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China's New Rules on Concession of Infrastructure Projects Welcoming Private Investment

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On April 21, 2015, the State Council of China (i.e. the central government) adopted the proposed draft of **Administrative Measures on Concession of Infrastructure and Public Utilities Projects** (the "**Infrastructure Measures**"). Four days later, the Infrastructure Measures were then jointly promulgated by the Chinese National Development and Reform Commission (NDRC), Ministry of Finance, Ministry of Housing and Urban-Rural Development, Ministry of Transport, Ministry of Water Resources and the People's Bank of China. The Infrastructure Measures are expected to enter into full force and effect commencing on June 1, 2015.

General Background

In order to encourage private capital to participate in the establishment and management of infrastructure and public utilities projects through concession arrangements, also known as public-private partnerships (PPPs), the Infrastructure Measures seek to establish certain fundamental guidelines relating to various aspects of such PPPs. For example, the Infrastructure Measures address, among other things, the scope and types of permissible concession arrangements, the longest time period for such concession arrangements, the execution and performance of such concession agreements, dispute resolution, and the regulation and protection of public interest, in each case as described in more detail below.

According to a public speech delivered by the head of the NDRC's legislature department, by promulgating the Infrastructure Measures, NDRC and the five other promulgating authorities aim to protect and stabilize the interests of private investors and expand their opportunities in Chinese infrastructure and utilities projects.

It should, however, be noted that even with the promulgation of the Infrastructure Measures, currently there is no clear statutory definition of PPPs or concessions under Chinese law. Indeed, some authorities in China (including NDRC) seem to hold the view that PPPs covered by the Infrastructure Measures could include either concession arrangements (where a private actor participates in infrastructure and public utilities projects largely as a partner to the governmental granting authority), or other approaches, such as where a governmental authority is largely procuring certain public services from particular private service providers who will simply be such authority's agents in interfacing with the public. As such, in practice uncertainties may arise when the latter scenario arises and it is unclear whether such arrangement falls within the scope of the Infrastructure Measures or whether such arrangement is subject only to more general legislation such as the Chinese Contract Law. Unfortunately, the Infrastructure Measures, as drafted, do not resolve this vagueness and it may be some time before these issues are tested and such questions are resolved.

Applicable Projects, Franchisees and Time Period

The Infrastructure Measures will broaden the scope of Chinese infrastructure and public utilities projects that are eligible for PPPs. Specifically, five major areas of infrastructure projects in China can be franchised to private parties through a PPP model pursuant to the Infrastructure Measures, including energy, transportation, water conservation, environmental protection and municipal construction projects.

The “franchisee” in a concession covered by the Infrastructure Measures is defined as the institution or organization selected and authorized by the government to invest, build, and operate infrastructure and public utilities projects and that is expected to provide products and services to the public. The Infrastructure Measures enlarge the category of eligible franchisees to encompass domestic, as well as foreign, entities.

The Infrastructure Measures specifically permit the use of various kinds of traditional PPP arrangements, such as BOT (Build-Operate-Transfer), BOOT (Build-Own-Operate-Transfer) and BTO (Build-Transfer-Operate) models. Finally, the Infrastructure Measures also require that the term of any such PPP must not, in general, exceed a duration of 30 years.

Financing

The Infrastructure Measures permit financial institutions to provide multi-layered and “diversified” financial support to eligible PPPs. Apart from traditional term loans with a tenor of up to 30 years, the participation of private equity investment funds and strategic investors, and the utilization of financing tools such as syndicated loans, corporate bonds and project revenue bonds, are all explicitly encouraged by the Infrastructure Measures, and the government is permitted to support the financing of PPPs with fiscal subsidies and interest subsidies.

Execution and Performance of Concession Agreements

Pursuant to the requirements of the Infrastructure Measures, the relevant governmental authority is required to conclude a concession agreement in writing with the selected private franchisee for each PPP arrangement. For the very first time, the Infrastructure Measures set out comprehensive Chinese law provisions stipulating the proper manner for the execution, performance, amendment and termination of the concession agreements made between the private franchisee and the relevant governmental party for the PPP addressed by the Infrastructure Measures. For example, the Infrastructure Measures identify 16 mandatory clauses that must be included in any concession agreement, including clauses identifying the project name and content, type of concession arrangement, geographical area impacted, duration of the concession arrangement, key information concerning the project company, tenor and method of investment and financing, etc. Most noteworthy, if there is any change in applicable Chinese law, regulation or policy which leads to economic loss in, or damage to, the expected return on investment of the private franchisee, or which leads to an early termination of the concession, the Infrastructure Measures provide that the relevant governmental party must compensate the franchisee, if applicable, in accordance with the concession agreement made between the parties.

However, the Infrastructure Measures address no specific rights and obligations of any other typical participants in PPPs, such as the creditors of the project companies, EPC contractors, O&M providers, suppliers, insurers, etc. Whether these parties have a right to damages or specific enforcement in connection with PPPs through the specific provisions of the Infrastructure Measures remains unclear.

Dispute Resolution

What will perhaps be most troubling to private investors considering potential PPP opportunities in China is that the statutory methods of dispute resolution under the Infrastructure Measures include negotiation, mediation, and administrative review/litigation (a special kind of dispute resolution method employed in China where a party to such dispute is a Chinese governmental authority), yet do not include the possibility of civil litigation or arbitration. Indeed, the option of relying on civil litigation and arbitration for dispute resolution was intentionally removed by Chinese law makers from the last draft of the Infrastructure Measures made available for public comment. Such a controversial approach may be indicative of the Chinese authorities’ viewpoint on the nature of PPPs in China. In particular, such PPPs may be seen by the relevant Chinese authorities as primarily a government-oriented arrangement

involving a private contractor rather than an equal commercial endeavor as between two mutual counterparties. From this perspective, practical uncertainties remain in relation to the protection and enforcement of the legal interests of private investors in such PPPs.

Regulation and Protection of the Public Interest

The Infrastructure Measures entitle the relevant governmental party to monitor and assess the construction and operation status of the projects in question on a regular basis, and adjust the consideration and amount of fiscal subsidies accordingly in accordance with the concession agreements. It is also specified that public opinion and feedback should be taken into consideration during such monitoring and assessment. In addition, detailed information concerning the PPPs, including the procedure for selecting the relevant franchisee, the full text of the underlying concession agreement, accounting data and financial statements concerning the project, etc., will need to be disclosed to the public pursuant to the requirements of the Infrastructure Measures.

Finally, the Infrastructure Measures stipulate that the selected franchisee is not permitted to adopt different conditions or terms in respect of different end users of the public products and services covered by the PPP within the same geographic area as prescribed in the relevant concession agreements, and must also prepare for contingency plans to secure the continuing supply of public products and services.

Preferential Tax Treatment and Financial Incentives

Unfortunately, the Infrastructure Measures are silent on whether the Chinese authorities will extend any preferential tax treatment or other financial incentives with a goal of encouraging private capital to participate in the PPPs covered by the Infrastructure Measures. Practically speaking, however, it may be possible for private participants in these PPPs to enjoy certain preferential financial treatment through tax rebates or refunds extended by local tax authorities. As such, private investors are encouraged to seek tax advice on a case-by-case basis before entering into any concession with a local Chinese governmental party.

Conclusion

Although they are not yet effective, the Infrastructure Measures are already viewed by public media as establishing the early foundations of a basic legal regime governing PPPs in China. In particular, it is expected that with the benefit of this basic legal framework, PPPs will serve as an effective means of facilitating aggressive urbanization in China, even as overall Chinese GDP slows and many local governments are challenged by increased debt.

In addition, for foreign investors interested in participating in infrastructure PPPs in China, it is important to remember that the Infrastructure Measures merely state that all existing Chinese laws and regulations relating to foreign direct investment in China will continue to apply. As such, foreign investors will still need to be aware of and consider all relevant Chinese statutory requirements for market entry. For example, foreign investors seeking to participate in Chinese PPPs under the Infrastructure Measures will nevertheless be required to establish a specific permanent business presence in China in order to seek to engage in such PPPs.

Consequently, some actions for potential investors to consider in connection with the Infrastructure Measures at this early stage include:

- Become familiar with the specific provisions of the Infrastructure Measures;
- Assemble and liaise with an advisor team with capabilities in multi-jurisdictional project development and financings in emerging markets, particularly in China; and



- Explore potential sources of capital and financing available for PPPs in China, including from commercial financial institutions, investment funds, government entities, development financial institution and high net worth individuals.

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