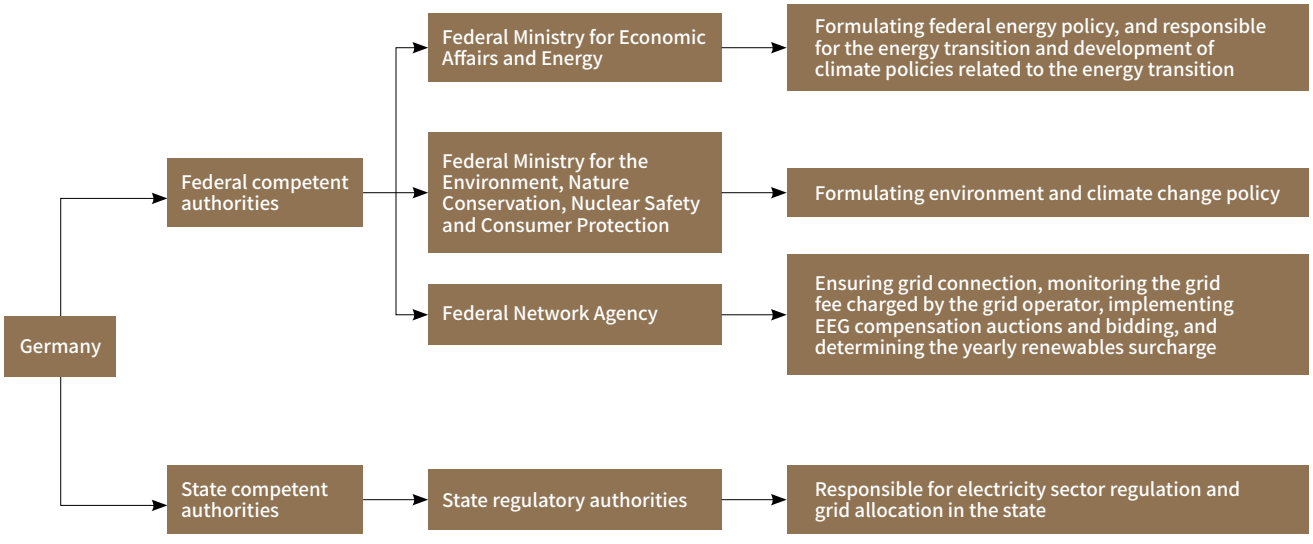

Figure 3: Competent authorities of electricity industry in Germany

The BMWi is mainly responsible for federal energy policy, energy transition and energy-transition-related climate policies. The Federal Network Agency (Bundesnetzagentur, BNetzA), as the main regulator of the power sector, is responsible for ensuring grid access, monitoring grid charges collected by grid operators, and determining the annual renewables surcharges.

The state regulatory authorities are responsible for power sector regulation and grid allocation in the state.

2. Project approval

Under the relevant German legal framework, renewable energy projects are subject to a multi-layered and complex industry supervision. In general, construction permits and operating permits are required for power projects in Germany.

The approvals required for planning, construction, commissioning and operation of renewable energy projects vary depending on the type of proposed project (e.g. a hydropower, wind energy, or solar power project), the location of the project, and the installed capacity. For example, onshore wind power projects require permits for the construction and operation of onshore wind facilities pursuant to the Federal Immission Control Act (Bundes-Immissionsschutzgesetz, BlmSchG); offshore wind power projects require planning permits from the Federal Maritime and Hydrographic Agency (Bundesamt für Seeschifffahrt und Hydrographie, BSH) pursuant to the Offshore Wind Energy Act (Wind-auf-See-Gesetz, WindSeeG); and hydropower projects require permits for the storage, discharge and re-storage of water for power generation pursuant to the Federal Water Act (Wasserhaushaltsgesetz, WHG).

In addition, renewable energy regulatory bodies may vary from state to state (e.g. state departments or municipalities), and specific projects may require approval by the federal authorities. This increases the complexity in obtaining the required approvals. Therefore, for a specific project, the investor needs to hire a German counsel to assess from which regulatory authorities the relevant permits will be obtained, depending on the size and location of the proposed investment.

(III) Subsidies for renewable energy projects

The development of renewable energy incentives in Germany is as follows:

The *Renewable Energy Sources Act* (Erneuerbare-Energien-Gesetz, EEG) sets out the determinants of access to subsidies, including the production mode and the capacity scale of renewable energy. In accordance with the Renewable Energy Act, power generators may sell electricity to transmission system operators at a fixed on-grid price, which is often higher than the price at which transmission system operators sell electricity, and the difference between the two is the renewable energy subsidy. The 20-year term of the subsidy has expired for the first power generators that have obtained such subsidy. For this reason, the German government has introduced a temporary programme so that specific companies could still receive a certain level of subsidy for a period of time after the subsidy term ended, thus avoiding the closure of a large number of renewable energy companies.

After 2014, new renewable energy generators with a capacity exceeding 100kW have had to sell their electricity in the electricity market. In addition to the sales price, they may obtain a certain market premium from the transmission system operators to compensate for the difference between the electricity price of the power generation enterprises (once known as the “feed-in tariff”) and the average trading price of electricity .

Germany introduced an auction bidding mechanism in 2017. Since then, the value to be applied has no longer been set by the state for large generating installations (PV or onshore wind with more than 750 kW capacity; biomass with more than 150 kW capacity, and offshore wind), but determined by competition in auctions. The relevant institution

adjusts and publishes the market premiums on a regular basis. Unlike large power plants, the value to be applied to small power plants (e.g. onshore wind farms with below 750 kW capacity) are determined by the average of the highest winning bid amounts at the auctions in the past few years.

Subsidies for renewable energy in Germany have changed from direct subsidies to indirect subsidies. If renewable energy companies want to receive subsidies, they need to improve their technology and management and reduce their cost of power generation in order to win in the auction.

In addition, as some of the first batch of power generators that received renewable energy subsidies lost their subsidies, they have started to approach and enter into power purchase agreements with the electricity users, in order to obtain reasonable operating profits.

III. Renewable energy projects in Vietnam

As an economy with rapid economic growth, Vietnam' s power demand is growing strongly. The Vietnamese government has introduced the National Power Development Plan VII (2011-2030) to encourage the development of energy and power industries. By the end of 2019, Vietnam had a total installed capacity of 54,880 MW, ranking 2nd in ASEAN (only after Indonesia) and 23rd in the world. Vietnam has launched a plan to establish a competitive electricity market and gradually deregulate the electricity market.

It should be noted that Vietnam' s laws are updated relatively quickly and lack stability, thus investors investing in Vietnam need to focus on the changes in the legal environment. From 2020 to 2021, Vietnam had promulgated or revised a large number of laws, including the Law on Investment, the Enterprise Law, and the Law of Public-Private Partnership (PPP Law), which has greatly modified the original legal system. Since the Vietnamese Government has not issued supporting implementation rules for all the new or revised laws, specific implementation requirements of the relevant laws need to be further clarified.

(I) Access of foreign investment

In June 2020, the National Assembly of Vietnam passed amendments to the Law on Investment, which came into effect on 1 January 2021. Under the Law on Investment, the market access conditions applicable to foreign investors are basically the same as those applicable to domestic investors in Vietnam.

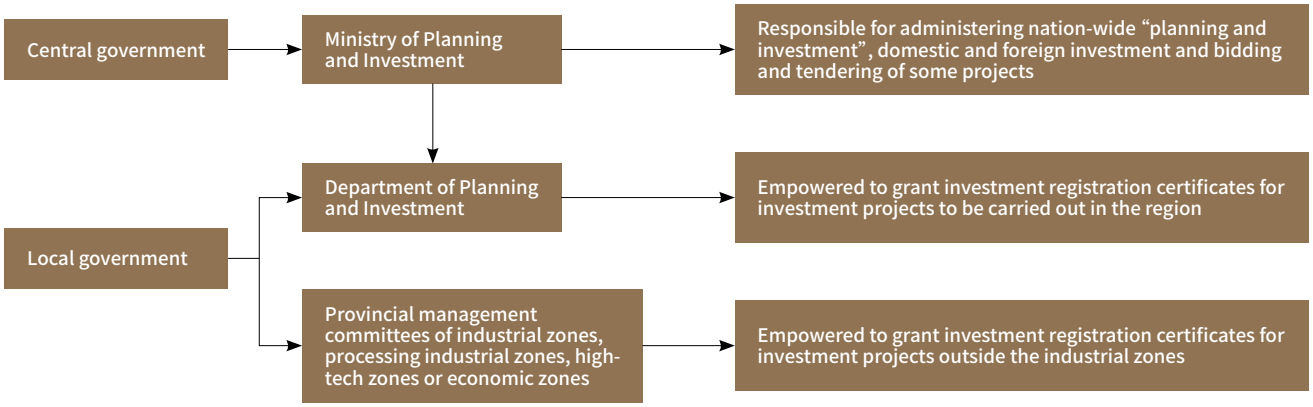

Figure 4: Competent authorities of foreign investment in Vietnam

In accordance with the Law on Investment, investment projects in Vietnam are categorized into prohibited, conditional and encouraged projects on the basis of industries. Solar and wind power projects (except offshore wind power) are listed as industries in which investment is encouraged, while other power projects are industries subject to conditional access. (The Appendix to the Law on Investment has provided a list of conditional and encouraged industries, but the Vietnamese government may amend this list by issuing a new regulation.)

In addition, pursuant to the Law on Investment, an investor shall apply for an investment registration certificate in the following cases:

(1) Direct investment projects of foreign investors;

(2) Investment projects in which:

a 51% of charter capital or more is held by foreign investors;

b 51% of charter capital or more is held by the business organizations mentioned in Point a of this Clause;

c 51% of charter capital or more is held by foreign investors and the business organizations mentioned in Point b of this Clause.

It should be noted that since the Law on Investment was amended, Vietnam has not yet issued its supporting implementation regulations. Therefore, the implementation of the Law on Investment is still unclear in its implementation as shown in the following aspects:

(1) The detailed investment conditions for conditional projects; and

(2) The procedures for obtaining investment registration certificates. According to the supporting provisions of the original Law on Investment, the encouraged projects only need to complete the registration procedures to obtain the investment registration certificate, while conditional projects need to be approved by the competent authorities before obtaining the certificate. At present, such provisions are no longer applicable.

(II) Project approval

1. Competent authorities

In Vietnam, the electricity sector is mainly regulated by the Prime Minister, the Ministry of Industry and Trade (MoIT), the Electricity Regulatory Authority of Vietnam (ERAV), the local People's Committees and the Vietnam Energy Association (VEA).

At the national level, the Prime Minister of Vietnam has the highest authority to regulate the power sector, and is responsible for approving the most important policies and regulations in the sector. The MoIT, the main regulator of the power sector, is responsible for formulating important electricity policies, supervising the implementation of relevant laws and regulations in the sector as well as issuing operation licences to entities engaged in power generation, transmission, distribution, wholesale, retail, consulting business related to national grid. The VEA subordinate to the MoIT is responsible for assisting the MoIT in the supervision of power activities and market to ensure a safe and stable power supply.

In the provinces and major cities of Vietnam, local People’ s Committees have the authority to formulate local power industry development plans as well as implement the plan after obtaining the MoIT approval and the National Assembly of Vietnam. In addition, the local People’ s Committees have the power to issue operation licences for small projects in the power industry.

2. Project approval

In general, in addition to the above investment registration certificate, the approval documents required for foreign investors to invest in power projects in Vietnam include, but are not limited to, enterprise registration certificate, feasibility study report, environmental impact assessment report or environmental protection plan, construction permit, and electricity licence. The specific approvals vary depending on the type of power project or the region where the project is located. Among them, the types and competent authorities of the electricity licences are as follows:

Type of licence	Approval authority
Electricity development planning consulting licence	ERAV Provincial People' s Committees: Providing electricity consulting services for the construction of transmission projects and substations with voltages not higher than 35 kV registered in the provinces
Power generation licence	MoIT: Power generation activities approved by the Prime Minister which are important for socio-economic and national defence security, with a capacity of not lower than 3 MW Provincial People' s Committees: Power generation activities with a capacity of more than 3 MW
Power transmission licence	MoIT
Power distribution licence	ERAV: Voltage not higher than 35 kV Provincial People' s Committees: Voltage lower than 35 kV
Power sales licence (wholesale/retail)	ERAV: Voltage higher than 35 kV Provincial People' s Committees: Voltage not higher than 35 kV

Table 3: Types and competent authorities of the electricity licences in Vietnam

In addition to the above approvals for general power projects, renewable energy projects are subject to the following requirements:

(1) Power development plan: The Vietnamese government releases power development plans on an ad hoc basis, which will list out the specific approved power projects. If the proposed renewable energy project is not included in the power development plan, the investor must first apply for inclusion in the power development plan. Projects with a capacity of 50 MW and below are subject to the MoIT approval; projects with a capacity of more than 50MW will be submitted by the MoIT to the Prime Minister for approval.

(2) Hydropower development plan: There is a separate development plan for hydropower projects. Prior to its development, a hydropower project needs to be approved by the MoIT and included in the hydropower development plan.

(III) Subsidies for renewable energy projects

Feed-in tariff (FIT) is a renewable energy subsidy policy, which provides fixed standard subsidies for power generation enterprises. In order to encourage the development of renewable energy, the Vietnamese government has introduced two rounds of FIT policies for PV and wind power projects. The standards for the second round of FIT subsidy are as follows.

The applicable FIT subsidies for wind power projects are as follows:

Wind power projects		
Category	**FIT**	**Terms and conditions**
Onshore wind power project	VND 1,928/kWh	The commercial operation date was before 1 November 2021. The subsidy period is 20 years.
Offshore wind power project	VND 2,223/kWh	

Table 4: FIT subsidies for wind power projects in Vietnam

The applicable FIT subsidies for PV projects are as follows:

Solar power projects		
Category	**FIT**	**Terms and conditions**
Floating PV project	VND 1,873/kWh	The conditions are as below: a) The project was approved before 23 November 2019 and the commercial operation date was between 1 July 2019 and 31 December 2020; and b) It is demonstrated that the solar cell performance ratio is greater than 16% or the module count is greater than 15%. The subsidy period is 20 years.
Onshore PV project	VND 1,644/kWh	
PV project in Ninh Thuan Province	VND 2,086/kWh	The conditions are below: a) The project is included in the power development plan; and b) The project entered into commercial operation before 1 January 2021, with a total capacity not exceeding 2,000 MW. The subsidy period is 20 years.

Table 5: FIT subsidies for PV projects in Vietnam

For investors to invest in renewable energy projects in Vietnam, the market has some doubts about the long-term stability of the FIT subsidy policy and whether subsidy payment will be defaulted due to factors such as policy instability. Meanwhile, investors should note that the Vietnamese government has issued a standard power purchase agreement applicable to renewable energy projects. But the standard agreement lacks compensation mechanism for "abandonment of PV power and restriction of power output" and "grid failure", as well as project suspension compensation mechanism. In addition, the power transmission company (Vietnam Electricity) generally do not accept amendments to the standard power purchase agreement. This may have a negative impact on the stability of income of renewable energy companies and the financability of projects.[1]

This article is mainly written by Lv Yinghao, Du Rui and Lu Shanshan, with contribution from Wang Fanyuan, Huang Zelin, Wei Zhen, Li Wenting and Li Hangyu.

[1] This article is intended to offer an introduction to some key issues in investing in renewable energy projects in Spain, Germany, and Vietnam, rather than a comprehensive and all-encompassing overview. In specific projects, investors are advised to pay attention to the local legal requirements on antitrust, environment, labour and other aspects. For the foreign investment screening regimes and approvals and subsidies for renewable energy projects mentioned in this article, investors should also seek professional advice from a counsel. None of the co-authors of this article is a lawyer registered in Spain, Germany, and Vietnam. This article is only a summary of our experience from relevant projects. This article does not constitute any legal advice on the laws of these jurisdictions. If you have any questions about the above contents, please contact us and we will provide you with solutions through our global network.

OVERVIEW OF INVESTMENT IN RENEWABLE ENERGY PROJECTS IN PORTUGAL, IRELAND AND MEXICO

Lv Yinghao, Du Rui, Lu Shanshan

This article focuses on the foreign investment review regime, renewable energy project approvals and renewable energy subsidies in Portugal, Ireland and Mexico.

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I. Renewable energy projects in Portugal

The Portuguese power market is highly regulated and supervised by the State. Portugal has an abundant supply of electricity which could meet the basic needs of the economy and society on electricity, with the ability to export the excess supply.

Portugal has witnessed rapid development in renewable energy power generation and has adopted measures to encourage wind power generation since 2000. Portugal is expected to increase investment in solar PV, offshore wind and biomass power generation.

On 10 July 2020, the Portuguese Council of Ministers approved the National Energy and Climate Plan 2030 by Resolution 53/2020. According to the Plan, Portugal aims to incorporate 47% of renewable energy into its gross energy consumption by 2030, and achieve net zero carbon emissions by 2050.

(I) Foreign investment screening regime

Portugal encourages foreign investment. In recent years the Portuguese government has made it a priority to enhance Portugal' s attractiveness to foreign investment.

1. Relevant Portuguese regulations

In 2014, Portugal enacted the Strategic Assets Special Framework and established its foreign investment review regime, which is currently in force. The Framework provides for a foreign investment review mechanism for the energy, transport and communications sectors in Portugal.

Specifically, foreign investors will be subject to foreign investment review if they invest in and exercise control over Portuguese "strategic assets". Assets in the energy sector are "strategic assets" related to Portugal' s national defence, national security and basic service supply. For such investments, the Portuguese sectoral authority may provide negative opinions upon review, and the Council of Ministers may veto specific investments based on such opinions.

The Minister of the competent authority may initiate an investigation procedure within the period prescribed by law if he/she deems necessary, and request the foreign investor to submit all the documents and information required for the investigation. The Portuguese Council of Ministers may decide whether to veto the M&A transaction within a specified period after the foreign investor has submitted all the requested documents and information. If the foreign investor disagrees with the Council of Ministers' s veto decision, it may appeal to the court.

Portugal' s current foreign investment review mechanism does not provide for a mandatory prior notification procedure for foreign investors. However, foreign investors intending to obtain control over strategic assets through an M&A transaction may, within a specified period prior to the transaction, apply to the Minister of the relevant authority to confirm whether the Council of Ministers will veto the transaction.

2. Relevant EU regulations

Considering that Portugal is an EU member state, foreign investors should also pay attention to the EU' s legal documents on foreign investment review when investing in Portugal. The European Commission has implemented the *Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union* (the Regulation) as of 11 October 2020, under which the European Commission was granted access to information, the right to provide comments and the power to adopt delegated acts. This actually strengthened the review of foreign investments. In addition, the European Commission issued the *Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe' s strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation)* (the Guidance) on 25 March 2020, providing further guidance on the implementation of the Regulation in order to protect criticial EU assets and technologies from control by foreign investors during the market turmoil caused by the COVID-19 pandemic. However, the Regulation and the Guidance are not mandatory for EU member states.

As of 28 May 2021, Portugal has not taken any measures in response to the Regulation and made no changes to its foreign investment review regime. We recommend investors seeking investment in renewable energy projects in Portugal pay close attention to whether Portugal will amend its foreign investment laws based on the Regulation.

(II) Project approval

1. Competent authorities

Direção-Geral de Energia e Geologia (DGEG) - The DGEG handles the operating, inspection and closure of power installations, drafts the relevant decision-making documents for the Government, and issues, amends and revokes production and operating licences in accordance with the Government' s decisions.

Entidade Reguladora dos Serviços Energéticos (ERSE) - The ERSE is an independent regulator that is established to protect consumer rights and interests, promote competition among market players and improve environmental and economic conditions related to the energy sector. Specifically, it is responsible for monitoring grid access, power supply quality and electricity prices. The ERSE has the power to impose fines on energy companies that violate laws and regulations.

Autoridade da Concorrência (AdC) - The AdC cooperates with the ERSE to ensure and promote market competition in the energy sector.

2. Project approval

(1) Electricity production

The approvals required for the construction and operation of power plants in Portugal include, but are not limited to, production and operating licences issued by the DGEG, environmental permits (for coal-fired power stations with an installed capacity of more than 50MW), environmental impact assessments, authorisation for the emission of greenhouse gases, permits or approvals for the use of water resources (where applicable), construction permits issued by municipalities (except for power plants with concessions).

New production and operating licences are required for any alterations to equipped electricity capacity, technology, fuel or energy sources, number of generators, boilers, turbines or power production centres.

Type of licence	Approval process
The main approval process for a production licence	• Apply to the DGEG by the applicants • Consider the applicants as market energy operators and pre-authorize their access to the grid based on their application • Pay deposit by the applicants • Conduct prior competition compliance checks on different applicants (if necessary) • Conduct reviews on power plants for issuing a license in parallel with the above process • During the review process, the DGEG will consult with other market players and conduct a project evaluation • The DGEG decides on the application for a license based on the results of the review
The main approval process for an operating license	• Administrative authorisation procedures, including pre-operating testing, experimentation and commissioning procedures • Before starting industrial activity, the applicants should apply to the DGEG for operating license • The DGEG conducts site inspection and assessment • A decision on the application for a license will be made based on the results of the inspection and assessment

Table 1: Main approval process for production and operating licenses

In addition, the DGEG applies simplified review procedures to the application for the approval of renewable energy power stations that utilize unique production technologies, with a maximum installed capacity of up to 1 MW and where all the electricity produced will be sold to the grid.

The above are the main approval requirements involved in the construction and operation of a power project. For a specific project, investors are recommended to seek professional legal advice on the approvals required.

(2) Electricity transmission and distribution

The Portuguese transmission and distribution networks can only be built and operated by entities with concessions. Rede Eléctrica Nacional SA and EDP Distribuição SA are the electricity transmission system operator and the major electricity distribution network operator respectively in Portugal. In general, projects for the construction or expansion of transmission lines or distribution network lines require a construction license from the DGEG.

(3) Electricity supply

The retail supply of electricity in Portugal is only subject to registration and confirmation with the DGEG.

Wholesale market traders are required to register with the ERSE and provide their trading records in the electricity market to the EU Agency for the Cooperation of Energy Regulators.

In addition, the suppliers are obligated to report to the DGEG and the ERSE.

(III) Compensation policies for renewable energy projects

The renewable energy sector in Portugal is mainly governed by Decree 163/2019 issued on 25 October 2019, which incorporates Directive (EU) 2018/2001 into the Portuguese legal system. Both regulations aim to enhance the production and consumption of electricity generated from renewable energy sources (mainly solar and wind energy).

In July 2020, the Portuguese government promoted a tender for a PV power plant with a total capacity of 670MW, 75% of which involves electricity storage. The construction of such a project will enhance the security of the Portuguese power system.

The existing compensation mechanisms for renewable energy projects in Portugal include, inter alia, the following:

1. Feed-in-Tariff (FIT)

The FIT, as a renewable energy subsidy policy, provides fixed standard subsidies to power enterprises. The FIT rate is gradually reduced to cost price as the number of electricity users increases. In Portugal, PV power has the highest FIT rate, reaching €500/MWh in 2003, before falling to €300/MWh; the FIT rate for other energy sources has steadily increased by €80 to €120/MWh.

FIT typically involves a long-term contract with a term ranging from 15 to 20 years. Such a contract provides guaranteed grid access and cost-based tariff within the above period. However, as a move to promote renewable energy development in the early stage, FIT is applied less frequently. In accordance with Portuguese Decree 76/2019 issued on 3 June 2019, the projects to which the FIT applies include:

(1) Power stations with an installed capacity of up to 1MW (subject to annual review by the Government); and

(2) Installation of new generating units under existing generation projects in case of overcapacity, or the installation of generating units using a different energy source when new generating units are installed under existing generation projects.

Unless otherwise agreed by the parties to the aforementioned contract, the FIT rate agreed prior to the promulgation of Decree 76/2019 shall remain in force. If the contract does not provide that the FIT rate will lapse as a result of any change in the shareholding of the generation company and the power generation company to which the FIT applies survives the M&A transaction, the power generation company will still be entitled to the subsidy.

2. Net metering

Net metering is currently the most common compensation policy for renewable energy in Portugal.

Renewable energy generators may deduct the tariff generated, for example, in wind turbines that use the electricity from the grid to keep operating when there is no wind, from the electricity they delivered to the grid.

II. Renewable energy projects in Ireland

Ireland, an energy importer, is dependent on significant oil and gas imports to meet its energy needs. Ireland mainly relies on natural gas for power generation.

Under the EU Renewable Energy Directive, Ireland shall supply 70% of its electricity from renewable sources by 2030. The Irish government is therefore vigorously promoting renewable energy generation and encouraging the development of renewable energy businesses. Due to its abundant wind energy resources, Ireland mainly relies on wind energy in its renewable energy generation.

(I) Foreign investment screening regime

Other than a strict prohibition on investment in the munitions industry (which applies to both foreign and local investors), Ireland imposes no restrictions on foreign investment based on public policy or national security, nor has it promulgated laws or regulations to restrict foreign investment.

However, with the promulgation of the Regulation and the Guidance, the Irish Government announced in July 2020 its plans to introduce relevant legislation and to assess, investigate, approve, conditionally approve, prohibit or revoke foreign investment from outside the EU in accordance with various security and public order criteria in order to implement the Regulation.

The introduction of a foreign investment law may have an impact on foreign investors in Ireland. Investors are advised to keep a close eye on the legislative developments in Ireland and to consult an Irish lawyer if necessary.

(II) Project approval

1. Competent authorities

The Commission for Regulation of Utilities (CRU) – As Ireland' s independent regulator in the electricity industry, the CRU is responsible for granting licences relating to electricity generation and supply, and regulating generation and supply activities, the ownership and operation of electricity transmission and distribution, and cable interconnection.

Minister for the Environment, Climate and Communications - The Minister is responsible for overseeing the performance of the CRU to discharge its responsibilities.

2. Project approval

(1) For the development of new projects, the general approvals involved in the construction and operation of power projects mainly include planning and environmental protection permits. In addition, it requires approvals for electricity generation, which mainly include the following:

a Authorisation for power station construction

Prior to the construction of a power station, an application for authorisation to build or rebuild a power station (construction authorisation) is required from the CRU.

In general, the construction and trial operation of a power station should be completed within five years of the entry into force of the construction authorisation. The CRU has the right to revoke the authorisation for the construction of a power station if the authorised person fails to comply with the terms and conditions specified in the construction authorisation.

b Electricity generation permit

A power station project requires an electricity generation permit issued by the CRU. Applicants may apply for a permit either separately after obtaining the construction authorisation or together with the application for the construction authorisation.

The power generation permit is valid for a minimum of 30 years. The CRU has the right to revoke a permit if the applicant fails to comply with the terms and conditions specified therein.

c Transmission/distribution network access permit

The transmission/distribution network access permit may be obtained for a power project through the execution of an access agreement with the transmission network operator or the distribution network operator. The access protocol is in the form text with the standard terms which shall be approved by the CRU.

(2) For the acquisition of existing power projects, the approvals for the construction and operation of the power project are as follows:

a. For an asset acquisition involving a change in the holder of a construction authorisation/ electricity generation permit, prior approval from the CRU is required;

b. For an equity acquisition involving only a change of control of the power project without a change in the holder of the construction authorisation/electricity generation permit), no Irish Government approval is required for the acquisition itself.

However, in the event of a change of control of a power project, the relevant companies shall promptly inform the CRU and the transmission system operator of the change as the construction and operation of the power project involves the relevant permits as described above. For power projects entitled to renewable energy subsidies, the government department responsible for renewable energy subsidies will also need to be notified.

(III) Subsidies for renewable energy projects

Ireland implemented the FIT policy until 2020, providing subsidies for each unit of electricity fed into the grid from renewable energy projects. The subsidy generally lasts for 15 years. The FIT policy establishes a minimum tariff for renewable energy projects. A renewable energy company may obtain government subsidies for the price difference if the actual price of the electricity generated by the company fails to reach the lowest tariff on the wholesale electricity market.

At present, the FIT is no longer open for applications. The Department of the Environment, Climate and Communications, however, has introduced a new support mechanism for renewable energy generation (new subsidy mechanism), which provides government subsidies to renewable energy projects in the form of auctions.

The core logic of the new subsidy mechanism, which was designed to accompany Ireland' s market-based electricity pricing mechanism, is to ensure a reasonable return on renewable energy projects through the provision of government subsidies. However, the government may withdraw the previous subsidies if the renewable energy project itself can achieve its expected return in the market. The specific mechanisms are as follows:

(1) Renewable energy projects that meet the relevant criteria can participate in the auction, and the bidder' s offer will be deemed as the strike price, which will remain unchanged during the subsidy period.

(2) A power generation company will enter into a power purchase agreement with an intermediary, agreeing on the sales of the electricity from the auctioned renewable energy project to a specific intermediary at the strike price.

(3) Government subsidies will be provided to the intermediary other than the power producers. For each auctioned renewable energy project, the government subsidy is calculated as follows:

a. The single wholesale electricity market price will be used as the market reference price (MRP);

b. The intermediary is entitled to a subsidy for the difference between the MRP and the strike price (subsidy amount) when the MRP is lower than the strike price and the MRP is zero or positive. The subsidy amount will be zero if the MRP is negative;

c. The intermediary is required to pay the difference between the MRP and the strike price if the MRP is higher than the strike price (premium amount);

d. The above subsidy amount and premium amount are subject to adjustment based on the actual sales of electricity; and

e. In each year when the public service fee is collected, the intermediary will receive a government subsidy paid out of the fee for the part of the subsidy amount that is higher than the premium amount; if the subsidy amount is lower than the premium amount, the intermediary will be obliged to pay the fee on a monthly basis in the following year for the part of the premium amount that is higher than the subsidy amount.

Upon expiry of the subsidy period or withdrawal of the relevant renewable energy project from the subsidy scheme, the government subsidy received for the renewable energy project during the subsidy period and the public service fee payable will be netted. If the result of the calculation shows that the intermediary is also required to pay a public service fee, such fee will be borne jointly and severally by the intermediary and the generation company.

The first phase of the auction under the new subsidy mechanism has been completed. The average strike price for the auctioned renewable energy projects is now €74.08/MWh, with a subsidy period from 1 July 2021 (or from the commercial operation date of the specific project) to 31 December 2037.

III. Renewable energy projects in Mexico

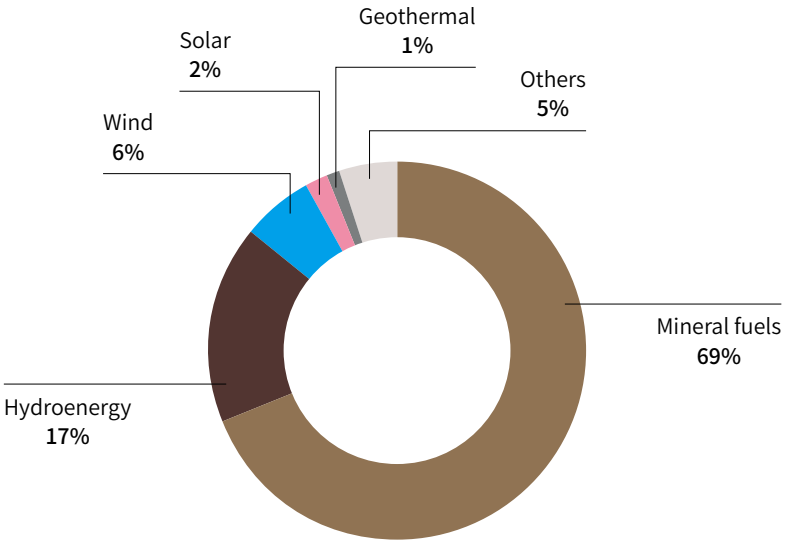

Figure 1: Energy mix of the Mexican electricity market

Mexico' s current energy mix in the electricity market is dominated by fossil fuels. In 2017, the Mexican Secretaría de Energía (SENER), or the Mexican Ministry of Energy, released its energy transition plan and confirmed in its Renewable Energy Development Plan 2017-2031 that Mexico will promote the development of renewable energy power generation projects in Mexico through the development of incentives, among other measures. In addition, under the Energy Transition Law, the Ministry of Energy is required to take measures to generate no less than 35% of the total electricity from renewable sources by 2024. The Special Programme for the Use of Renewable Energy published by the Ministry of Energy further stipulates five objectives, 24 strategies and 114 action guidelines relating to promoting the development of renewable energy projects.

(I) Foreign investment review regime

In Mexico, foreign investment is mainly governed by the *Foreign Investment Law* and its supporting regulations.

The *Foreign Investment Law* sets out the areas in which foreign investment is prohibited, restricted or subject to the approval of the National Foreign Investment Committee. The energy sector does not fall into any of the aforementioned areas.

In addition, under Mexican law, Mexican companies with foreign shareholders (eg. some of the founders are foreign investors) are required to complete their registration with the National Registry of Foreign Investment at the time of incorporation or within the prescribed period after the investment by the foreign investor. Failing to complete the registration within the specified time limit may result in a fine.

(II) Project approval

1. Competent authorities

Mexico' s electricity sector is mainly regulated by the SENER, the Comisión Reguladora de Energía (CRE), the El Centro Nacional de Control de Energía (CENACE), and the Secretaría de Medio Ambiente y Recursos Naturales (SEMARNAT).

SENER is primarily responsible for formulating and implementing Mexico' s electricity policy and overseeing the Mexican electricity market.

CRE is a regulator with technical and operational autonomy, which is responsible for issuing permits relating to electricity activities (i.e. generation, distribution and transmission).

CENACE is the regulator that manages the wholesale power market and the grid, which is responsible for reviewing applications from power generation companies for access to the transmission and distribution networks, and for monitoring the power sales.

SEMARNAT is responsible for monitoring the environmental aspects associated with power projects.

2. Project approval

(1) Power production

The main approvals required for the construction and operation of power plants in Mexico include, but are not limited to, the construction and generation permits granted by the CRE (authorization from the SENER is also required for the construction of nuclear power plants), environmental permits granted by the **SEMARNAT**, social impact report issued by the SENER, as well as land use permits, municipal construction permits, and resident protection permits issued by the regional and/or municipal authorities where the proposed power plant is to be located.

For the construction and power generation permits granted by the CRE, applicants are required to submit documents to the CRE, including identification documents, description of the proposed project, and certification documents of the applicant' s financial and technical capabilities. In addition, construction and power generation permits are only applicable to power plants with a proposed installed capacity of more than 0.5MW. Power plants with an installed capacity of less than 0.5MW are not required to apply for this type of permit.

In addition, in order to deliver the produced electricity to the national transmission and distribution network after the construction of the power plant, the plant operator needs to register with and submit an application for grid access to the CENACE and sign a grid connection contract with the Comisión Federal de Electricidad. The operator will need to sign a market participation contract with CENACE if it wishes to sell its electricity on the wholesale electricity market.

(2) Electricity transmission

The main approvals required for the construction and operation of power transmission projects include, but are not limited to, permits issued by the CRE for the construction and operation of power transmission lines, environmental permits, municipal permits, construction permits, and land use permits.

(3) Electricity distribution

The main approvals required for the construction and operation of the distribution network include, but are not limited to, municipal permits, construction permits, land use permits, and environmental permits. The private entity will need to apply to the CENACE for authorisation if it intends to participate in power distribution.

The above are the main approvals involved in the construction and operation of power projects. For a specific project, investors are recommended to seek professional legal advice on the approvals required.

(III) Incentives for renewable energy projects

The incentives for renewable energy projects in Mexico are as follows:

(1) Clean energy certificate

In Mexico, generating units using clean energy will receive a clean energy certificate from the CRE for every 1MW of electricity generated per hour.

Clean energy certificates have certain economic value. The suppliers and end-users in the electricity market have a demand for such certificates as they are required by the SENER to consume a certain percentage of clean energy each year. Market entities with such certificates may sell them through auctions or bilateral transactions.

(2) "Green" transmission rates

For transmission and distribution activities of renewable energy generation projects, the CRE is authorised to set a lower "green" transmission rate for such activities, which is far lower than that applicable to generating units using conventional energy.

(3) Tax relief

In order to promote market investment in renewable energy generation projects, the Mexican government imposes no taxes and fees on renewable energy generating units and equipment.[1]

Thanks to Wang Fanyuan, Huang Zelin, Wei Zhen, Li Wenting and Li Hangyu for their contributions to this article.

[1] This article is intended to offer an introduction to some key issues in investing in renewable energy projects in Portugal, Ireland and Mexico, rather than a comprehensive and all-encompassing overview. In specific projects, investors are advised to pay attention to the local legal requirements on antitrust, environment, labor and other aspects. For the foreign investment screening regimes and approvals and subsidies for renewable energy projects mentioned in this article, investors should also seek professional advice from a counsel. None of the co-authors of this article is a lawyer registered in Portugal, Ireland and Mexico. This article is only a summary of our experience from relevant projects. This article does not constitute any legal advice on the laws of these jurisdictions. If you have any questions about the above contents, please contact us and we will provide you with solutions through our global network.

OVERVIEW OF INVESTMENT IN RENEWABLE ENERGY PROJECTS IN BRAZIL, EGYPT, JORDAN AND PAKISTAN

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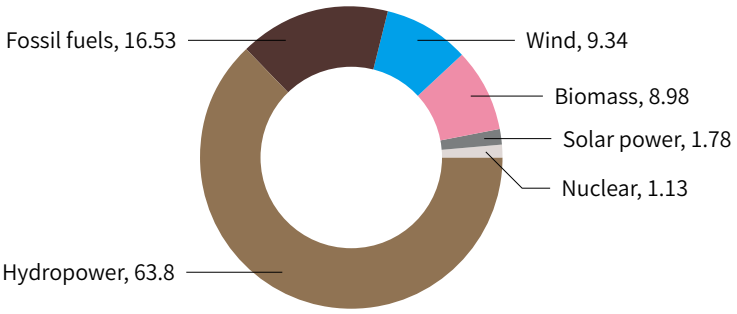
This article will introduce the policies of Brazil, Egypt, Jordan and Pakistan concerning the screening of foreign direct investments (FDI), the approval of renewable energy projects, and renewable energy subsidies.

I. Renewable energy projects in Brazil

The Brazilian government values the development of renewable energy sources and has issued a series of incentive programmes to promote clean and renewable energy generation. The Programme for the Alternative Electricity Sources Incentive Programme (PROINFA) under Decree No. 5025/2004, for example, will diversify the energy mix of the country by promoting the power supply from wind, biomass and small hydroelectric plants. In order to promote the market-oriented development of renewable energy related projects, most renewable energy projects in Brazil are planned by the government and open to investors for public bidding.

Approximately 83% of Brazil' s existing power supply is from renewable energy sources, with hydropower accounting for 63.8%, wind power for 9.34%, biomass for 8.98% and solar power for 1.78%. The Brazilian government plans for 91% of its domestic use of all energy sources to be renewable by 2025, and for the share of non-hydropower renewables to expand to more than 28% of the current total installed capacity by 2030.



Energy sources for existing electricity supply in Brazil

(I) Foreign investment screening regime

Brazil is relatively open to foreign investment. Foreign investment is generally not subject to specific approval, but must be registered with the Brazilian central bank and tax authorities.

The Brazilian law does not impose restrictions on foreign investment, except in the sectors of media, aerospace, nuclear activities (including nuclear power generation), rural land, mining and maritime. In the energy sector, the current Brazilian law does not impose any special restrictions on foreign investors, except that they are not allowed to hold more than 49.99% of the voting shares in nuclear power generation enterprises.

Notably, under the Brazilian laws, no local company controlled by foreign investors may purchase or lease any rural land. If any project to be invested in by a foreign investor involves the purchase or lease of any rural land, it may be subject to restrictions under the relevant land policies.

(II) Project approval

1. Competent authorities

In Brazil, the competent authorities in the electricity sector include:

National Council for Energy Policy (Conselho Nacional de Política Energética, CNPE) - formulating policies related to the energy sector; providing strategic guidance to other relevant bodies in policy development, including guidance for specific projects involving natural gas, methanol, other biomass fuels, coal, nuclear fuels, etc.; and periodically revising the proportion of energy sources in various regions of Brazil.

Ministry of Mines and Energy (Ministério de Minas e Energia, MME) - formulating and implementing energy policies; setting basic conditions for renewable energy auctions and concession bids; and awarding concessions for mining and energy projects.

National Electric Energy Agency (Agência Nacional de Energia Elétrica, ANEEL) - planning and overseeing the generation, transmission, distribution and commercialisation of electricity in Brazil; advocating and administering auctions for power distribution and generation companies to enter into long-term electricity purchase contracts; and setting transmission and distribution prices and regulated tariffs for electricity sales.

Electric Sector Monitoring Committee (Comitê de Monitoramento do Setor Elétrico, CMSE) - as a specialised advisory body under the MME, monitoring and evaluating the security and sustainability of power supply in Brazil; and monitoring the generation, transmission, distribution, commercialisation, import and export of electricity.

National Electric System Operator (Operador Nacional do Sistema Elétrico, ONS) - operating, overseeing and controlling the power supply connected to the national grid system; managing the transmission of electricity in Brazil; reducing transmission costs while ensuring the stability and reliability of the grid; and formulating input standards for high-voltage grids.

Energy Research Office (Empresa de Pesquisa Energética, EPE) - making studies related to the electricity sector to provide the basis for decisions on energy planning in Brazil, including studies and forecasts on the proportion of electricity sources in the country, studies on the economic, social and environmental impacts of electricity generation projects and transmission projects; and coordinating environmental permits for hydroelectric projects and transmission projects prior to their commencement.

Electricity Trading Chamber (Câmara de Comercialização de Energia Elétrica, CCEE) - determining prices and

spreads in short-term transactions in the power market; and identifying all participants and volume of electricity in multilateral electricity transactions.

2.Project approval

(1) Construction and operation of generating units

Firstly, the construction and operation of power generation units requires the authorisation of relevant government authorities in Brazil. The MME is responsible for authorising the construction and operation of generating units by the winning bidders in renewable energy auctions, among other activities. ANEEL is responsible for authorising the construction and operation of other generating units in the free electricity market.

a. For small hydroelectric projects of 50 MW, and cogeneration, wind, solar, biomass and thermal power projects of any installed capacity, ANEEL authorises their construction and operation in accordance with the simplified procedures stipulated in its normative resolutions No. 343/2008, 390/2009, 391/2009 and 0235/2006;

b. For hydropower projects (except for small projects below 50 MW), ANEEL grants concessions through public bidding procedures.

Environmental permits, specifically prior permit, installation permit and operating permit, are also required for the construction and operation of a power generation project. Before launching a project that may pollute the environment, a company should obtain a prior permit from the Brazilian Institute of Environment and Renewable Natural Resources (Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renováveis, IBAMA). Before the project construction, the enterprise should obtain an installation permit, which allows the enterprise no more than six years to complete the infrastructure construction. Before putting the project into operation, the enterprise should obtain an operating permit for the daily operation of the project and the operation of the pollution control equipment, which is generally valid for 4-10 years.

Last, additional authorisations and permits may be required depending on the characteristics, location and other details of power projects. For example, an airspace authorisation is required from the Commander of the Brazilian Air Force if the project is located in or near an important area of air traffic safety. A mine closure permit is required from the Brazilian National Mining Agency (Agência Nacional de Mineração, ANM) if the project is located in an area in which a third party enjoys mining rights.

(2) Power transmission and distribution

ANEEL grants bidders the right to build, operate and maintain power transmission projects through a reverse auction process. Bidders must submit to ANEEL a proposed annual revenue from the target project and the successful bidder will be the one who submits the lowest proposal. The successful bidder will be entitled to enter into a concession agreement with ANEEL.

Similar to power transmission, ANEEL organises auctions related to power distribution projects. Bidders must submit a proposed annual revenue waiver for the target project and the winning bidder will be the one who submits the highest waiver proposal. The winning bidder will be entitled to enter into a concession agreement with ANEEL.

(3) Power supply

The parties who intend to provide power supply services are required to submit application documents and their corporate certificates to ANEEL. Subject to the authorisation of ANEEL, the parties engaged in power trading must comply with the applicable CCEE requirements and carry out the transactions under any terms and conditions set out in the specific trading procedures (i.e. trading convention). They must also comply with the trading conventions, by-laws, rules and procedures issued by the CCEE as authorised by ANEEL.

(III) Renewable energy compensation policies

1. Net metering

In order to encourage the development of distributed generation, ANEEL has established a subsidy mechanism for power generation system, adopting net metering for billing purposes. Eligible renewable energy generation companies are allowed to offset the electricity they add to the grid against their electricity use (e.g., the electricity

used for wind turbines to keep spinning when the wind is not blowing). They only need to pay the electricity distributors corresponding to the net difference between their electricity use and their injection to the grid.

In accordance with ANEEL Resolution No. 77/2004, renewable energy (hydropower, biomass, methane, wind, solar and eligible cogeneration) projects are entitled to at least 50% discounts on tariffs when using the transmission and distribution systems.

2. Auctions

MME generally conducts at least one auction for renewable energy projects each year to award long-term (i.e. 20 to 25-year) power purchase agreements to these projects. MME may also conduct auctions specifically for renewable energy projects because they do not offer competitive pricing compared with conventional energy projects.

3. Tax incentives

The Brazilian government also stipulates certain tax incentives for renewable energy projects. For wind and solar power markets, ICMS Agreement No. 101/1997 (valid until 2028) applies, which exempts from VAT certain equipment for wind and solar energy projects. Under the Special Regime of Tax Exemption for Infrastructure Development, the Brazilian government has suspended the collection of federal taxes on the import and sale of equipment, machinery and services for infrastructure projects, including power projects.

II. Renewable energy projects in Egypt

Due to aging infrastructure and limited power generation and transmission capacity, Egypt suffers from power shortages for energy-intensive industries, especially during the summer months when power demand is highest. Egypt' s current energy mix is dominated by natural gas. Of the total power generation of the country, natural gas accounts for approximately 75%, renewable energy sources for a relatively small proportion, and hydropower, the third largest source, for only 7.2%. In recent years, the Egyptian government has been committed to the development of the power sector and the diversification of the energy mix. Thus, there is more room for the future development of renewable energy generation.

The new Electricity Law of 2015 aims to gradually reform the single buyer model and estalish a fully competitive market, based on bilateral contracts, to segregate generation, transmission and distribution in the electricity market. It also requires a SPV in the form of a joint stock company for projects related to electricity generation, distribution or sale.

(I) Foreign investment screening regime

The Investment Law and the Companies Law and their implementing regulations govern foreign investment in Egypt. Foreign investors are free to invest in most sectors and hold 100% of shares in companies. There are no special minimum shareholding requirements for Egyptian entities in renewable energy sector.

Under Egyptian laws, foreign entities must be subject to national security review regardless of establishment of an entity or acquisition of an Egyptian entity. For establishing an entity, all foreign shareholders are required to submit a security review application to the General Authority of Investment and Free Zones (GAFI). Upon receipt, GAFI will forward the application for review to the relevant national authorities, such as the General Intelligence Directorate, the Military Intelligence and Reconnaissance Administration, the National Security Agency. For acquiring an Egyptian entity, all foreign parties involved in the equity transfer must be subject to national security review before the commencement of the equity transfer procedure in accordance with the relevant Egyptian Exchange regulations.

The above competent authorities of national security review decide whether to approve the security review application at their respective discretion. In practice, the establishment or acquisition procedures may be suspended, even for six to seven months, due to national security review. Investors are therefore recommended to seek advice from an Egyptian counsel, if necessary.

(II) Project approval

1. Competent authorities

In Egypt, the competent authorities in the electricity sector include:

Ministry of Electricity and Renewable Energy (MOEE) - formulating policies and overall plans for power generation, transmission and distribution, overseeing the implementation of the plans and the activities in the power sector, and setting tariffs.

Egyptian Electric Utility and Consumer Protection Regulatory Agency (Egypt ERA) - formulating general principles and rules applicable to participants or stakeholders in the power market, and rules and procedures for electricity generation and use of renewable energy projects, and issuing licences for electricity generation, distribution or sale of renewable energy projects.

New and Renewable Energy Authority (NREA) - as a subsidiary of MOEE, promoting electricity generation from renewable energy sources such as solar and wind.

2. Project approval

The development of renewable energy projects requires the following approvals:

(1) Generation license

A project company should first obtain a temporary power generation license issued by Egypt ERA in order to carry out power generation activities in Egypt. Egypt ERA will issue the license to the project company within 60 days of receipt of all documents and information required.

In order to operate a power plant, the project company must subsequently obtain a permanent generation license from Egypt ERA after obtaining the temporary power generation license. The license is generally valid for five years, during which Egypt ERA will issue an annual certificate to certify the validity of the license. In order to apply for a permanent generation license, the project company should submit to Egypt ERA the feasibility study report, construction permit and other documents related to the project.

(2) Land use permit

NREA has allocated state-owned land specifically for the development of renewable energy projects and will further allocate such land to investors under the land use agreements between NREA and investors. Generally, the term of the land use agreements is 25 years for photovoltaic projects and 20 years for wind power projects. In accordance with the Renewable Energy Law, the project company under the feed-in tariff model should pay NREA land use fee equivalent to 2% of the total value of the electricity sold.

(3) Construction permit

Before the start of construction of a power project, the project company must obtain a construction permit from the local planning authority of the relevant province/city, generally through the engineer responsible for the construction of the project. The local planning authority will issue the construction permit within 1-2 months of receiving all the application documents required.

(4) Environmental impact assessment (EIA)

In Egypt, enterprises are required to obtain an EIA issued by relevant authorities before undertaking projects or activities that may pollute the environment. For a power project, the project company should obtain an EIA from the Egyptian Environmental Affairs Agency (EEAA) before the start of the construction of the project. Generally, the EEAA will issue the EIA for a project within 30 days of receiving all application documents required.

(5) Others

In addition, distribution or transmission projects also require a distribution or transmission license from Egypt ERA.

(III) Renewable energy compensation policies

1. Tax incentives

The Investment Law provides for general and special tax incentives and other benefits for renewable energy projects. General incentives include: equal treatment for foreign investors; a uniform tariff rate of 2% applicable to all machinery and equipment required for the construction of these projects; exemption from registration fee for project land use. Special incentives include tax deductions. Specifically, the project company may deduct the following amount from its net taxable profit on a pro rata basis within seven years from the date of commencement of operation of the project: 50% of the investment cost if the project company is located in the Suez Canal Economic Zone, Golden Triangle Economic Zone or any other underdeveloped region decided by the Egypt' s Prime Minister (collectively the "underdeveloped regions"); or 30% of the investment cost if located outside the underdeveloped regions.

2. Non-tax incentives

Renewable energy projects may also be entitled to additional government incentives, as decided by the Egyptian Cabinet, including but not limited to: the government' s payment of some or all of the costs for additional public facilities once the project is in operation; the government' s payment of part of the costs for technical trainings for the project company' s staff; and the government allocation of land free of charge for specific strategic energy projects.

III. Renewable energy projects in Jordan

Due to the scarcity of natural resources, Jordan suffers from a serious energy shortage, relying on imports for more than 97% of its energy and spending about 20% of its GDP on energy imports each year. In order to change the excessive dependence on imports of energy, the Jordanian government has attached importance to the development and utilisation of renewable energy in recent years, focusing on promoting the development of solar, wind and other clean energy projects. Renewable energy generation has a large potential for future development. Wind and solar power generation currently occupy a large proportion of the renewable energy generation market in Jordan.

(I) Foreign investment screening regime

In accordance with the main FDI regulations in Jordan, the Investment Law No. 30 for the year 2014 and the Non-Jordanian Investments Regulation No. 77 for the year 2016, foreign investment is prohibited in the industries or activities, including land passenger and cargo transportation services, security and investigation services, and sports clubs, and restricted in the industries or activities, including aircraft leasing services and air transportation services. Foreign investors are not allowed to invest in the prohibited industries or activities but are allowed to hold 49% or less ownership in local Jordanian companies in the restricted ones.

Except for the expressly prohibited and restricted industries and activities, foreign investors are not subject to any other restrictions under the Jordanian laws and regulations. In addition, foreign investors may apply to the Jordan Investment Commission (JIC) for exemptions for projects in the prohibited or restricted industries. After reviewing the exemption application, the JIC will make recommendations to the Cabinet about whether to approve the exemption application, and the Cabinet will make the final decision.

Neither traditional nor new energy production is prohibited or restricted for foreign investment. Foreign investors may hold 100% ownership in local power companies and are not required to obtain the permission or approval from the Jordanian government for foreign investment in the energy sector.

(II) Project approval

1. Competent authorities

In Jordan, the competent authorities in the electricity sector include:

Ministry of Energy and Mineral Resources (MEMR) - formulating the overall plans and objectives for Jordan' s energy sector and mineral resources development, and taking measures to achieve such plans and objectives; conducting exchanges with the neighbouring countries on energy and other matters; and attracting international capital to invest in power generation and oil and gas transportation in Jordan.

Energy and Minerals Regulatory Commission (EMRC) - regulating and supervising the energy and minerals sectors to ensure the provision of safe, sustainable, durable, high-quality and affordable power and mining services and to protect the interests of consumers and investors; and in the case of the power sector, issuing licenses for power projects in Jordan and monitoring electricity prices in the market.

2. Project approval

In accordance with the applicable Jordanian laws and regulations, the construction and operation of power projects require authorizations, consents and permits, including but not limited to:

No.	Approvals	Competent authorities	Applicable
1	MEMR recommendation for the Cabinet approval of power generation project	MEMR	To power generation projects initiated by the Jordanian government or for which Jordanian government will enter into a project agreement, ensure sale or grant exemption
2	Ministry of Finance recommendation for the Cabinet approval of Jordanian government guarantee agreement	Ministry of Finance	To power generation projects for which the government will provide guarantee
3	Cabinet resolution approving the project, signing of the project agreement and the implementation of the government guarantee and authorizing the Minister of Finance to sign the government guarantee agreement	Cabinet	To power generation projects for which the government will sign the project agreement and provide guarantee, ensure sale or grant exemption
4	(1) Generation license (2) Transmission license (3) Distribution license	EMRC	To power generation, transmission and distribution projects respectively

No.	Approvals	Competent authorities	Applicable
5	EMRC resolutions: (1) Approving the signing of the electricity purchase or grid connection agreement, and granting the license (2) Authorizing the EMRC chairman to sign the electricity purchase or grid connection agreement and issuing the license	EMRC	/
6	Contractor registration certificate		
7	Water abstraction license	Ministry of Water and Irrigation	To power generation projects that require water abstraction on a large scale
8	JIC license for economic activities after the project company registers with JIC	JIC	To power generation projects in the development zones
9	Construction permit	Municipal authority of the project location	/
10	Approval of environmental and social impact assessment	Ministry of Environment	/
11	Import license for the project company' s import of special machinery, equipment, parts, materials and supplies needed for the project	Ministry of Industry and Trade	To import of certain controlled products that require special licenses
12	Residence and work permits for foreign employees	Ministry of Labour	To projects for which foreign employees are employed
13	Approved internal regulations of the project company	Ministry of Labour	If the project company has 10 or more employees
14	Certificate of registration of foreign contractors	Jordan Construction Contractors Association; Jordanian Engineers Association	If the project contractor is a foreign entity
15	Certificate of registration of construction and operation and maintenance agreements	Jordan Construction Contractors Association	/
16	Certificate of no objectionagreements	Civil Aviation Regulatory commission	To projects whose construction and operation may affect the aircraft overhead

Key approvals for power projects in Jordan

The above table only shows the key approvals required for power projects in Jordan. For particular projects, investors are recommended to seek advice from a Jordanian counsel to make judgments based on specific project conditions.

(III) Renewable energy compensation policies

1. Tax incentives

In accordance with the Jordan' s Renewable Energy & Energy Efficiency Law of 2012, for a renewable energy project, the project company will be entitled to a reduction or exemption from corporate income tax for a period of 10 years from the first taxable year of operation. The developer, project company and contractor will be exempt from all duties and taxes that would otherwise be payable for the import of any equipment (fixed assets) related to the project. The project company will be exempt from the stamp duty that may be payable for the project and all project related agreements, including but not limited to project agreements, financing documents, land lease agreements, any agreements with the project company' s subsidiaries, contractors and subcontractors and any other agreements necessary for the implementation of the project. All duties and sales taxes will be exempt for all renewable energy and energy efficiency improvement systems and equipment and items such as consumables used in the production, whether locally manufactured or imported.

2. Government incentives

In addition to the tax preferences above, the Jordanian government also provides government guarantees for the fee payment obligations in relation to eligible renewable power projects.

IV. Renewable energy projects in Pakistan

In terms of energy structure, Pakistan' s power industry is dominated by thermal power generation, with oil and gas power generation accounting for about 60% of the total power generation capacity. As oil and gas are the main fuels, the cost of power generation is relatively high. In terms of energy supply, electricity has been undersupplied for a long time in the market. With the acceleration of Pakistan' s industrialization process, power demand continues to grow and the shortage of power supply is becoming increasingly prominent in the country.

In recent years, the Pakistani government has focused on the development and utilisation of renewable energy, hoping to address the growing energy supply shortage through energy structure reform. According to the Alternative & Renewable Energy Policy 2020, Pakistan is committed to increasing the share of renewable energy in the total power generation from the current 6% to 25% by 2025, and further to 30% by 2030. According to the National Electricity Policy adopted in 2021, Pakistan plans to increase the share of renewable energy in the energy structure. Specifically, the Pakistan' s energy structure reform will focus on encouraging and supporting the development and utilisation of renewable energy sources such as solar, wind, geothermal, tidal, wave and biomass. Considering the power generation costs and stability, priority will be given to the layout of relevant projects in areas suitable for the development of renewable energy generation projects.

(I) Foreign investment screening regime

To attract foreign investment, Pakistan has implemented an open foreign investment management regime. Under the Investment Policy 2013, except for sectors where investment is restricted to safeguard national and public security (mainly those arms and ammunition, potent explosives, radioactive substances, special printing, banknote printing, minting and consumer alcohol), Pakistan has no access restrictions on foreign investment, domestic and foreign

investors enjoy the same preferential investment policies, and the same investment conditions apply to foreign investors in special industries.

Foreign investors are generally not required to obtain approval from the government of Pakistan for investments in Pakistan, except for the security clearance from the Ministry of Interior. According to the Ministry of Interior, all foreign shareholders and individuals are required to obtain security permission from the Ministry of Interior before they are registered as shareholders, directors or chief executive officers of a Pakistani company. Due to the length of time it takes to obtain a security clearance, such requirements have been relaxed at present. Foreign shareholders, directors or CEOs may be registered prior to the formal security clearance, provided that they have made the relevant commitment. Investors are recommended to seek advice from a Pakistani counsel on national security clearance, if necessary.

(II) Project approvals

1. Competent authorities

In Pakistan, the competent authorities in the electricity sector include:

National Electric Power Regulatory Authority (NEPRA) - regulating the power service industry, including the verification of pricing, determination of tariffs and other related terms and conditions for the provision of electricity services by power generation, transmission and distribution companies.

Alternative Energy Development Board (AEDB) - encouraging, facilitating, and promoting the development of renewable energy in Pakistan; reviewing private power generation projects to enter the renewable energy sector, encouraging the transfer of renewable energy technologies, promoting the development of related local industries, providing services for power generation projects using renewable energy sources, and promoting the commercialization of renewable energy projects.

Private Power and Infrastructure Board (PPIB) - promoting, evaluating and negotiating investment projects in the power sector throughout Pakistan.

In addition, the construction of power projects may also involve government agencies such as the Ministry of Water and Power, the Board of Investment, the Ministry of Petroleum and Natural Resources, the Environmental Protection Agency, and the Competition Commission.

2. Project approvals

In Pakistan, the construction of power projects requires a license issued by NEPRA. Depending on the actualities of power projects, NEPRA licenses are divided into generation, transmission and distribution licenses (collectively referred to as "NEPRA licenses"). When submitting an application for the NEPRA licenses, the project company should indicate in the application the type, location and expected life cycle of the facility.

Power projects involving renewable energy sources also should complete the project registration procedure with the AEDB and obtain a letter of intent and a letter of support issued by the AEDB.

In addition, the construction and operation of power projects in Pakistan may also require tariff approvals from NEPRA, approvals from the environmental protection authorities for preliminary EIA or EIA reports, land related approvals, approvals for land surveys for projects, approvals for feasibility studies, project construction permits, import and export permits, and power hub stability certificates (if required). For specific projects, investors are therefore recommended to seek advice from a Pakistani counsel.

(III) Preferential tax policies and support policies for renewable energy

1. Preferential tax policies

In order to overcome the energy crisis and facilitate the industrialisation process of the country, Pakistan' s Finance Act, 2015 grants a certain period of income tax exemption to specific energy companies, including:

(1) A 10-year income tax exemption for power transmission and transformation projects commencing after 1 July 2015;

(2) Income tax exemption stated in the above paragraph (1) for project companies registered under the Companies Ordinance, 1984 that operate power transmission and transformation if they meet certain requirements; and

(3) A five-year income tax exemption for LNG terminal operators and solar and wind energy equipment manufacturers if they are established after 31 December 2016 and manufacture products exclusively for use of solar and wind generation companies.

In addition, project companies using renewable energy sources for power generation are exempted from corporate income tax under the Alternative and Renewable Energy Policy 2019.

2. Support policies

In accordance with the AEDB' s Policy for Development of Renewable Energy for Power Generation, 2006 applicable to hydropower, wind and solar power projects, the main supporting policies for renewable power generation projects in Pakistan include:

(1) Hydropower projects. In view of the huge potential of hydroelectric power generation in Pakistan and the lower actual exploitation and utilization, the country plans to promote the development of hydropower projects in areas rich in hydro resources according to the Pakistan "Vision 2025".

(2) Solar power projects. Pakistan supports solar power generation projects, and plans to promote solar residential programs to ease the power shortage for residents in various provinces.

(3) Wind power projects. Pakistan supports wind power generation projects, and gradually promotes the commercialization of wind power projects.[1]

Thanks to paralegals Wang Fanyuan, Huang Zelin, Wei Zhen, Li Wenting and Li Hangyu for their contributions to this article.

[1] This article is intended to offer an introduction to some key issues in investing in renewable energy projects in Brazil, Egypt, Jordan and Pakistan, rather than a comprehensive and all-encompassing overview. In specific projects, investors are advised to pay attention to the local legal requirements on antitrust, environment, labor and other aspects. For the foreign investment screening regimes and approvals and subsidies for renewable energy projects mentioned in this article, investors should also seek specific advice from a counsel. None of the co-authors of this article is a lawyer registered in Brazil, Egypt, Jordan or Pakistan. This article is only a summary of our experience from relevant projects. This article does not constitute any legal advice on the laws of these jurisdictions. If you have any questions about the above contents, please contact us and we will provide you with solutions through our global network.

OVERVIEW OF THE RENEWABLE ENERGY INDUSTRY AND ITS REGULATION IN SOUTH AFRICA

Xiong Jin, Chen Lan

I. Overview of the South African energy market

South Africa is the world' s sixth largest thermal power producer, with up to 80% of its electricity generated from thermal (coal) power. As a result, South Africa is also the most significant greenhouse gas emitter in Africa. As a signatory to the Paris Agreement, South Africa will need to reduce its carbon emissions by 60-75% by 2050.

To achieve its national strategy of achieving carbon neutrality by 2050, the South African government published its Integrated Resource Plan (IRP) in 2010, a long-term power planning target that sets out the proportion of renewable energy in its energy mix, to plan for the country' s power development through 2030. The IRP states that, by 2030, South Africa' s energy portfolio will consist of 33,847 MW of coal (46%), 1,860 MW of nuclear (2%), 4,696 MW of hydro (6%), 2,912 MW of pumped storage (4%), 7,958 MW of solar PV (10%), and 11,442 MW of wind (14%).

The development of renewable energy projects in South Africa is primarily based on the Renewable Energy Independent Power Producer Procurement Programme (REIPPP) developed by the Department of Mineral Resources and Energy (DMRE) and the National Energy Regulator of South Africa (NERSA). The REIPPP introduces independent power producers through competitive bidding and allows private companies and foreign investors to invest in and develop renewable energy projects in South Africa. The South African government hopes that the introduction of the REIPPP system will substantially improve South Africa' s current energy supply structure, which is still largely dependent on thermal power generation, and alleviate the long-standing power supply shortage crisis. Previously, the NERSA introduced the Feed-in Tariff in 2009. It was fully replaced by the REIPPP in 2011, however, as subsidized tariffs continued to fall and the Feed-in Tariff was declared non-competitive under South African law. Another important feature of the South African electricity market is that approximately 94% of electricity in South Africa is supplied by Eskom Holdings SOC Limited (Eskom), a South

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African state-owned company, while the remaining 6% is provided by municipal power stations and private entities. Introducing independent power producers and foreign-owned companies will help break Eskom' s long-standing monopoly on the South African electricity market.

The *National Energy Regulator Act* (2004), the *National Energy Act* (2008), the *Electricity Regulation Act* (2006), and the related supporting regulations constitute the regulatory framework for electricity and renewable energy in South Africa. Under the *National Energy Regulator Act*, South Africa established the NERSA, which is responsible for regulating the power, pipeline gas, and petroleum pipeline industries. The *Electricity Regulation Act* establishes the national regulatory framework for the electricity supply industry in South Africa, makes NERSA the regulator and enforcer of the national electricity regulatory framework, and provides for the licensing and registration of municipal electricity generation, transmission, distribution, gridding, trading, import and export. The *National Energy Act* requires the DMRE to provide a variety of energy resources in sustainable quantities and at reasonable prices to support economic growth and poverty alleviation, taking into account environmental management requirements.

In terms of regulatory agencies, the DMRE, the NERSA, and Eskom are the main regulators of the energy market in South Africa. The DMRE is not only responsible for the procurement, development, utilization, and management of energy in South Africa, but also responsible for developing regulatory policy on renewable energy and providing strategic support. Besides, the DMRE is also in charge of the REIPPP tender process. The NERSA is primarily responsible for approving the relevant permits involved in the construction and operation of power stations, power generation, distribution and transmission. Eskom is a power generator, power station operator and power purchaser, which is also responsible for supervision. As Eskom is the owner and maintainer of the National Grid of South Africa, any grid-related activities such as power distribution and transmission as well as power import and export trade and the signing of long-term power purchase agreements under the REIPPP framework must be preceded by the conclusion of a transmission agreement or power distribution agreement with Eskom.

II. Concerns of investors

South Africa has no general restrictions on foreign investors in the renewable energy sector, but investors need to pay particular attention to the following issues, which significantly impact on investors' participation in REIPPP bidding and the development of renewable energy projects after winning the bid.

(I) Land issues

The acquisition of suitable project land is critical to the development of renewable energy projects.

Land in South Africa is either privately or state-owned. According to the provisions of the *Land Holdings Bill* (which is still a draft bill at present), foreign investors are no longer permitted to own certain types of land in South Africa (such as agricultural land). However, they are allowed to enter into long-term leases for 30-50 years in respect of all types of land.

Typically, bidders bidding for renewable energy projects in South Africa are required to provide in their bid response documents either a **title deed** or a **notarial lease** and related lease registration document for the project site, or a valid option agreement for the sale or lease of the land and a servitude agreement. To control transaction costs, bidders often enter into a lease option agreement with the land owner and then exercise the option to enter into a lease for the land after winning the bid. For this purpose, the bidder is required to pay a small fee, and the option agreement usually provides for an exercise period of 3-5 years (depending on the business negotiations between the parties). Investors must pay particular attention to whether the exercise period of the land lease option agreement is compatible with the window of bidding in order to consider whether the option agreement needs to be extended.

Some notarial leases provide that the land owner has the right to unilaterally terminate the notarial lease if the project fails to be closed within a certain period of time.

Regardless of whether an investor acquires the land rights to meet the project requirements through the execution of a notarial lease or a land lease option agreement, if the relevant land in question is agricultural, the investor will be subject to additional restrictions imposed by the Department of Agriculture, Forestry and Fisheries (DAFF). Specifically, the investor must obtain the consent of the Minister of the DAFF before signing a notarial lease with the land owner, and no lease on any agricultural land may be entered into for more than 10 years unless the Minister' s consent is obtained. In addition, if the investor enters into an option agreement with the land owner concerning a long-term lease of agricultural land, such option agreement may be void if the consent of the Minister of the DAFF is not obtained prior to the execution of such option agreement, according to a recent decision of the Supreme Court of Appeal of South Africa.[1] In practice, however, given the time and cost required to obtain the consent of the relevant ministers, most investors would largely not consider obtaining such consent, and the market seems to have accepted this potential risk.

(II) Broad-based Black Economic Empowerment

The Broad-based Black Economic Empowerment (B-BBEE) in South Africa' s *Broad-based Black Economic Empowerment Act* of 2003 is designed to redress the inequalities of apartheid and promote black participation in the South African economy. The South African government has also introduced a number of relevant implementation rules to ensure the implementation of the B-BBEE. In evaluating the B-BBEE, the South African government scores enterprises on the following factors: ownership, management control, skills development, enterprise, supplier development, and socio-economic development, in order to ensure the percentage of black South Africans in the economic program.

In South Africa, compliance with B-BBEE is not mandatory by law. However, a higher B-BBEE rating allows enterprises to remain competitive in the South African market. The B-BBEE rating can enable enterprises to remain competitive in the South African market, and is also an important evaluation factor in the government and public entities' bidding and licensing processes. In addition, the South African government also specifies in the bidding documents for a REIPPP project the B-BBEE requirements for bidders. For example, the combined shareholding of the South African entity in the target company must exceed 49% (see the table in Part III (III) below).

(III) Environmental permits

Participation in the South African government' s renewable energy tenders requires an environmental permit under South Africa' s *National Environmental Management Act* of 1998. Usually, it requires the tender to submit a full environmental impact assessment or basic assessment report. The South African government has very stringent requirements for environmental assessments. Environmental permits are usually the most difficult to obtain among the relevant licenses and permits required for a project. For example, whether wind power and photovoltaic (PV) projects will affect the living environment of animals such as birds, destroy biodiversity, destroy vegetation and encroach on historical sites during construction are all factors that need to be considered when selecting a site for a project. Therefore, investors who purchase or invest in greenfield projects need to pay special attention to whether the project has obtained relevant environmental permits.

[1] Four Arrows Investments 68 v Abigail Construction (SCA) (Unpublished Case No.: 20470/2014, 17-9-2015)

(IV) Foreign exchange controls

In accordance with South Africa' s *Exchange Control Regulations* promulgated in 1961, South Africa' s capital inflows and outflows are subject to regulation. Such regulation is enforced by the South African Reserve Bank (SARB) and its authorized dealers (which are designated South African commercial banks).

Under the *Exchange Control Regulations*, no South African company or individual may own foreign assets or borrow from a foreign country without approval. With the approval of the financial regulators, South African residents may freely remit after-tax profits to shareholders, individuals, or companies that are not South African residents. However, only South African residents are subject to such restrictions. In general, there are no restrictions on the outward remittance of non-resident investment income. Foreign investors investing in shares in South African companies are required to make a declaration to the authorized dealer and confirm that the share certificate bears the word "Non-resident" as indicated by the authorized dealer, in order to remit out of the country proceeds such as dividends in the future. In practice, such applications for the SARB approvals are handled directly by the authorized dealer. The latest practice shows that foreign acquisition of shares in a South African company requires no prior consent or notice of non-objection from the SARB through an authorized dealer before the settlement of shares but a filing after the settlement (with the assistance of the seller).

(V) Project financing

Currently, the renewable energy projects in the South African market are mainly funded by the five major commercial banks (Rand Merchant Bank, ABSA, Nedbank, Standard Bank and Investec) as well as development finance institutions and pension funds. Moreover, most REIPPP projects are financed by limited or non-recourse project financing.

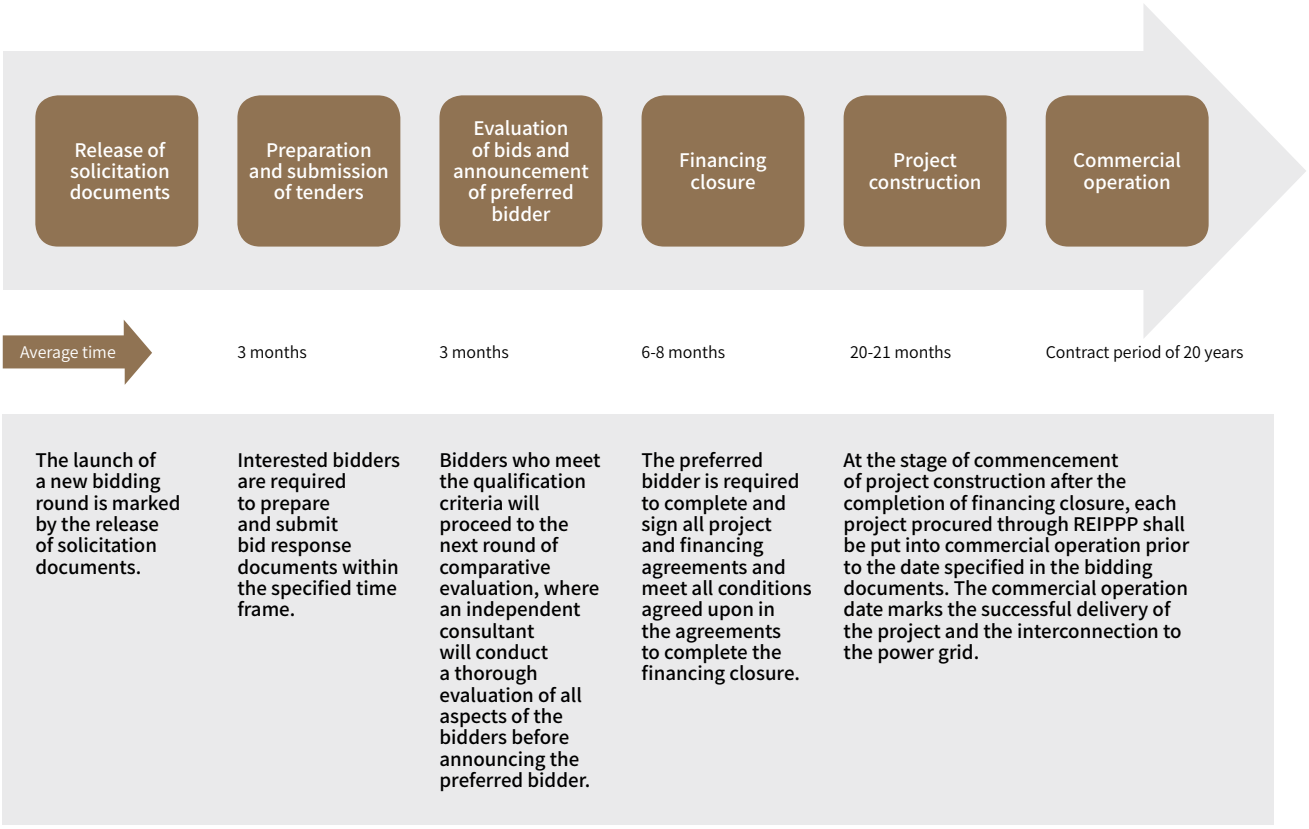
There are certain restrictions on financing by foreign investors in South Africa. Specifically, companies in which more than 75% of the share capital and assets are owned by non-residents of South Africa or in which 75% of revenues are distributed to non-residents of South Africa, and in which more than 75% of the voting rights and control are dominated or represented by non-residents of South Africa, are considered "affected companies". Any local financing by these companies in South Africa requires the prior consent of the SARB, and and the financing amount will be limited.

III. Introduction to REIPPP projects

REIPPP is a public procurement program that allows independent power producers (IPPs) to design, develop and operate large-scale renewable energy power plants in South Africa through competitive bidding. REIPPP is essentially a public-private-partnership (PPP) project. The South African government wants to attract and leverage private and foreign capital to develop its renewable energy industry through such public-private partnership. REIPPP is of great significance in alleviating the current power shortage in South Africa and prompting South Africa' s transition to a low-carbon economy.

(I) Launch of REIPPP

REIPPP is designed as a multi-round non-public bidding auction, starting with the release of the solicitation documents. REIPPP has already conducted six rounds of bidding as well as an accelerated round of bidding. The bidding period is typically three months after the issuance of the solicitation documents. An independent bid evaluation committee will pre-screen bidders that meet the general requirements and qualification criteria, who will then proceed to a subsequent comparative evaluation. An illustration and timeline of the entire REIPPP process from bidding, financing closure to commercial operation is shown below.



(II) Qualification examination

Solicitation documents specify the general requirements and qualification criteria for bidding enterprises. Generally, only those projects that meet the technical, financial and legal requirements can enter the comparative evaluation phase, and the bidding enterprises must have sufficient experience and resources to carry out such projects. Therefore, a bidding enterprise is considered qualified only when each item in its tender meets or exceeds the specified criteria for a project.

The qualification criteria listed in the solicitation documents of REIPPP' s first six rounds of bidding include but are not limited to:

- Project structure: the project company shall be a limited liability company under South African law, meet the criteria for risk segregation under the *Companies Act*, and satisfy the requirements for black shareholding as well as local community shareholding;
- Legal criteria: the project company shall be a special purpose vehicle (SPV) for the project under the tender, and shall issue a confirmation letter of full acceptance of the standard agreement;
- Land acquisition and land use criteria: the project company is required to provide land deeds, option agreements, notarized leases and easement agreements for the land required for project construction;
- Environmental permit criteria: the project company is required to provide environmental assessment documents, environmental authorizations and water use permits;

- Financial criteria: there are different requirements depending on the type of financing;
- Technical criteria: technical assessment of the project company, including the provision of an energy sales forecast report;
- Local economic development requirements: contribution to local employment and local procurement.

(III) Comparative evaluation

All bidders who meet the examination criteria are eligible to enter the comparative evaluation phase. In this phase, all bidders are scored on two dimensions: the **bid price** and the **contribution to local economic development**. According to both the fifth round and the sixth round bidding documents, 90% of the total score is for bid price (70% in the first four rounds) and 10% for contribution to local economic development (30% in the first four rounds). The top bidder in the overall score is the preferred bidder who wins the bid.

In terms of contribution to local economic development, the South African government sets out a number of requirements in the solicitation documents for the percentage of black and local community participation in the REIPPP. Specifically, bidders will be required to demonstrate that at least **49%** of the shares in the project company are held by South African entities (penetrating to the top tier of shareholders). At the same time, the solicitation documents provide detailed criteria for assessing contribution to local economic development from different perspectives, some of which are listed in the table below:

Assessment dimension	Requirements	Threshold
Job creation	Proportion of South African employees	65%
	Proportion of black South African employees	40%
	Proportion of black technical employees	20%
	Proportion of employees from the local community where a project locates	20%
	Proportion of black women employees	10%
Ownership	Black shareholding in the project company	30%
	Local community shareholding in the project company	2.5%
	Black women shareholding in the project company	5%
	Black shareholding in the construction contractor	25%
	Black shareholding in the operating contractor	25%
Requirements for local procurement	Proportion of local procurement during the construction and maintenance of the project	40% (wind power) 45% (PV)
Management control	Black representation on the board of directors	25%

(IV) Execution of standard agreements

Upon winning the bid, the preferred bidder shall sign and fully accept the standard agreements which may include but are not limited to the followings, with no room for negotiation with the South African government (or Eskom).

- **Power Purchase Agreement (PPA)**: which shall be signed by the preferred bidder' s project company and Eskom, mainly agreeing on power purchase price, etc. In developing standard agreements, consideration will be given to making the PPA meet the requirements for fundability;
- **Implementation Agreement**: which shall be signed by the project company and the DMRE, mainly agreeing on the objective of promoting local economic development, as well as imposing restrictions on changes in the project company' s shareholding and IPP' s transfer of its relevant licenses;
- **Framework Agreement**: which shall be signed by the DMRE, the South African National Treasury, Eskom and the NERSA, aiming at providing further agreement on the guarantee responsibilities to be assumed by the South African government under the Implementation Agreement to ensure that Eskom has sufficient funds to pay for the power;
- **Direct Agreement**: which shall be signed by the preferred bidder, Eskom, the DMRE and the lender, mainly agreeing on the protection of the lender' s rights and interests. The lender may enjoy step-in rights under agreed circumstances;
- **Connection Agreement**: the specific agreement arrangement depends on whether the project is connected to the transmission network or the distribution network.

As of December 2020, 112 IPPs have signed long-term power purchase agreements through REIPPP for the injection of more than 6,300 MW of electricity into the grid, which is mainly generated by solar and wind projects.

Conclusion

In general, the South African government has constructed a comprehensive legislative framework and supporting regulatory system for power regulation that are largely in line with those of major developed countries. However, due to South Africa' s long-standing reliance on thermal power generation and the inefficiencies associated with Eskom' s absolute monopoly position in the market, South Africa is facing a severe power crisis and is under pressure to meet the carbon emission reduction targets under the Paris Agreement. In recent years, the South African government has been actively pursuing a sustainable approach to restructuring the energy mix and enhancing the power supply, including building a comprehensive legal framework for climate change and launching a large-scale renewable energy investment program to introduce IPPs.

The global COVID-19 pandemic has disrupted the bidding plan of the REIPPP in South Africa, and the South African government has postponed the fifth round of bidding twice. In the sixth round of bidding, the total purchase volumes of wind and PV power are 3,200 MW and 1,000 MW, respectively. However, based on our recent project experience, Eskom' s current operating grid does not have the load capacity to meet the future feed-in requirements of these planned renewable energy developments. As a result, many of the proposed renewable projects cannot be developed.

The South African government' s strong policy support for renewable energy projects, and the great investment opportunities and potential in its market have attracted international energy investors, including Chinese investors. They have begun to focus on investment opportunities in the country' s renewable energy industry, especially in the wind power and PV sectors. Chinese investors may enter the South African renewable energy market by selling or supplying wind turbines and PV modules, participating in project construction as a general contractor, or establishing

joint ventures with local enterprises as bidders for renewable energy projects. Chinese investors' major projects include: in 2013, a Chinese company which is one of the largest wind power generators in Asia won the award of two wind power projects in the third round of REIPPP; a Chinese listed company in the wind power sector has been awarded wind turbine purchase orders and EPC works for several projects won by BioTherm, a South African renewable energy development giant, since 2015; in 2018, Zhongsheng Energy and CanadianSolar established a project joint venture in South Africa to provide general contracting services for EPC projects of BioTherm. It is foreseeable that South Africa, as an important investment destination along the "Belt and Road," will continue to attract Chinese investors with its huge renewable energy market potential.[2]

[2] References:

(1) *Electricity Regulation 2021-South Africa*, by Jonathan Behr from Werksmans Attorney.

(2) *Electricity regulation in South Africa: Overview*, by Eric Le Grange from ENS Africa.

(3) *Renewable Energy Law Review-South Africa*, third edition, by Lido Fontana and Yolanda Dladla.

(4) *Renewable Energy 2021 - South Africa, ICLG*, https://iclg.com/practice-areas/renewable-energy-laws-and-regulations/south-africa.

(5) *The South African Renewable Energy, IPP Procurement Programme*, by Anton Eberhard and Raine Naude.

INTRODUCTION TO BRI COUNTRY — VIETNAM[1]

Peng Fu, Lv Yu, Huang Xixi

Located in the east of the China-Indochina Peninsula, Vietnam, with a long coastline of more than 3,260 kilometres, has rich and diverse population composition and religious cultures. With the adherence to opening up in recent decades, the country is increasingly unleashing its economic potential. The relatively stable domestic political situation has laid a solid foundation for its development[2], and various preferential policies for foreign investment have made it especially attractive to foreign investors[3].

Considering Vietnam' s current high openness to foreign investment and its role in promoting the Belt and Road Initiative (BRI), this article briefly combs Vietnam' s investment environment there.

I. Overview of the investment environment

(I) Advantages and disadvantages

1. Advantages[4]:

(1) The relatively stable political situation and coherent policies;

(2) Abundant natural resources: Vietnam has more than 50 kinds of mineral deposits with large reserves of coal, iron and aluminium. With a forest area of about 10 million hectares, the country has a high forest coverage rate;

(3) Superior geographical location and numerous ports, facilitating export to East and Southeast Asian markets;

(4) Sufficient, hardworking and low-cost labour force; and

(5) Promising economic growth prospects and a relatively high degree of openness.

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[1] King & Wood Mallesons does not provide legal advice under the Vietnamese law. This introduction is for general information only and should not constitute or be construed as advice on the laws of Vietnam.

[2] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, pp. 1-14.

[3] Please see the analysis of investment incentive policies in Vietnam below.

[4] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, pp.1-14 and p. 36.

2. Disadvantages:

(1) The credit status of local enterprises varies considerably, posing certain risks for cooperative operation[5];

(2) Foreign exchange control in Vietnam is relatively strict, and VND and RMB cannot be exchanged directly[6];

(3) Vietnamese labour unions play an important role in labour negotiations, which may affect investors' interests[7]; and

(4) The low education level of Vietnam' s labour force makes it less attractive to foreign investment in some high-tech areas[8].

(II) Investment in Vietnam

According to a report by Vietnam Investment News on 27 January 2022, as of 20 January 2022, Vietnam' s newly approved investment, additional investment and mergers and acquisitions have attracted more than USD 2.1 billion of foreign investment, up 4.2% year-on-year. Among them, 103 projects were newly approved, with an agreed investment of USD 388 million, down 70.7% year-on-year; 71 receive increased investments with an agreed capital increase of USD 1.27 billion, up 54.3% year-on-year in number, and 2.69 times the investment amount compared with the same period last year. 206 mergers and acquisitions involve an investment of USD 444 million, up 6.2% year-on-year, and the investment amount is twice that of the same period last year. These foreign investments cover 15 of Vietnam' s 21 economic sectors. Among them, the processing and manufacturing industry attracts USD 1.2 billion, accounting for 58.9% of the total foreign investment; real estate ranks second with USD 472 million, accounting for 22.5%; followed by the administrative and support services, and the wholesale and retail industry with the agreed investment of USD 221 million and USD 52.5 million respectively. The sources of investment come from 33 countries and regions. Singapore, the largest investor, accounts for 31.7% of the total foreign investment with USD 666 million, down 2.2% from the same period of last year; the Republic of Korea ranks second with USD 481 million, accounting for 22.9%, five times the amount compared with the same period of last year; and Chinese mainland ranks third with USD 451 million, accounting for 21.5%, down 27% from the same period of last year, followed by Japan, Hong Kong SAR of the PRC and China' s Taiwan region. As of 20 January 2022, Vietnam has approved 34,642 foreign-invested projects with an agreed investment amount of USD 415.6 billion. The funds in place were USD 253.2 billion, equivalent to 61% of the total investment amount[9]. Despite the COVID-19 pandemic, investment in Vietnam has expanded in scope and volume as shown from the above aspects.

At present, the Chinese Chamber of Commerce is now stationed in all major cities in Vietnam, including Ho Chi Minh City, Ha Long City, Hai Phong City, Hanoi City. The major Chinese-invested enterprises in Vietnam are involved in infrastructure construction, high-tech, finance, textile, processing and manufacturing, communications and many other fields[10].

[5] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, p. 92.

[6] See below for details on exchange control.

[7] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, p. 95.

[8] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, p. 15.

[9] "Vietnam attracted more than USD 2.1 billion in foreign investment in January," the Ministry of Commerce, China, available at http://hochiminh.mofcom.gov.cn/article/jmxw/202202/20220203280130.shtml.

[10] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, pp. 112-116.

(III) Foreign exchange control and financial system

The *Ordinance on Foreign Exchange Control* issued in 2005 is the main foreign exchange regulation in Vietnam. The State Bank of Vietnam (SBV) is the central bank of Vietnam[11] that is responsible for the implementation of the *Ordinance on Foreign Exchange Control* and other national policies and regulations on foreign exchange regulation[12]. In general, the Vietnamese government imposes relatively strict control over foreign exchange. Foreign currency cannot be used directly for recurring payments, nor can it be freely exchanged. Foreign exchange-related transactions may only be conducted through authorised credit institutions or other means permitted by the regulations of the SBV[13].

Vietnam' s commercial banks mainly include four state-owned banks, i.e. Joint Stock Commercial Bank for Investment and Development of Vietnam (BIDV), Joint Stock Commercial Bank for Foreign Trade of Vietnam (Vietcombank), Vietnam Joint Stock Commercial Bank for Industry and Trade (VietinBank) and Vietnam Bank for Agriculture and Rural Development (Agribank), as well as 31 joint-stock commercial banks. Most of the foreign banks are from Japan, the Republic of Korea, the United States, China and China' s Taiwan region. The major Chinese banks are the Bank of China, Industrial and Commercial Bank of China, Agricultural Bank of China, China Construction Bank and Bank of Communications[14].

As to the repatriation of profits, although Vietnam cannot directly use foreign exchange for profit payment, investors may remit the profits converted into foreign currencies abroad. So long as the source of profits is legal, investors will not be subject to much restrictions when remitting profits out of Vietnam[15]. It should be noted that credit institutions, branches of foreign banks and other institutions are authorised to conduct foreign exchange services with written approval from the SBV. The business scope, conditions, requirements and procedures for such institutions to provide foreign exchange services are regulated by the SBV[16].

As to the control of the inbound and outbound foreign exchange, Vietnam has set strict control measures for individuals to bring foreign currency into and out of the country. When an individual enters Vietnam, if the amount of foreign currency he/she carries exceeds the limit set by the SBV, he/she should declare it to the Customs; when an individual exits Vietnam, if the amount of foreign currency he/she carries exceeds the limit, he/she should not only declare, but also presents to the Customs the relevant documents specified by the SBV[17].

As to the exchange rate, the exchange rate between Vietnam' s official currency, VND, and foreign currencies is determined by market supply and demand. The specific exchange rate is announced by the SBV[18]. Since the introduction of the new exchange rate management mechanism in early 2016, Vietnam has replaced the long-standing fixed exchange rate mechanism with the "central bank' s daily reference exchange rate price"[19]. On 29 March 2022, the SBV announced the reference central parity rate of the USD/VND exchange rate to be USD 1/VND 23,151, and the RMB/

[11] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, p. 32.

[12] See chapters of Ordinance on Foreign Exchange, No. 28/2005/PL-UBTVQH11 on State Bank of Vietnam.

[13] Article 1.13, AMENDING AND SUPPLEMENTING A NUMBER OF ARTICLES OF THE ORDINANCE ON FOREIGN EXCHANGE CONTROL, No. 06/2013/UBTVQH13.

[14] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, pp. 32-33.

[15] Article 8.4, Ordinance on Foreign Exchange, No. 28/2005/PL-UBTVQH11, which was not amended in 2013.

[16] Article 1.27, AMENDING AND SUPPLEMENTING A NUMBER OF ARTICLES OF THE ORDINANCE ON FOREIGN EXCHANGE CONTROL, No. 06/2013/UBTVQH13.

[17] Article , 1.3, AMENDING AND SUPPLEMENTING A NUMBER OF ARTICLES OF THE ORDINANCE ON FOREIGN EXCHANGE CONTROL, No. 06/2013/UBTVQH13.

[18] Article 30.1, Ordinance on Foreign Exchange, No. 28/2005/PL-UBTVQH11 ; Article 1.20, AMENDING AND SUPPLEMENTING A NUMBER OF ARTICLES OF THE ORDINANCE ON FOREIGN EXCHANGE CONTROL, No. 06/2013/UBTVQH13.

[19] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, p. 31.

VND exchange rate to be RMB 1/VND 3,636.72 (for the period from 24 March 2022 to 30 March 2022)[20]. According to the Vietnam News Agency, Vietnam' s external debt outstanding structure has been gradually optimised. S&P Global Ratings expects Vietnam' s average annual external debt ratio to be 15% in 2021-2024. The Vietnamese government' s foreign debt ratio has dropped below 40%, indicating a decline in exchange rate risk[21].

As to financing, foreign-invested enterprises enjoy the same treatment as local enterprises. When providing loans, banks or other financial institutions need to consider borrowers' borrowing needs and repayment capacities, as well as their financial capabilities. Based on prudential requirements, the proportion of the borrowings provided by a bank to a single customer or a group customer to the bank' s capital shall not exceed the prescribed upper limit (15% in the case of a single customer and 25% in the case of a group customer). If a customer' s borrowing needs exceed the maximum capital available from a bank, the customer may consider applying for a syndicated loan[22]. In 2019, when allocating credit growth limit for each commercial bank, the SBV gave priority to the commercial banks that have met the capital security and risk management standards stipulated in Basel II to ensure the safety of the national financial system[23].

II. Main foreign investment laws and regulations

(I) Foreign investment regulation

The legal policies of Vietnam are friendly to foreign investment, making it an attractive investment destination. Since the *Law on Investment* was initially released in 2006, Vietnam has been providing equal treatment for domestic and foreign-invested enterprises and encouraging foreign investment in certain industries and regions. The unified administration of domestic and foreign-invested enterprises is mainly reflected in the restrictions of export commodities and services, the proportion of localization in commodity production, and the required level of research and development. As for the preferential policies to encourage foreign investment, Vietnam has provided different preferential treatment concerning land acquisition costs, taxes and fees payable by enterprises as well as visas of foreign workers, for foreign-invested enterprises investing in difficult areas designated by the state, as well as in the encouraged industries[24]. Currently, except for very few industries which endanger the national interests or social public interests, foreign investors may engage in all other freely or when meeting statutory conditions.

1. Categories of industries for market access by foreign investors

Banned business lines: narcotics trading specified in Appendix I of the Law on Investment of Vietnam; trade in the chemicals and minerals specified in Appendix II of the Law on Investment of Vietnam; trading of endangered species of wild fauna and flora and their specimens; prostitution; human trafficking; trade in human tissues, corpses, human organs and human fetuses; commercial activities involving asexual human reproduction; and trade in firecrackers and provision of debt collection services[25].

Conditional business lines: conditional business lines are the business lines in which the investment must satisfy certain conditions for reasons of national defence and security, social order and security, social ethics, or public

[20] See the official website of SBV, available at https://sbv.gov.vn, last accessed on 29 March 2022.

[21] See S&P Global Rating: Vietnam' s Economy Poised for Strong Recovery, Ministry of Commerce, China http://vn.mofcom.gov.cn/article/jmxw/202106/20210603069459.shtml.

[22] Guide for Countries and Regions on Overseas Investment and Cooperation (Edition 2020) issued by the Ministry of Commerce, China, p. 34.

[23] See Central Bank of Vietnam Limits Commercial Banks' Scale of New Loans, Economic and Commercial Office, Embassy of China in Vietnam, available at http://vn.mofcom.gov.cn/article/jmxw/201904/20190402853249.shtml.

[24] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, pp. 48-53.

[25] Article 6, Law on Investment, No. 61/2020/QH14.

health[26]. In accordance with the relevant implementation regulations of the Law on Investment of Vietnam, the conditional business lines mainly involve banking and finance, publication of cultural products, entertainment services, exploitation of natural resources, and real estate[27]. Regulations on investments in conditional industries include the following: (1) subjects and scope of the business investment conditions; (2) form conforming to business investment conditions; (3) contents of the business investment conditions; (4) documentation and administrative procedures for compliance with commercial investment conditions (if any); and (5) valid dates of licenses or certificates or other written confirmation or approval (if any).

Business lines eligible for investment incentives[28] include (1) technology industries: high-tech activities, high-tech ancillary products, research, manufacturing and development in accordance with regulations of law on science and technology; manufacturing of new materials, new energy, clean energy, renewable energy; manufacturing of products with an added value of 30% or more; energy-saving products; manufacturing of key electronics, mechanical products, agricultural machinery, automobiles, automobile parts; ship-building; manufacturing of products on the list of prioritised supporting products; (2) agricultural industries: breeding, growing and processing of agriculture products, forestry products, aquaculture products; afforestation and forest protection; salt production; fishing and fishing logistics services; production of animal and plant varieties and biotechnology products; (3) environment protection and infrastructure construction: collection, treatment, recycling or re-use of waste; investment in development, operation, management of infrastructural works; development of public passenger transportation in urban areas; (4) education, culture, society, sports and public health industries: pre-school education, general education, compulsory education, vocational and higher education; medical examination and treatment; manufacturing of medicinal products and medicinal materials, storage of medicinal products; scientific research on preparation technology and biotechnology serving creation of new medical products; manufacturing of medical equipment; investment in sport facilities; protection and promotion of value of cultural heritage; investment in care centers for vulnerable groups; people' s credit funds, microfinance institutions.

Areas eligible for investment incentives[29] include (1) disadvantaged areas and extremely unfavorable areas; (2) industrial parks, export-processing zones, hi-tech zones, and economic zones. In addition, the Vietnamese government further divides these areas into areas with difficult socio-economic conditions and areas with particularly difficult socio-economic conditions, which enjoy preferential policies and special incentives respectively[30].

2. Forms of foreign investment

(1) Establishing business organisations in Vietnam

Foreign investors may invest in Vietnam through the establishment of business entities, in the forms of capital contribution or purchase of shares, execution of an investment project, and a commercial cooperation contract[31]. For the establishment of a business entity, the foreign investor must have an investment project and follow the procedures for issuing or adjusting an investment registration certificate, except for the establishment of small and medium-sized start-up enterprises and a start-up investment fund in accordance with regulations of the Law on Small and Medium-sized Enterprises; the foreign investor also needs to meet the market access conditions including the scope of investment, investment method, and the proportion of registered capital[32].

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[26] Article 7, Law on Investment, No. 61/2020/QH14.

[27] Appendix 4, Law on Investment, No. 61/2020/QH14.

[28] Article 16, Law on Investment, No. 61/2020/QH14. For the categories of business lines eligible for investment incentives, see Appendix I, Decree No.118/2015/ND-CP, Guidelines for Some Articles of Law on Investment, d November 12, 2015. http://www.itpc.gov.vn/investors/how_to_invest/law/Decree_No.118_2015/mldocument_view/?set_language=en.

[29] Article 16, Law on Investment, No. 61/2020/QH14.

[30] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, p. 51.

[31] Article 21, Law on Investment, No. 61/2020/QH14.

[32] Article 22, Law on Investment, No. 61/2020/QH14.

(2) Contributing capital to local business organizations

Foreign investors may contribute capital to business organisations by purchasing shares of joint-stock companies through the initial public or additional issuance, contributing capital to limited liability companies and partnerships, purchasing shares in a joint-stock company from the company or its shareholders, or stakes of capital contributing members of a partnership[33]. If the capital contribution or purchase of shares or stakes results in a foreign investor holding 50% of the charter capital of the business entity or more, or the majority of the general partners are foreigners, the foreign investor shall go through the procedures for registration of capital contribution or purchase of shares or stakes of a business entity in accordance with the Law on Investment[34].

(3) Executing special investment agreements

Foreign investors may enter into a business cooperation contract (BCC) with other investors for business cooperation and distribution of profits or product sharing without establishing an economic entity. The Law on Investment requires all parties to the BCC to establish a coordinating committee to execute the BCC; the functions, tasks and powers of the coordinating committee shall be agreed by all parties[35]; and stipulates that a BCC shall contain at least the basic information of all parties, objectives and scope of business, capital contribution and distribution of business investment results, schedule and duration of the contract, rights and obligations of the parties to the contract, amendment, transfer and termination of the contract, responsibilities for breaches of the contract and method of dispute resolution[36].

3. Investment incentives for foreign investors[37]

The new version of the Law on Investment implements unified administration on domestic and foreign-invested enterprises so that foreign investors can enjoy the same preferential investment treatment as local investors. Specifically, investors can enjoy the following preferential investment incentives:

(1) Application of a lower rate of corporate income tax for a certain period or throughout the project execution; exemption from and reduction of corporate income tax;

(2) Exemption from import tax on goods imported to form fixed assets; raw materials, supplies, and components for manufacturing purposes;

(3) Exemption from and reduction of land levy and land rents; and

(4) Accelerated depreciation, increasing deductible expenses when calculating taxable income.

Such investment incentives, however, shall only apply to investment projects and enterprises specified in the Law on Investment, specifically including: (1) investment projects in business lines eligible for investment incentives specified in the Law on Investment; (2) investment projects located in the areas eligible for investment incentives specified in the Law on Investment; (3) any investment project that invests at least VND 6 trillion within three years from the date of obtaining the investment registration certificate or the approval of the investment plan and meets one of the following conditions: the total revenue reaches at least VND 10,000 billion per year within three years from the year in which the

[33] Article 25, Law on Investment, No. 61/2020/QH14.

[34] Article 23, 26, Law on Investment, No. 61/2020/QH14.

[35] Article 27, Law on Investment, No. 61/2020/QH14.

[36] Article 28, Law on Investment, No. 61/2020/QH14.

[37] Article 15, Law on Investment, No. 61/2020/QH14.

revenue is earned or the project has more than 3,000 employees; (4) social housing construction projects, investment projects located in rural areas and employing at least 500 employees; investment projects that employ disabled persons in accordance with the provisions of relevant laws on disabled persons; (5) high-tech enterprises, science and technology enterprises and science and technology organisations, projects involving transfer of technologies on the list of technologies the transfer of which is encouraged, and enterprises manufacturing and providing technologies, equipment, products and services with a view to satisfaction of environmental protection requirements; (6) start-up projects, national innovation centers and R&D centers; and (7) commercial investment supporting small and medium-sized enterprises and start-ups.

However, investment projects eligible for these investment incentives do not include mineral mining projects, projects on manufacturing/sale of goods/services subject to special excise tax in accordance with the Law on Special Excise Tax (except for the manufacturing projects of automobiles, aircraft and yachts), and the commercial housing construction projects prescribed by the Law on Housing.

(II) Employment

In accordance with the Vietnam Labour Code, effective on 1 January 2021, employers have the right to recruit employees directly or through employment agencies or dispatching agencies[38].

Unless otherwise stipulated by the Labour Code, foreign employees in Vietnam must have a work permit granted by a competent authority of Vietnam[39]. The maximum duration of a work permit is two years. A work permit may be extended once for up to two more years after the expiration, but only once[40]. Concerning the validity period of the work permit, in addition to the failure to renew the work permit upon expiration, cases in which a work permit is invalid also include: the employment contract is terminated; the contents of the employment contract are inconsistent with the contents of the work permit granted, and the Vietnamese party or foreign organisation that hires the foreign employee ceases its operation[41]. The Labour Code also stipulates certain exceptions for foreign employees in Vietnam. A foreign employee is not required to have a work permit if he/she is the owner or capital contributor, a member of the Board of Directors or other responsible person of his/her organisation; enters Vietnam for less than three months to resolve a complicated technical or technological issue which (i) affects or threatens to affect the business operation and (ii) cannot be resolved by Vietnamese experts or any other foreign experts currently in Vietnam, or gets married with a Vietnamese citizen and wishes to reside in Vietnam[42]. In terms of labour treatment, in addition to the public holidays with pay in Vietnam, foreign employees can also enjoy their own traditional public holidays and National Day holidays in Vietnam[43].

In 2014, the Ministry of Labour, Invalids and Social Affairs of Vietnam issued Circular No. 03/2014/TT-BLDTBXH Providing Guidance on Implementation of Some Articles of Decree No. 102/2013/ND-CP Detailing the Implementation of Some Articles of Labour Code on Foreign Employees in Vietnam (the Circular). In accordance with the Circular, before at least 30 days from the day the employer (except for the contractor) plans for the recruitment of foreign employees, the employer should submit a written report on the demand for employment of foreign labor services to the Ministry of Labour, Invalids and Social Affairs of the place where the employer' s head office is located. The report should include job position, number of foreigners employed, professional level, work experience, salary level, and working period. The employers who have been accepted for use of foreign employees but have changes in demand for

[38] Article 11, Labour Code, No. 45/2019/QH14.

[39] Article 151, Labour Code, No. 45/2019/QH14.

[40] Article 155, Labour Code, No. 45/2019/QH14.

[41] Article 156, Labour Code, No. 45/2019/QH14.

[42] Article 154, Labour Code, No. 45/2019/QH14.

[43] Article 112, Labour Code, No. 45/2019/QH14.

use of foreign employees must directly submit a report on the adjustment and supplementation before at least 30 days from the tentative day of new recruitment, additional recruitment or recruitment for replacing foreign employees to the provincial Departments of Labour - Invalids and Social Affairs where the employers locate head offices[44].

(III) Tax system

1. Tax System

In Vietnam, indirect tax is a prominent source of revenue. With a territorial-based taxation system, the country has established a national unified tax system with income tax and value-added tax as the core[45]. The main types of taxes under the existing tax system include corporate income tax, individual income tax, value-added tax, import duties, capital assignment profits tax, special sales tax, natural resources tax, export duties, property taxes and environment protection tax[46]. Among them, the main tax rates applicable to foreign investors are:

(1) Corporate income tax (CIT): The standard CIT rate is 20%. Companies operating in the oil and gas industry are subject to CIT rates ranging from 32% to 50% depending on the location and specific project conditions[47].

(2) Value added tax (VAT): The tax rate varies (0%, 5% and 10%) depending on the type of goods and services. The VAT rate of 0% applies to exported goods, construction services for export processing enterprises, and aviation, marine and international transport services; the VAT rate of 5% applies generally to areas of the economy concerned with the provision of essential goods and services; and the VAT rate of 10% applies to activities not specified as not-subject to VAT, exempt or subject to 0% or 5%[48].

(3) Personal income tax (PIT): for tax residents, their employment income is taxed on a progressive tax rates basis ranging from 5% to 35%, and other income is taxed at a flat tax rate ranging from 0.1% to 20%[49]. Tax non-residents are subject to PIT at a flat rate of 20% on their Vietnam-related employment income and a flat rate ranging from 0.1% to 10% on their non-employment income[50].

(4) Natural resources tax (NRT): The rate varies from 1% to 40% depending on the types of natural resources exploited. Crude oil, natural gas and coal gas are taxed at progressive rates depending on the average daily production output[51].

(5) Environment Protection Tax (EPT): EPT is levied at fixed amounts according to per unit weight of goods. The standard for gasoline is 1,000 - 4,000 VND per litre, and for coal is 15,000 - 30,000 VND per ton[52].

(6) Import and export duties: Import duty rates are classified into ordinary rates, preferential rates and special preferential rates. Preferential rates are implemented based on the Most Favoured Nation rates in accordance

[44] Article 3,Providing Guidance on Implementation of Some Articles of Decree No. 102/2013/ND-CP Dated September 05, 2013 of the Government Detailing the Implementation of Some Articles of Labour Code on Foreign Employees in Vietnam, No. 03/2014/TT-BLDTBXH.

[45] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, pp. 47-48.

[46] PWC Vietnam Pocket Tax Book 2020, p. 6, available at https://www.pwc.com/vn/en/publications/2020/pwc-vietnam-ptb-2020-cn-simplified.pdf.

[47] PWC Vietnam Pocket Tax Book 2020, p. 7.

[48] PWC Vietnam Pocket Tax Book 2020, pp. 22-23.

[49] PWC Vietnam Pocket Tax Book 2020, p. 40.

[50] PWC Vietnam Pocket Tax Book 2020, p. 41.

[51] PWC Vietnam Pocket Tax Book 2020, p. 31.

[52] PWC Vietnam Pocket Tax Book 2020, p. 33.

with Vietnam' s WTO commitments. Special preferential rates apply to imported goods from countries which have a special preferential trade agreement with Vietnam. Currently, countries that enjoy special preferential rates include ASEAN members with whom Vietnam has signed free trade agreements[53], and the ordinary rate is generally 50% higher than the preferential rate[54]. The export duty rates range from 0% to 40%[55]. The specific duty rates of the commodities can be inquired on the official website of the Ministry of Commerce according to the commodity code duty catalogue[56].

2. Tax incentives for foreign investment

In addition to the preferential tax rates under the Law on Investment, the *Decree Detailing and Guiding the Implementation of the Law on Corporate Income Tax* (the Decree) provides more specific provisions on the preferential tax policies for foreign investors. In accordance with the Decree, the economic organisation established under Vietnamese law by a foreign investor and branches of its companies in Vietnam shall be taxed in accordance with the Law on Corporate Income Tax on corporate income[57]. Currently, the applicable preferential tax policies for income derived from investment projects are divided into preferential tax rates and tax reductions and exemptions.

The applicable incentive tax rates are 10% and 20%, respectively; each based on two modes of fixed years and the project operation period: the incentive tax rate of 10% within 15 years applies to the income of an enterprise from the performance of new investment project in the area with special social and economic difficulties, economic zones, and high technology zones, or from performing new investment projects in the field of environmental protection[58]; incentive tax rate of 10% within the operation period of the investment project applies to the income of enterprise from education and culture, publication and news and social housing business[59]. Incentive tax rate of 20% during 10 years applies to the income of an enterprise from performing new investment projects in areas with difficult socio-economic conditions or from performing new investment projects involving machinery and equipment for agriculture and development of traditional industries, etc.[60], and small and micro financial enterprises and cooperative banks may enjoy the incentive tax rate of 20% within the operation period[61].

Concerning tax reduction and exemption, enterprises are exempted from CIT within a certain period, and after the expiration of the period, enterprises are allowed to enjoy a 50% reduction of CIT for several consecutive years. The tax exemption period is divided into two periods: two years and four years; and the tax reduction period is divided into three periods: four years, five years and nine years. The specific applicable period is determined according to the location of the investment project and the field involved[62].

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[53] PWC Vietnam Pocket Tax Book 2020, p. 34.

[54] Doing Business in Vietnam 2020 – Investing in Vietnam, Engaging the World, P53, Deloitte,https://www2.deloitte.com/content/dam/Deloitte/vn/Documents/tax/vn-tax-vietnam-doing-business-2020.pdf.

[55] PWC Vietnam Pocket Tax Book 2020, p. 36.

[56] Foreign trade practice inquiry service of the Ministry of Commerce, China: http://wmsw.mofcom.gov.cn/wmsw/.

[57] Article 2, Circular Guiding the Implementation of the Government' s Decree No. 218/2013/ND-CP of December 26, 2013, Detailing and Guiding The Implementation of the Law on CIT.

[58] Article 19.1, Circular Guiding the Implementation of the Government' s Decree No. 218/2013/ND-CP of December 26, 2013, Detailing and Guiding The Implementation of the Law on CIT.

[59] Article 19.3, Circular Guiding the Implementation of the Government' s Decree No. 218/2013/ND-CP of December 26, 2013, Detailing and Guiding The Implementation of the Law on CIT.

[60] Article 19.4, Circular Guiding the Implementation of the Government' s Decree No. 218/2013/ND-CP of December 26, 2013, Detailing and Guiding The Implementation of the Law on CIT.

[61] Article 19.5, Circular Guiding the Implementation of the Government' s Decree No. 218/2013/ND-CP of December 26, 2013, Detailing and Guiding The Implementation of the Law on CIT.

[62] Article 20, Circular Guiding the Implementation of the Government' s Decree No. 218/2013/ND-CP of December 26, 2013, Detailing and Guiding The Implementation of the Law on CIT.

(IV) Intellectual property protection

Vietnam' s intellectual property protection system is mainly composed of provisions on intellectual property protection in the Law on Intellectual Property, the Civil Code, the Trade Law, the Law on Competition, the Law on Civil Procedure and the Criminal Code, as well as several international trade treaties, such as the CPTPP, to which Vietnam is a party[63], covering types of intellectual property including patents for inventions, utility patents and industrial designs, layout designs of integrated circuits, trademarks, geographical indications, trade names, trade secrets, new plant varieties, copyrights and copyright-related rights[64]. The application methods and protection measures for several types of intellectual property rights relevant to foreign investors are as follows:

(1) Inventions include invention patents and utility solution patents[65]. Inventions may be registered by authors who have created inventions, or by organizations or individuals who have supplied funds and material facilities to authors in the form of job assignment or hiring[66]. The application for registration shall have its form examined within one month from the filing date[67], and shall be substantively examined within 18 months from the date of its publication or the date of receipt of a request for substantive examination[68]. An invention patent shall be valid from the grant date until the end of 20 years after the filing date[69], and such period for a utility solution patent is from the grant date until the end of 10 years after the filing date[70]. During the validity period of a patent, the patent owner shall pay a validity maintenance fee on time[71], otherwise, the validity of such protection title shall, upon the expiration of the stipulated time limit, automatically terminate[72].

(2) Industrial designs: the rules for applicants for industrial designs are the same as those for applicants for inventions[73]. In terms of application process, an application for registration shall have its form examined within one month after the applicant submits the application materials[74], and shall be substantively examined within seven months from the date of its publication[75]. An industrial design patent shall be valid from the grant date until the end of five years after the filing date and the term of validity is extended for five years after each renewal[76]. The obligee shall pay a corresponding validity extension fee for each renewal[77].

(3) Registered marks: marks may be registered by producers of commodities, operators engaged in the trading of commodities produced by others, and service providers. When any operator registers a mark for a product manufactured by others, the manufacturer does not use such mark for a product it manufactured and does not

[63] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, pp. 77-78.

[64] See Intellectual Property, Embassy of the Socialist Republic of Vietnam in the United States of America, http://vietnamembassy-usa.org/basic-page/intellectual-property.

[65] Article 58, Law on Intellectual Property, No. 50/2005/QH11, not amended in 2009 and 2019.

[66] Article 86.1, Law on Intellectual Property, No. 50/2005/QH11, not amended in 2009 and 2019.

[67] Article 119.1, Law on Intellectual Property, No. 36/2009/QH12, not amended in 2019.

[68] Article 119.2, Law on Intellectual Property, No. 36/2009/QH12, not amended in 2019.

[69] Article 93.2, Law on Intellectual Property, No. 50/2005/QH11, not amended in 2009 and 2019.

[70] Article 93.3, Law on Intellectual Property, No. 50/2005/QH11, not amended in 2009 and 2019.

[71] Article 94.1, Law on Intellectual Property, No. 50/2005/QH11, not amended in 2009 and 2019.

[72] Article 95.2, Law on Intellectual Property, No. 50/2005/QH11, not amended in 2009 and 2019.

[73] Article 86.1, Law on Intellectual Property, No. 50/2005/QH11, not amended in 2009 and 2019.

[74] Article 119.1, Law on Intellectual Property, No. 36/2009/QH12, not amended in 2019.

[75] Article 119.2, Law on Intellectual Property, No. 36/2009/QH12, not amended in 2019.

[76] Article 93.4, Law on Intellectual Property, No. 50/2005/QH11, not amended in 2009 and 2019.

[77] Article 94.2, Law on Intellectual Property, No. 50/2005/QH11, not amended in 2009 and 2019.

object to such registration[78]. In terms of application process, an application for registration shall have its form examined within one month from the filing date[79], and shall be substantively examined within nine months from the date of its publication[80]. The period of validity of a registered trademark starts from the date of grant and ends 10 years after the date of submission of the application materials. After the expiration, it can be renewed for several times, and the period of validity can be extended for 10 years after each renewal[81]. The owner must pay a validity extension fee for each renewal[82].

(V) Land-related provisions

In accordance with the current Land Law of Vietnam, the land belongs to the entire people with the State acting as the owner' s representative and uniformly managing land[83]. However, collectives and individuals have the right to use the land owned by the State[84]. The land use rights may be acquired through land allocation and land lease. The State may allocate the land with or without land use levy. Foreign investors may only obtain the land use right through land allocation with land use levy or land lease; the former is only applicable to investment projects on commercial housing while the latter is applied for various commercial purposes[85].

Foreign investors leasing land shall provide evidence of their financial capacity to ensure the land use according to the investment project' s schedule depending on land uses, procedures for land acquisition and investment projects[86]. Moreover, foreign investors may be granted land use rights for different terms based on investment projects and locations. Under normal circumstances, foreign investors may not lease land for more than 50 years. The lease term may be extended to a maximum of 70 years for large investment projects with the slow recovery of capital, projects in areas with difficult socio-economic conditions or with particularly difficult socio-economic conditions which require a longer term[87].

(VI) Environmental protection

The Ministry of Natural Resources and Environment (MONRE) is a government ministry in Vietnam responsible for the management of land, water resources, mineral resources, geology, environment, hydrology and astronomy, climate change, surveying and mapping, as well as management of marine and island resources. The MONRE adopts a three-level administration structure, i.e. Department, Division and Township[88].

[78] Article 87, Law on Intellectual Property, No. 50/2005/QH11, not amended in 2009 and 2019.

[79] Article 119.1, Law on Intellectual Property, No. 36/2009/QH12, not amended in 2019.

[80] Article 119.2, Law on Intellectual Property, No. 36/2009/QH12, not amended in 2019.

[81] Article 93.6, Law on Intellectual Property, No. 50/2005/QH11, not amended in 2009 and 2019.

[82] Article 94.2, Law on Intellectual Property, No. 50/2005/QH11, not amended in 2009 and 2019.

[83] Article 4, Land Law, No. 45/2013/QH13.

[84] Article 5, Land Law, No. 45/2013/QH13.

[85] Article 54, 55, 56, Land Law, No. 45/2013/QH13.

[86] Article 58, Land Law, No. 45/2013/QH13.

[87] Article 126, Land Law, No. 45/2013/QH13.

[88] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, p. 70.

The Law on Investment requires environmental protection throughout the investment project. In accordance with the Law on Investment, an investment project shall be subject to the National Assembly' s approval if it exerts a significant or potentially serious impact on the environment (including nuclear power plants and projects that require repurposing of special-use forests)[89]. The environmental protection measures submitted by the investor will be a consideration by the National Assembly in its approval decision[90]. In addition, the preliminary environmental assessment may also be included in the assessment report submitted to the Prime Minister for investment projects on petroleum processing, construction and operation of infrastructure in industrial zones and export processing zones, among others[91]. In the process of investment, the investor shall perform the obligation of submitting periodic reports to the competent authority, including special indicators such as environmental protection[92]. The competent investment authority may, at the request of the competent environment authority, decide to suspend in part or in full the investment project to rectify any violation of the environmental protection law. If the project is suspended due to the failure of the investor to overcome the difficulties that lead to project suspension, the competent investment registration authority may terminate in part or in full the corresponding investment project[93].

(VII) Dispute resolution

In Vietnam, an investor may resolve disputes through litigation or arbitration. Generally, investors may submit an investment-related dispute to the local court to be heard and resolved by the economic division of the court[94] . In accordance with the Code of Civil Procedure, the Vietnamese courts have jurisdiction over investment disputes involving foreign-related factors, among others, where the defendant has the nationality of Vietnam, the defendant has properties in Vietnam, and civil cases are related to civil relations which are established, changed or terminated in Vietnam. Civil lawsuits involving rights to properties being immovables in the Vietnamese territory fall under the exclusive jurisdiction of Vietnamese courts[95].

When foreign investors submit the dispute for arbitration, they may choose either a Vietnamese arbitration body, a foreign arbitration body or an international arbitration body[96]. In recent years, as Vietnam has paid more attention to the improvement of its business environment, its commercial dispute resolution system has been gradually aligned with international practices, and the court system has vigorously strengthened the training of judges on arbitration recognition, foreign arbitration awards are increasingly recognised by Vietnamese courts. According to a report by Global Arbitration Review, the number of arbitral awards set aside in Vietnam is far lower than that of extraterritorial arbitral awards that are denied recognition and enforcement, thus choosing Vietnam as the seat of arbitration could reduce the risk involving the enforceability of arbitration awards. It should be noted that although only five arbitral awards were annulled in 2019, the value of these five awards combined accounted for over 90% of the total value of the awards subject to annulment in 2019; and the reasoning in these decisions conflicts with that in the decisions not to annul awards of lower value to some extent, especially the Decision No.11/2019/QD-PQTT of the People' s Court of Hanoi. According to such report, Vietnamese judicial practices in 2019 show that the risk of foreign arbitral awards not being recognised and enforced is higher and the time required is longer when it involves state-backed enterprises or particularly high values at stake[97].

[89] Article 30, Law on Investment, No. 61-2020-QH14.

[90] Article 34, Law on Investment, No. 61-2020-QH14.

[91] Article 31, 35, Law on Investment, No. 61-2020-QH14.

[92] Article 72, Law on Investment, No. 61-2020-QH14.

[93] Article 47, 48, Law on Investment, 61-2020-QH14.

[94] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, p. 102.

[95] Article 469, 470, Code of Civil Procedure, No. 92/2015/QH13.

[96] Article 14, Law on Investment, No. 61-2020-QH14.

[97] *The Asia-Pacific Arbitration Review 2021*, Vietnam, https://globalarbitrationreview.com/review/the-asia-pacific-arbitration-review/2021/article/vietnam 。

Vietnam has developed relatively sound laws and regulations as well as judicial procedures for dispute resolution. Besides, the provisions and the substantive content of its contract law are similar to those of China, making its legal system relatively easy to understand. Vietnam also recognises international arbitration or foreign court awards, which provides the possibility for parties to take multiple remedies. In recent years, however, due to the lack of enforcement power of the courts, it is very difficult to enforce the judgment even if the local court rules in favour of the Chinese party in a contract dispute with a Vietnamese party[98].

III. Considerations for Chinese enterprises investing in Vietnam

(I) Investment

It is advisable for Chinese enterprises investing in Vietnam to get fully prepared for the difficulties they may face and pay special attention to the following matters:

1. Strict control over foreign exchange

Since RMB and VND cannot be exchanged directly, and foreign currency cannot be used for payment of goods or profit distribution in Vietnam, investors should fully estimate the risks arising from exchange rate fluctuations during the project. Especially for projects with long investment return cycle, investors may take appropriate risk hedging measures, such as purchasing financial derivatives of the industry where the project operates, to minimise exchange rate losses.

2. Arranging the investment properly according to the lease term of the land

In Vietnam, the land is owned by the whole people and land distribution shows strong features of the planned economy. Investors, therefore, can only obtain land use rights through leasing. Investors should not only plan the project operation reasonably within the limited lease term but also conduct a detailed investigation of the land parcels to be leased and fully evaluate the possibility of investment returns before investing capital, to form a reasonable expectation of the risk of land recovery.

3. Environmental protection and governance during the investment

In some industries (e.g., electricity, oil and gas), the processing of raw materials may often pose a great threat to the local ecological environment. Investors should take into account the inherent costs that come along with certain projects such as environmental protection tax during decision-making. In addition, during the duration of the investment project, investors should always pay attention to the environmental pollution it may cause, take corresponding control measures, and actively repair the damage to the environment, to avoid the project being terminated by the competent investment authority due to environmental protection issues.

4. Carrying out investment activities in accordance with the local tax system

Under Vietnam' s taxation system, investors may be required to pay the natural resources tax specifically for natural resources exploitation and can enjoy tax relief measures for certain necessary equipment and raw materials. Investors need to reasonably arrange the expenses based on the specific situation of the project and the local tax system to maximise cost savings by using existing preferential tax incentives.

[98] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, p. 78.

5. Investigating the credit of partners in the industry in advance

Due to the insufficient enforcement of judgments and decisions by Vietnamese judicial authorities, seeking judicial relief after disputes may not achieve the effect expected by investors. Therefore, it is necessary to conduct a prior investigation on the credit standing of the local investors in the joint venture company, suppliers of raw materials and equipment, and buyers of goods and services before the investment and during the project. In addition, seeking assistance from a local legal adviser with contract drafting, review or amendment can also, to some extent, avoid the losses caused by the bad reputation of business partners.

(II) Preventing investment and cooperation risks[99]

In addition to the above matters, in the process of investment, trade, contracting and labour cooperation in Vietnam, enterprises should pay attention to exchange and profit remittance risks and policy risks. Investors should investigate, analyse and assess the relevant risks in advance, and make good risk prevention and management during investment and cooperation to effectively protect their interests. This includes credit investigation and evaluation of the project or trade customers and related parties, analysis and avoidance of political and commercial risks in the project location, and analysis of project feasibility. Investors may consider using the services of financial institutions such as insurance companies, banks, guarantee and other specialised institutions to protect their interests.

(III) Relevant cases

Case facts: The Ministry of Commerce of the People' s Republic of China announced a typical case where a Chinese enterprise' s trademark was preemptively registered by a Vietnamese manufacturer [100]. The Chinese enterprise entered the Vietnamese market through intermediaries in 2002, and within just two years, its building materials won wide recognition from local customers, including a Vietnamese plastics group (the Vietnamese Company). In 2007, the Vietnamese Company maliciously registered the trademark for the Chinese enterprise' s building materials at the Trademark Division of the Intellectual Property Office of Vietnam, and put the building materials bearing the trademark into production in large quantities for sale. In 2012, the Vietnamese Company requested the local economic security officials to drive the Chinese enterprise' s products out of the Vietnamese market on the ground of trademark infringement and interfered with the Chinese enterprise' s local agents. In the same year, the Chinese enterprise entrusted a lawyer to file a complaint with the Trademark Division of the Intellectual Property Office of Vietnam, requesting the cancellation of the maliciously registered trademark by the Vietnamese Company. In the process of trademark dispute settlement, the case was administratively intervened by the inspection department of the Ministry of Science and Technology of Vietnam to direct the Intellectual Property Office to support the claims of the Vietnamese Company.

Risk warning: Chinese enterprises should improve their awareness of intellectual property protection. For a Chinese enterprise planning to enter the Vietnamese market, it is recommended to submit a trademark registration application to the Vietnam trademark authority as early as possible. It is also advisable to conduct the necessary credit surveys on business partners, and draft clear intellectual property clauses in the business contract to reduce risks. When finding that its trademark has been registered by others, an enterprise is recommended to contact legal counsel in time to take necessary rights protection measures and make full use of the rights granted by law to safeguard its own rights and interests, including but not limited to submitting a written objection to the competent trademark registration authority against the preemptive registration and providing solid evidence to prove that the subject of the application for registration does not enjoy the right to register the relevant trademark[101] .

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[99] *Guide for Countries and Regions on Overseas Investment and Cooperation* (Edition 2020) issued by the Ministry of Commerce, China, p. 95.

[100] See A Typical Case of Malicious Preemptive Registration of Chinese Enterprise' s Trademark by a Vietnam Company, the Commercial Counsellor of the Embassy of China in Vietnam http://vn.mofcom.gov.cn/article/dxal/201407/20140700671973.shtml.

[101] Article 112, Law on Intellectual Property, No. 50/2005/QH11, not amended in 2009 and 2019.

INVESTMENT IN RUSSIAN MINING INDUSTRY: LEGAL FRAMEWORK AND KEY CONSIDERATIONS

Fan Duoling (Grace), Zhang Jingjia

As an important country for mineral extraction, ore processing and export of mineral products, Russia has long been attractive for the players in the global mining market. At the same time, mining investments in Russia may face multiple challenges, such as restrictions on foreign ownership, the federal system' s dealings with local agencies, inadequate infrastructure, and difficulties in project financing due to sanctions.

Chinese mining investors often seek to acquire resources and undertake works, supplemented by equity investments as financial investors. In the whole process of a project, the legal complexity is certainly one of their main concerns. This paper will analyse the legal framework and key issues related to mining investments in Russia, in order to provide preliminary guidance for Chinese investors.

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I. Overview of the legal framework for mining investment

Mining activities: relevant core laws (federal)	
1	*Federal Law № 2395-1 "On Subsoil" of 21 February 1992* (the Law on Subsoil)
2	*Federal Law № 41-FZ "On Precious Metals and Gemstones" of 26 March 1998* (the Law on Precious Metals and Gemstones)
3	*Federal Law № 225-FZ "On Production Sharing Agreements" of 30 December 1995*
4	*Federal Law № 57-FZ "On the Procedure of Making Foreign Investments in Companies of Strategic Importance for National Defence and State Security" of 29 April 2008* (the Strategic Investment Law)
5	*Federal Law № 7-FZ "On Environmental Protection" of 10 January 2002* (the Law on Environmental Protection)
6	*Federal Law № 116-FZ "On Industrial Safety of Hazardous Production Facilities" of 21 July 1997* (the Law on Industrial Safety of Hazardous Production Facilities)

Mining operations: main regulatory authorities[1]	
1	**Ministry of Natural Resources and Environment** The Ministry of Natural Resources and Ecology administers the licensing system applicable to mining operations, and supervises and regulates the work of mining agencies and other institutions.
2	**Federal Agency for Subsoil Use** (*Rosnedra*) The Federal Agency for Subsoil Use conducts tenders and auctions for subsoil resources in order to grant subsoil production licences and joint licences.
3	**Federal Service for Supervision of Natural Resource Usage** (*Rosprirodnadzor*) The Federal Service for Supervision of Natural Resource Usage controls and supervises the environmental protection and the rational use of natural resources, including in mining areas.
4	**Federal Environmental, Industrial and Nuclear Supervision Service** (*Rostekhnadzor*) The Federal Environmental, Industrial and Nuclear Supervision Service controls and supervises the compliance with the industry safety requirements, including in mining areas, and enforces corrections of violations.

Some key Russian mining investment laws are introduced below.

(I) Law on Subsoil: resource blocks and mineral rights certificates

The Law on Subsoil systematically regulates the development and utilisation of subsoil resources. In Russia, all subsoil resources are owned by the Federation. Traditional mineral rights are actually embodied as **the right to use** subsoil resources.

In accordance with the Law on Subsoil, subsoil blocks are divided into three categories: (1) federal subsoil blocks[2], (2) federal subsoil reserve blocks, and (3) local subsoil blocks. Federal subsoil blocks are most regulated and complex for foreign investment as they are regulated by the Law on Subsoil, the Strategic Investment Law and other relevant laws and regulations.

There are three types of subsoil licences for mineral rights in Russia:

(1) Geological exploration licence

(2) Production licence

(3) Joint licence (integrated licence for geological research, geological exploration and production)

[1] Matters relating to the possession, use and disposal of mineral resources (including the granting of subsoil licences) are within the joint jurisdiction of the federal and regional authorities in the locality of the mineral resources.

[2] Federal subsoil resources:

The catalogue of subsoil deposits belonging to the Federation is officially published in the official publication of the Russian Federation by the federal agency designated by the Federal Government for the management of geological and mineral resources of the country (https://www.rosnedra.gov.ru/category/144.html).

Subsoil deposits belonging to the Federation include:

1) Subsoil deposits of uranium, diamonds, raw materials for pure crystal (quartz), rare earths such as yttrium, nickel, cobalt, tantalum, niobium, beryllium, lithium and platinum;

2) Developable underground mineral reserves located in one or several constituent entities of the Russian Federation and included in comparison tables of mineral reserves issued by the government on 1 January 2006:

- Recoverable oil reserves in excess of 70 million tons;
- Gold reserves in excess of 50 tons;
- Copper ore reserves in excess of 500,000 tons;

3) Internal seas, territorial seas, continental shelves of the Russian Federation;

4) Sections in the areas belonging to the departments of national defence and security must be used when mining underground mineral reserves.

The geological exploration licence and production licence are more widely used in practice. Depending on the type of licence, the duration of the licence varies from 5 to 25 years.

In principle, subsoil licences are issued by the Federal Agency for Subsoil Use. In addition, the Law on Subsoil specifically provides for the principle of federal resolution for legal entities with foreign participation or for foreign investors, i.e. federal subsoil licences **may be only issued subject to the approval of the Russian federal government by resolution**.

(II) Strategic Investment Law: Special restrictions on foreign investments

In 2008, Russia began to implement the Strategic Investment Law which restricts foreign investment and M&As in strategic areas. This is one of the key contents of the framework and negotiation for the initial investment projects in Russia. The Government Commission on Control over Foreign Investments was established under the Strategic Investment Law to oversee foreign investment in legal entities that have strategic importance for national defence and state security. The Commission is composed of members from the Federal Government, the Federal Anti-Monopoly Service, the Federal Security Service, and the Ministry of Natural Resources and Environment. It coordinates the imposition of control over strategic legal entities by a foreign investor or a group of private individuals and legal entities comprising a foreign investor.

The Strategic Investment Law stipulates the list of areas of strategic importance for national defence and state security. The Law and its amendments specify 46 types of business activities as "strategic industries", including the development of **federal subsoil blocks**. The foreign ownership restrictions under the Strategic Investment Law will be detailed in Part II of this article.

(III) Law on Precious Metals and Gemstones: Processing and sale of mineral resources

Subsoil licence holders must comply with the requirements for reasonable recovery of valuable minerals. Under the Law on Precious Metals and Gemstones, all precious metal and gemstone products must be inspected and stamped with a state licence mark (along with a fee paid to the government).

The government (federal and regional) has **the right of first refusal** for precious metals and gemstones. Within one month from the date of the offer made by the subsoil user, the government must inform the users of its intention to purchase. The competent government authority will subsequently sign a purchase and sale agreement with the subsoil users and pay an advance.

The government' s failure to notify the subsoil user of its intended exercise of the right of first refusal within the one-month period will be deemed as a waiver of such right. The subsoil user may then sell the precious metals and gemstones to other legal entities and individuals, use them for production or guarantee (pledge as collateral), or export them abroad.

Export of precious metals (raw or processed) requires a licence from the Ministry of Industry and Trade. Export tariffs are set by the Government of the Russian Federation. The tariff rates for export of metals and minerals to China are set by the Eurasian Economic Commission; they vary from 0% to 10% depending on the types of metals or mineral products. Purchase and sale agreements of precious metals and gemstones are required to be registered with the Ministry of Finance and the Ministry of Economic Development of the Russian Federation.

(IV) Law on Environmental Protection: Environmental protection requirements

Federal environmental protection laws in force include the Law on Environmental Protection and the Federal Law No. 174-FZ "On Ecological Expertise" of 23 November 1995.

In accordance with the Russian Constitution, environmental protection falls within the common competence of the Russian Federation and its constituent entities. Therefore, the regional authorities have also adopted environmental legislation. In most cases, the regional legislation merely adds details to the federal laws rather than introducing completely new region-specific regulations.

For subsoil resources such as minerals, after expiration or termination of the subsoil licence, the licence holder must make decommissioning (environmental restoration, reclamation or abandonment) arrangements for its operations. Decommissioning must comply with environmental protection and industrial safety requirements.

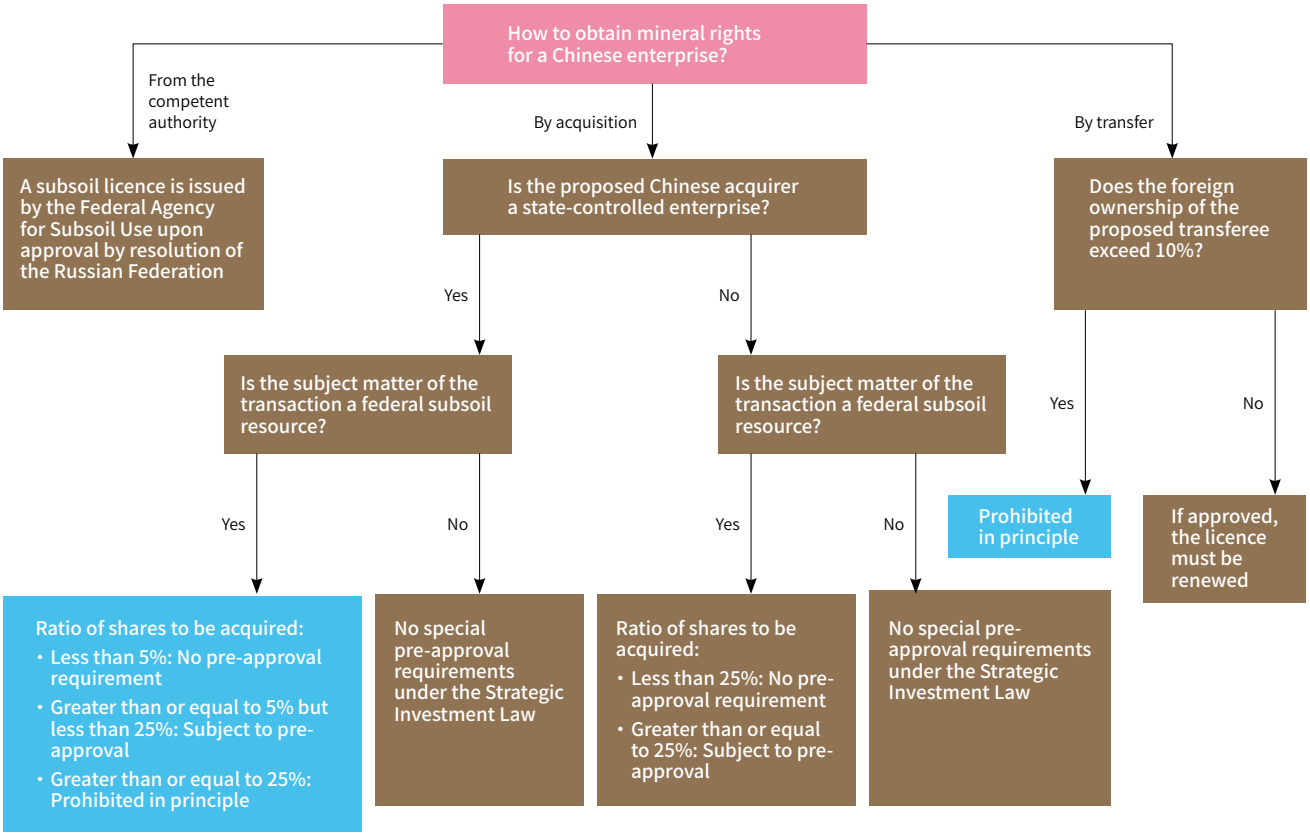
(V) Law on Industrial Safety of Hazardous Production Facilities: Health and safety

The legal and regulatory requirements for health and safety in mines are the same as the general requirements for the operation of hazardous industrial facilities. In fact, mining operations are generally considered hazardous industrial operations under Russian law and are therefore covered by the Federal Law on Industrial Safety of Hazardous Production Facilities, which places the following requirements:

- Obtaining of certain special permits and licences (including permit for dangerous production facilities and for operation of such facilities).
- Arrangement for facility certification and training of professionals.
- Compliance with industry health, safety and environmental requirements on a daily basis.
- Avoidance of pollution exceeding specified levels.
- Payment for releases of polluting substances into the environment.
- Entry into and maintenance of insurance agreements and contracts with specialty companies (e.g., for hazardous waste utilisation, except for the permitted utilisation of waste).

II. Process analysis: obtaining of mineral rights

In practice, the process of obtaining the right to use Russian subsoil resources is complex for foreign-funded enterprises, especially when involving interaction with federal and local governments. This article only analyzes how to obtain mineral rights under the existing legal framework of Russia.



Following the traditional mining investment model, the Russian mineral rights may be obtained originally from the competent authority or indirectly by transfer or acquisition.

(I) From the competent authority

In general, subsoil licences are obtained through competition (bidding or auction) and are issued by the Federal Agency for Subsoil Use. In accordance with Article 2 of the Law on Subsoil, if the resource user is a legal entity with foreign equity participation or a foreign investor, the federal subsoil licence can only be issued after the approval of the Russian federal government by resolution.

In practice, few foreign enterprises obtain mineral rights directly from the competent authority and it is common obtain the rights indirectly.

(II) By transfer

The right to use subsoil resources can be transferred (by change of the legal entity or in any other form) after the original acquisition. But the licence must be renewed and the relevant regulations must be complied with during the period of renewal and may also be extended upon expiration. In particular, Article 17 of the Law on Subsoil provides for the following restrictions on the transfer to a foreign entity:

In the absence of other regulations, this Law prohibits the transfer of the right to use subsoil mineral deposits belonging to the Federation to legal entities with the participation of foreign investors or to legal bodies with the membership of foreign investors in compliance with the legislation of the Russian Federation, which:

(1) possess the power to directly or indirectly control (including, inter alia, by contracts authorizing the management of assets, contracts of general business association, entrustment contracts or other contracts) more than 10% of the voting shares in the registered capital of such incorporated company;

(2) possess the power to make decisions acceptable for such legal entity on contractual or other grounds, including the determination of the conditions under which any corporate action is to be carried out;

(3) have the authority to appoint more than 10% of the members of a single executive body and/or a collective executive body of such incorporated company and/or the power without restriction to select more than 10% of the members of the board of directors (board of supervisors) or other collective governing body;

…

(6) The following shall be supplemented to Article 10:

Under exceptional conditions, pursuant to the decision of the government of the Russian Federation, it is allowed to transfer the right to use subsoil mineral deposits belonging to the Federation to the corporate entity as mentioned in Article 9 of this Chapter.

(III) By acquisition

It is most common to obtain mineral rights by acquisition in practice. The Strategic Investment Law imposes many restrictions on foreign investment in the Russian mining industry, but also lays down clear criteria and conditions.

As mentioned above, Article 6 of the Strategic Investment Law stipulates a list of areas of strategic importance for national defence and state security. Currently, 46 types of business activities are considered to be within the "**strategic industries**", including the development of federal subsoil blocks. Entities engaged in the strategic industries are considered "**strategic entities**".

The Strategic Investment Law also sets out clear restrictions on the shareholding proportion of strategic entities in M&As.

In accordance with Article 7 of the Strategic Investment Law, in the case of acquisition of a commercial company engaged in the exploitation of federal mineral resources which is of strategic importance to the national defence and state security, a foreign government owned company shall not control more than 5% of a federal subsoil company, and is required to file a notice with the Federal Anti-Monopoly Service when such proportion reaches 5%; in the case of an acquisition of more than 5% but less than 25% shares, a pre-approval is required, i.e. an application for pre-approval shall be submitted to the Federal Anti-Monopoly Service and notification shall be provided within 45 days of closing of the transaction, and failure to do so will result in the invalidity of the transaction; furthermore, foreign government owned companies are expressly prohibited from acquiring 25% or more of the shares or voting power in a strategic entity using federal subsoil resources through any transaction.

Despite the prescribed shareholding proportions, a large Chinese central stated-owned enterprise was exempted from the restrictions under Strategic Investment Law for its acquisition of 70% of the equity interest in an Indian company holding the control of a Russian national strategic mineral property in 2018. After effective negotiations with the Ministry of Industry and Trade, the Federal Anti-Monopoly Service and other relevant authorities, the Chinese acquirer finally signed an intergovernmental agreement, obtaining the exemption for the acquisition. The success of this landmark deal has successfully set a precedent for a state-owned Chinese investor to control Russian strategic resources.

Conclusion

Although Russia has imposed many restrictions on foreign investment in the mineral sector, the good China-Russia relations in recent years and the bilateral investment agreements and bilateral cooperation projects have also undoubtedly provided opportunities for Chinese investors. At present, the cooperation between the Belt and Road Initiative and the Eurasian Economic Union is progressing steadily. China and Russia are actively implementing the Agreement on Economic and Trade Cooperation Between the People' s Republic of China and the Eurasian Economic Union, which came into force in October 2019, to promote the in-depth development of regional economic integration.

Cooperation in the mineral sector has also been the focus of bilateral cooperation: during the 25th regular meeting of Russian and Chinese Prime Ministers in 2020, the two sides pointed out that the energy cooperation between China and Russia is of mutual benefit, strategic and long-term nature. Therefore, the two countries will deepen all-round cooperation, promote the gradual implementation of existing intergovernmental agreements, and study new cooperation models in the energy sector. During the meeting, China and Russia also agreed to effectively implement the *China-Russia Cooperation and Development Plan in the Russian Far East* (2018 - 2024) (the Far East Plan), and support enterprises of the two countries to carry out investment cooperation in the Russian Arctic and Far East according to the principle of sustainable development.

In accordance with the Far East Plan, solid mineralsare one of the priority areas for economic and trade cooperation between China and Russia in the Russian Far East. Russia pointed out that the Far East has concentrated the largest reserves of solid mineral resources (including precious metals) in the Asia- Pacific region. The well-developed railways, ice-free port transport and complete infrastructure there offer huge advantages for cooperative development.

Russia gave positive comments on various mineral projects implemented by Chinese investors in the Russian Far East in accordance with the Russian laws on foreign investment and mineral resources. Russia also expressed continued support for the investments in solid mineral development, promote the implementation of favourable investment policies and measures, and eliminate investment barriers for Chinese investors in the Russian Far East. The Belt and Road Initiative has opened up a broader new space for economic growth in China and Russia, built a new platform for trade and investment cooperation between the two countries, and provided new opportunities for Chinese investors.

Thanks to intern Xie Zixuan for the contribution to this article.

KAZAKHSTAN — THE NEW WORLD OF BITCOIN "MINERS" FROM CHINA

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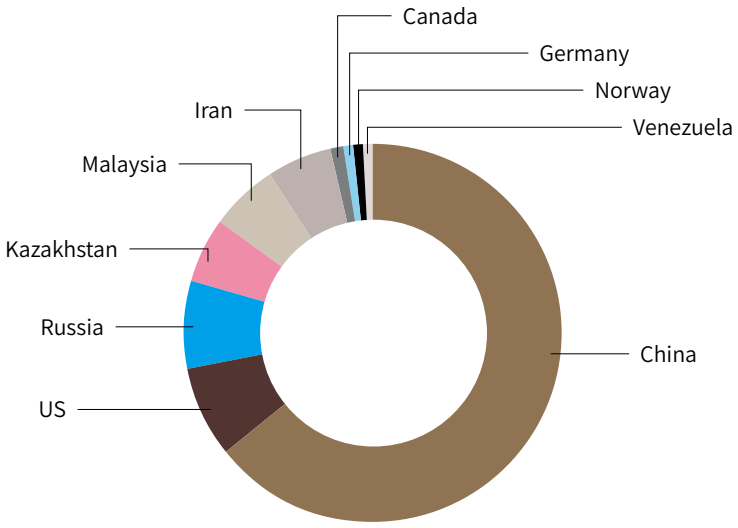
The National Internet Finance Association of China and two other associations warned of the risks of speculation in virtual currency trading in May 2021. In addition, the Financial Stability and Development Committee of the State Council ordered to "crack down on bitcoin mining and trading". Against such a drop, government authorities in Inner Mongolia, Xinjiang, Sichuan and other places have successively issued bans on bitcoin mines. China, once a big bitcoin mining club that accounted for at least 60% of the world' s computing power, is rapidly tightening its regulations on the industry. This has forced leading cryptocurrency mining companies, represented by bitcoin, to turn to overseas mines.

Kazakhstan, which is adjacent to China, emerged as a popular destination with its low electricity prices and mining-friendly environment. As reported by news agencies, Chinese cryptocurrency mining company BIT Mining has planned to build and operate a mining center with a 100 MW capacity by cooperating with local Kazakh partners. On 17 June 2021, US cryptocurrency mining company Wattum announced its cooperation with Enegix, Kazakhstan' s largest mine operator, to build a mining center with a 16 MW capacity in Kazakhstan. On 23 June 2021, Canaan, the world' s largest bitcoin mining machine manufacturer, issued a statement, deciding to set up a company in Kazakhstan and launch its mining operations. Although there are numerous pioneers who have set foot on the Kazakhstan market, most industry participants still adopt a wait-and-see approach to the adventure due to a lack of experience in cross-border transactions and insufficient knowledge of the legal framework of Kazakhstan.

I. Overview of the bitcoin mining industry in Kazakhstan

Kazakhstan ranks in the forefront in terms of the distribution of worldwide computing power of bitcoin mining. Data shows that it was ranked the fourth largest bitcoin mining country in the world, standing next to China, the US, and Russia (before China' s intensive introduction of policies to regulate bitcoin mining and trading in May 2021). As of August 2021, it climbed to second place only next to the US, followed by Russia and Canada. In early 2022, Kazakhstan experienced political turmoil. Although

the regions where the mining assets were located were generally in a stable situation, the network outages during the turmoil still adversely affected the operation of the bitcoin mining industry. Some large mining companies reportedly have no plans to withdraw from Kazakhstan at present and are still taking a wait-and-see attitude.



Source: Cambridge Bitcoin Electricity Consumption Index · Data as of April 2021

Kazakhstan has a typical continental climate, characterized by cold and windy weather. With an average temperature of -19 °C to 4 °C in January and 19 °C to 26 °C in July, Kazakhstan has rarely seen extreme weather. This makes the cooling cost of the mining machines relatively controllable, which works favourably for the establishment of a mining center. The Kazakhstan Blockchain and Cryptocurrency Association has been set up, which is committed to researching and better serving the blockchain and cryptocurrency industry. Currently, active players in the Kazakh bitcoin market include such local mine operators as Enegix, Powerr and AQ Group. With self-contained power plants and high-capacity data centres, they can offer low electricity prices and hosting service of mining machines. In addition, a slew of well-known international mining enterprises have set up branches in Kazakhstan, including Bitfury and Canaan (international mining machine suppliers), BTC.com (bitcoin data service provider and mining pool), Xive (mine operator), ViaBTC (mining pool and cloud mining service company), and Chilkoot (mining machine retailer).

For the electricity market and electricity price that have a significant influence on bitcoin mining, Kazakhstan has a highly commercialised electricity market, with the current national power generation capacity surplus exceeding 5,000 megawatts. It' s estimated that Kazakhstan' s comprehensive industrial electricity consumption cost is between USD 0.037 and USD 0.05 /kWh. For mining centers with self-contained power plants or electrical substations, this figure can be as low as USD 0.03 /kWh. At present, only about 27% of the world's mining electricity price is below USD 0.04 /kWh. Currently, the domestic power generation in Kazakhstan is still dominated by coal-fired power stations, accounting for more than 70% of the national power generation. Karagandy, Pavlodar, Oskemen, Ekibastuz and other northeast cities, where most of the large coal-fired power stations are concentrated, are the main mining hubs in Kazakhstan, contributing to 80%-85% of the country' s computing power. In addition, to achieve the goal of "making renewable energy and alternative energy account for half of the total energy consumption by 2050" in Kazakhstan' s national energy development strategy, the Kazakh government is also vigorously building renewable energy power plants to meet the rising demand for electricity brought by bitcoin mining.

II. Industry regulation and legal framework on foreign investment in digital mining

Besides its sound industry environment and mature mining industry chain, the country also opened its arms to foreign mining companies at the legislative level, creating a relatively friendly regulatory and foreign investment environment.

(I) Recognising cryptocurrency as a kind of property and digital mining as legal operations

To ride a wave of the digital economy, Kazakhstan amended 35 laws in July 2020 including the Civil Code and the Information Law. In addition to recognising the cryptocurrency as a property in the Civil Code, the concepts of digital currency and digital mining (i.e. "mining") are clarified and stipulated mainly through the Informatization Law. . The revised Information Law provides that the miner is the owner of the digital assets obtained by mining and is obligated to report its mining activities to the competent authorities. As subordinate regulations of the Law, the detailed regulations issued by the Ministry of Digital Development, Innovation and Aerospace Industry (MDDIAI) further provide that the mine operators shall, within 30 days prior to mine designing, report in writing or electronically to the MDDIAI and other relevant authorities, the location of the planned mining center, electricity demand, capacity expansion potential, investment amount and bank account information, and, after the mine was put into operation, periodically report the current energy consumption, expected equipment and infrastructure investment, number of employees. The MDDIAI shall inform the electricity authority of the relevant information within five days after receiving the reported information. In addition to the updates of relevant digital technology-related regulations, Kazakhstan has also passed amendments to its tax laws, deciding to charge a mining tax of KZT 1 /kWh based on electricity consumption starting 1 January 2022. On the whole, although Kazakhstan' s laws still prohibit the issuance and circulation of cryptocurrencies such as bitcoin, mining activities have been clearly recognized and protected by law as shown by the amendments to the Civil Code, the Information Law, the Tax Law and other legislation.

(II) Imposing no bans or restrictions on foreign investment in digital mining, the business environment generally friendly

Kazakhstan adopts a friendly policy to foreign investors without imposing any special restrictions in the mining sector. Under Kazakh laws, most sectors are open to foreign investors, except for a few sectors such as media and telecommunications, which have restrictions on the proportion of foreign shares. Although digital mining is broadly defined as a business operating in the information and communication sector under Kazakh laws, it does not fall into the scope of remote or cross-border telecoms operation business on which the Kazakh law impose restrictions on foreign investment. Furthermore, Kazakhstan provides an excellent investment environment as a whole. According to the World Bank' s Doing Business 2020, Kazakhstan ranks 25th among more than 190 countries in the world in terms of the business environment, surpassing Russia (28th) and China (31st).

(III) The feasible option of contributing by mining machinery; lower requirements for registered capital of limited liability companies

Foreign investors engaged in cryptocurrency mining can either open branches or representative offices in Kazakhstan or establish companies solely or jointly with other investors. Kazakh laws provide for a variety of organisational forms of enterprises, including limited liability companies (LLC), joint-stock companies, general partnerships and limited partnerships. In practice, foreign investors generally choose LLCs as the corporate organizational form for establishing subsidiaries in Kazakhstan.. The Limited Liability Company Law determines the company size based on the number of employees and the average annual income of the company. However, even for large LLCs[1], the statutory minimum registered capital is only 100 times the monthly calculation index (MCI)[2] (about USD 705). Shareholders can contribute in cash or kind, or securities, property rights (including land use rights, and IP rights.) and other assets. It should be noted, however, that Kazakh laws do not allow a single-shareholder structure for three

[1] Large companies are legal entities engaged in private business with an average annual employee of more than 250 and/or an average annual income of more than 3,000,000 times MCI.
[2] MCI is established by the State Budget Act of Kazakhstan for the calculation of benefits, social payments, fines, taxes and other payments. The MCI for 2022 is KZT 3063.

levels in succession. In other words, a mining enterprise registered in China as a one-person LLC under Chinese law is not allowed to set up a wholly-owned subsidiary in Kazakhstan and needs to consider adjusting the transaction structure.

(IV) Providing multiple tax incentives with low thresholds

As the "data processing" and "supporting services for computing and integrated computing infrastructure for data processing" involved in digital mining are the priority activities in Kazakhstan' s information technology field, mining enterprises can enjoy many tax concessions by registering as members of Astana Hub international technology park, mainly including:

(1) Exemption of corporate income tax (20%);

(2) Exemption of import VAT on 42 categories of goods contained in the № 10/HK list dated 18 March 2019 issued by the MDDIAI (12%);

(3) Exemption of individual income tax of local and foreign employees (10%);

(4) Exemption of social tax of foreign employees (9.5%);

(5) Exemption of withholding tax on dividends received by non-resident shareholders from enterprises in the park within the range of 5%; and

(6) Exemption of withholding tax on service fees paid to non-residents (20%).

All the tax incentives above will be valid until 1 January 2029 except item (6) which will expire as of 1 January 2024. In addition, Astana Hub has also provided great convenience to enterprises in the park in terms of employment of foreign employees, visa processing and infrastructure in the park.

Astana Hub does not set a high threshold for admission. In accordance with the relevant provisions of the *Code of Conduct of Astana Hub*, mining enterprises may apply for membership online if they meet such basic conditions as not having implemented statutory priority investment projects and strategic investment projects, not being controlled by the government or state-owned enterprises, not being the owner of the right to use underground resources or members of other special economic zones, not engaging in consumer goods business, earning income from activities included in the list of priority activities in the information technology field (such as cryptocurrency mining), and having no other branches. After being approved by the Member Selection Committee of the park, a mining enterprise will be listed in the register of members. Thereafter, it will be required to enter into a member activity agreement with the park to finally obtain membership. If a mining enterprise intends to submit an application during the period up to 1 January 2024, it is not required to have its actual business location in the park. Therefore, it will have full freedom of site selection while enjoying special preferences.

(V) Investment preferential policies continue to drive the development of the mining industry chain

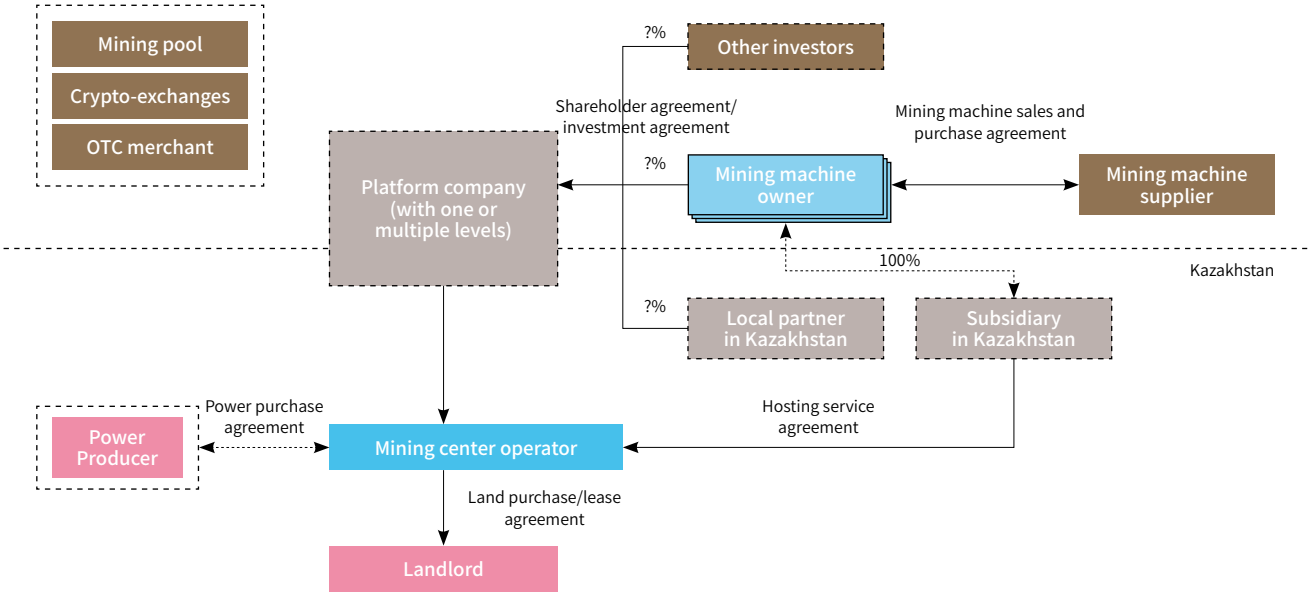
Apart from the policy incentives in the IT industry, traditional incentives such as investment contracts are also worthy of attention. Since the equipment installation, venue construction, power supply and other activities that may be involved in the digital mining industry chain are included in the list of priority activities for investment projects, foreign investors, after the establishment of local commercial entities, may apply to Kazakhstan' s foreign investment authorities for relevant incentives, regardless of the size of their investments. They may enjoy the exemption of import VAT (12%) and import tariffs on some technical equipment as well as the State' s in-kind subsidies (including free land lease, and equipment ownership, with a value not exceeding 30% of the investment amount) through signing a standard investment contract with Kazakhstan' s Investment Committee of the Ministry of Foreign Affairs. Investors are also entitled to obtaining additional tax relief such as corporate income tax (20%), property tax (1.5%) and state subsidies (30% of the expenditures for construction project and equipment procurement in the implementation phase) if their projects meet the criteria for priority investment projects. In addition to investment contracts, it should be noted that Astana International Financial Centre (AIFC), which has an independent regulatory environment, strongly supports the establishment of cryptocurrency exchanges and has introduced relevant measures. The upstream and downstream industries of mining all have the opportunity to enjoy the policy incentives in Kazakhstan.

III. Legal protection for the overseas mining

The transaction structure and transaction chain of mining in China are relatively simple. After purchasing mining machines from the supplier, the mining machine owner/miner will sign a hosting service agreement with the mine operator for the machine. Under familiar environment, legal issues are often ignored. As overseas mining involves relatively complicated transaction structure arrangements and cross-jurisdictional issues, mining enterprises should in particular prepare themselves from legal and right protection perspectives, including implementing commercial arrangements and allocating management risks through the formation of proper contracts. Some recommendations are summarised below for enterprises' reference:

(I) Making a good arrangement for the "top-level design" of the transaction structure

Based on our understanding of the core demands of Chinese mining enterprises, the overall transaction structure for mining in Kazakhstan is presented as follows:



Notes:

- Mining center operator and mining machine supplier may be the same entity;
- A mine operator may establish or purchase a power plant on its own, and may not need to sign an electricity supply and utilisation agreement depending on whether connected to the grid.

The establishment and selection of a platform company in the above transaction structure are one of the top priorities to be considered in overseas investment. In general, the considerations for investors to establish platform companies outside the host country often include isolation of investment risks, tax planning, fund collection, corporate governance costs, freedom to transfer shares and exit, and investment dispute resolution. Some of these factors are from a commercial perspective, others from the perspective of seeking the best legal protection. The feasibility and convenience of cryptocurrency trading is another consideration for Chinese mining companies planning to go to Kazakhstan for mining.

From the perspective of seeking the best legal protection for investment, the conditions set forth in the Agreement between the Government of the People' s Republic of China and the Government of the Republic of Kazakhstan on Reciprocal Encouragement and Protection of Investments (the China-Kazakhstan BIT), which has entered into force for a long time, are not very favourable. Only the dispute between Chinese investors and the Government of Kazakhstan with respect to the amount of compensation for expropriation can be directly referred to ICSID for settlement under China-Kazakhstan BIT without the Government of Kazakhstan' s written consent. This means that unless agreed in writing by the Kazakh government for resorting to international arbitration, potential investment disputes that may arise in connection with such matters as expropriation, nationalisation, unequitable treatment, and unjustified administrative actions of the Kazakh government, are overwhelmingly subject to litigation before local courts instead of international arbitration.

In contrast, the conditions set forth in the bilateral investment treaties (BITs) signed by Kazakhstan with six economies in Europe, Asia and America, are more favourable for investors. Therefore, compared to investing directly in Kazakh companies, Chinese mining enterprises will secure additional protection for their investment by locating their platform companies in these economies.

(II) Attaching importance to the contract protection mechanism for cross-border transaction documents

Domestic mining generally involves relatively simple mining machine purchase contracts, hosting services contracts, electricity supply and utilisation contracts, land lease contracts, etc. Overseas mining, however, requires more careful consideration and design for these contracts as they are the basic documents for rights and obligations and important tools for risk management.

For example, according to the common practice of concluding hosting service contracts in China, in addition to the prepaid portion of the hosting service fee, the hosting service fee is generally settled on the contract management platform of mine operators on a daily basis, and will be adjusted daily and paid in RMB according to the ratio of digital assets "converted" into RMB on that day. Aggressive mine operators may participate in currency distribution. However, when Chinese mining machine owners/miners sign hosting service contracts with Kazakh mine operators, it is less likely that the mine operators will accept RMB as the currency for payment of the hosting service fee. If the Chinese mine owners/miners pay the service fee in foreign currency, they may need to reserve a sufficient payment period for themselves in the hosting service contracts to satisfy Chinese regulators' filing requirements for foreign payment in service trade. As an alternative solution, they may consider executing the hosting service contract through their offshore branches who will pay the fees accordingly. In addition, considering that the costs of mine operators are incurred in Kazakhstan, the formula for the calculation of the hosting service fee may be adjusted on a daily basis taking into account the exchange rate of Kazakh tenge, and the ratio of digital assets "converted" into KZT on that day.

It should also be noted that contracts to which a Kazakh entity is a party must have a Kazakh or Russian version, otherwise, the transaction documents may be invalid or unenforceable. This rule, however, does not prevent the parties from choosing English or another foreign language version as the prevailing language version.

Conclusion

Kazakhstan is attractive to Chinese mining enterprises for its legal guarantee and lower digital mining costs. Yet, the complexity and the risk factors involved in overseas mining are much greater compared with mining in China. Everything should be planned in advance. Chinese mining enterprises, when conducting overseas mining, should manage legal risks properly and make favourable contractual arrangements in advance, to realise sustainable business development.

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