Italian Grant Agreement

(for Co-financing of Heilongjiang Dairy Project)

between

PEOPLE’S REPUBLIC OF CHINA

and

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

Dated April 26, 2006
ITALIAN GRANT AGREEMENT

AGREEMENT, dated April 26, 2006, between PEOPLE’S REPUBLIC OF CHINA (the Recipient) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank) acting as Administrator (the Administrator) of grant funds (the Italian Grant) provided by the Republic of Italy (Italy).

WHEREAS (A) Italy has provided grant funds (the Grant Funds) to the Bank as Administrator pursuant to an Administration Agreement, dated June 30, 2004, between the Republic of Italy and the Bank for the financing of an environmental protection program in China;

(B) the Recipient, having satisfied itself as to the feasibility and priority of the project described in Schedule 2 to this Agreement (the Project), has requested a grant to be made available out of the Grant Funds in an amount of equal to five million five hundred thousand Dollars ($5,500,000) (the Italian Grant) for financing Part C of the Project;

(C) the Recipient has also requested the Bank to provide additional assistance towards the financing of the Project, and by an agreement of even date herewith between the Recipient and the Bank (the Loan Agreement), the Bank is agreeing to provide such assistance in an amount equal to one hundred million Dollars ($100,000,000) (the Loan);

(D) the Project will be carried out by Heilongjiang Province (Heilongjiang) with the Recipient’s assistance and, as part of such assistance, the Recipient will make the proceeds of the Italian Grant available to Heilongjiang to finance Part C of the Project, as provided in this Agreement;

WHEARES, the Bank, as Administrator of the Italian Grant has agreed, on the basis of the foregoing, to extend the Italian Grant to the Recipient upon the terms and conditions set forth in this Agreement; and

NOW THEREFORE the parties hereto hereby agree as follows:
ARTICLE I

General Conditions; Definitions

Section 1.01 (a) The following provisions of the “General Conditions Applicable to Loan and Guarantee Agreements for Single Currency Loans” of the Bank, dated May 30, 1995 (as amended through May 1, 2004), with the modifications set forth in paragraph (b) of this Section (the General Conditions) constitute an integral part of this Agreement:

(i) Article I;

(ii) Sections 2.01 (2), (3), (4), (5), (6), (7), (8), (14), (15), (16), (18) and (21), 2.02 and 2.03;

(iii) Section 3.01;

(iv) Sections 4.01 and 4.06;

(v) Article V;

(vi) Sections 6.01, 6.02 (a), (c), (d), (e), (f), (i), (l), (m), (n), (o) and (p), 6.03, 6.04 and 6.06;

(vii) Section 8.01 (b);

(viii) Sections 9.01 (a) and (c), 9.04, 9.05, 9.06, 9.07, 9.08 and 9.09;

(ix) Sections 10.01, 10.03 and 10.04;

(x) Article XI; and

(xi) Sections 12.01 (c), 12.02, 12.03 and 12.04.

(b) The General Conditions shall be modified as follows:

(i) the term “Bank”, wherever used in the General Conditions, other than in Sections 2.01 (6), 6.02 (f) and 5.01 (a) thereof, means the Bank acting as Administrator of the Italian Grant, except that in Section 6.02, the term “Bank” shall also include the Bank acting in its own capacity;

(ii) the term “Borrower”, wherever used in the General Conditions, means the Recipient;
(iii) the term “Loan Agreement”, wherever used in the General Conditions, means this Agreement;

(iv) the term “Loan” and “loan”, wherever used in the General Conditions, means the Italian Grant;

(v) the term “Loan Account”, wherever used in the General Conditions, means the Italian Grant Account, an account opened by the Administrator on its books in the name of the Recipient to which the amount of the Italian Grant is credited; and

(vi) the words “corrupt or fraudulent” in paragraph (c) of Section 6.03 are replaced with the words “corrupt, fraudulent, collusive or coercive”.

Section 1.02. Unless the context otherwise requires, the several terms defined in the Loan Agreement, General Conditions and in the Recitals to this Agreement have the respective meanings therein set forth, and the following additional terms have the following meanings:

(a) “Loan Agreement” means the agreement of even date herewith between the Recipient and the Bank for the Project, as such agreement may be amended from time to time; and such term includes all schedules and agreements supplemental to the Loan Agreement; and

(b) “Special Account” means the account referred to in Section 2.02 (b) of this Agreement.

ARTICLE II

The Italian Grant

Section 2.01. The Bank agrees to make available to the Recipient, on the terms and conditions set forth or referred to in this Agreement, the Italian Grant in an amount equal to five million five hundred thousand Dollars ($5,500,000).

Section 2.02. (a) The amount of the Italian Grant may be withdrawn from the Italian Grant Account in accordance with the provisions of Schedule 1 to this Agreement for: (i) expenditures made (or, if the Bank shall so agree, to be made) in respect of the reasonable cost of goods, works, and services required for Part C (except for Part C.4) of the Project and to be financed out of the proceeds of the Italian Grant; and (ii) Competitive Research Sub-grants under Part C.4 of the Project to meet the reasonable costs of goods, works, or services required for an eligible Competitive Research Sub-
project and in respect of which the withdrawal from the Italian Grant Account is requested.

(b) The Recipient may, for the purposes of Part C of the Project, open and maintain in Dollars a separate special deposit account in a commercial bank on terms and conditions satisfactory to the Bank, including appropriate protection against set off, seizure or attachment. Deposits into, and payments out of, the Special Account shall be made in accordance with the provisions of Schedule 3 to this Agreement.

Section 2.03. The Closing Date shall be December 31, 2010, or such later date as the Bank shall establish. The Bank shall promptly notify the Recipient of such later date.

ARTICLE III

Execution of the Project

Section 3.01. (a) The Recipient declares its commitment to the objectives of the Project, and, to this end, without any limitation or restriction upon any of its other obligations under this Agreement, shall cause Heilongjiang to perform in accordance with the provisions of the Project Agreement all the obligations of Heilongjiang therein set forth, shall take and cause to be taken all action, including the provision of funds, facilities, services and other resources necessary or appropriate to enable Heilongjiang to perform such obligations, and shall not take or permit to be taken any action which would otherwise prevent or interfere with such performance.

(b) The Recipient shall make the proceeds of the Italian Grant available to Heilongjiang under terms and conditions satisfactory to the Bank.

Section 3.02. Except as the Bank shall otherwise agree, procurement of the goods, works, or services required for Part C of the Project and to be financed out of the proceeds of the Italian Grant shall be governed by the provisions of Schedule 1 to the Project Agreement, as said provisions may be further elaborated in the Procurement Plan.

Section 3.03. The Bank and the Recipient hereby agree that the obligations set forth in Sections 9.04, 9.05, 9.06, 9.07, 9.08 and 9.09 of the General Conditions (relating to insurance, use of goods and services, plans and schedules, records and reports, maintenance and land acquisition, respectively) shall be carried out by Heilongjiang to Section 2.03 of the Project Agreement.
ARTICLE IV

Financial Covenants

Section 4.01. (a) The Recipient shall cause Heilongjiang to maintain a financial management system, including records and accounts, and prepare financial statements, all in accordance with consistently applied accounting standards acceptable to the Bank, adequate to reflect its operations, resources and expenditures related to the Project.

(b) The Recipient shall cause Heilongjiang to:

   (i) have the financial statements referred to in paragraph (a) of this Section for each fiscal year (or other period agreed to by the Bank) audited, in accordance with consistently applied auditing standards acceptable to the Bank, by independent auditors acceptable to the Bank;

   (ii) furnish to the Bank as soon as available, but in any case not later than six (6) months after the end of each such year (or such other period agreed to by the Bank), (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year (or such other period agreed to by the Bank), as so audited, and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to the Bank; and

   (iii) furnish to the Bank such other information concerning such records, accounts and the audit of such financial statements, and concerning said auditors, as the Bank may from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Italian Grant Account were made on the basis of statements of expenditure, the Recipient shall:

   (i) ensure that all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures are retained until at least (1) one year after the Bank has received the audit report for, or covering, the fiscal year in which the last withdrawal from the Italian Grant Account was made;

   (ii) enable the Bank’s representatives to examine such records; and

   (iii) ensure that such statements of expenditure are included in any audit that the Bank may have requested pursuant to paragraph (b) of this Section.
ARTICLE V

Remedies of the Bank

Section 5.01. Pursuant to Section 6.02 (p) of the General Conditions, the following additional events are specified:

(a) Heilongjiang shall have failed to perform any of its obligations under the Project Agreement;

(b) As a result of events which have occurred after the date of the Italian Grant Agreement, an extraordinary situation shall have arisen which shall make it improbable that Heilongjiang will be able to perform its obligations under the Project Agreement; or

(c) (i) Subject to sub-paragraph (ii) of this paragraph (c),

(A) the right of the Recipient to withdraw the proceeds of the Loan shall have been suspended, canceled or terminated in whole or in part, pursuant to the terms of the Loan Agreement; or

(B) the Loan shall have become due and payable prior to the agreed maturity thereof.

(ii) Sub-paragraph (i) of this paragraph (c) shall not apply if the Recipient establishes to the satisfaction of the Bank that: (A) such suspension, cancellation, termination or prematuring is not caused by the failure of the Recipient to perform any of its obligations under the Loan Agreement; and (B) adequate funds for the Project are available to the Recipient from other sources on terms and conditions consistent with the obligations of the Recipient under this Agreement.

ARTICLE VI

Effectiveness, Termination

Section 6.01. This Agreement shall become effective upon its execution by the parties hereto or the Effective Date of the Loan Agreement, whichever is later.

Section 6.02. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.
Section 6.03. This Agreement shall continue in effect until the Italian Grant has been fully disbursed and the parties to this Agreement have fulfilled all their obligations hereunder, provided, however, that if the Loan Agreement terminates prior to the termination of this Agreement, this Agreement shall terminate automatically and shall cease to have any further force or effect.

ARTICLE VII

Representative of the Recipient; Addresses

Section 7.01. The Minister of Finance of the Recipient is designated as representative of the Recipient for the purposes of Section 11.03 of the General Conditions.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Recipient:

Ministry of Finance
Sanlihe, Beijing 100820
People’s Republic of China

Facsimile:

(86-10) 68551125

For the Bank:

International Bank for Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address: INTBAFRAD
Telex: 248423 (MCI) or 64145 (MCI)
Facsimile: (1-202) 477-6391
IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in Beijing, People’s Republic of China, as of the day and year first above written.

PEOPLE’S REPUBLIC OF CHINA

By /s/ Yang Shaolin

Authorized Representative

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

By /s/ David Dollar

Authorized Representative
### SCHEDULE 1

**Withdrawal of the Proceeds of the Italian Grant**

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Italian Grant, the allocation of the amounts of the Italian Grant to each Category and the percentage of expenditures for items so to be financed in each Category:

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount of the Italian Grant Allocated (Expressed In Dollars)</th>
<th>% of Expenditures to be Financed</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Competitive Research Sub-grants under Part C.4 of the Project</td>
<td>600,000</td>
<td>55% of amounts under Competitive Research Sub-projects</td>
</tr>
<tr>
<td>(2) Goods under Part C of the Project</td>
<td>2,200,000</td>
<td>100% of foreign expenditures, 100% of local expenditures (ex-factory cost) and 75% of local expenditures for other items procured locally.</td>
</tr>
<tr>
<td>(3) Works under Part C of the Project</td>
<td>2,300,000</td>
<td>50%</td>
</tr>
<tr>
<td>(4) Consultants’ services under Part C of the Project</td>
<td>350,000</td>
<td>100%</td>
</tr>
<tr>
<td>(5) Training under Part C of the Project</td>
<td>50,000</td>
<td>100%</td>
</tr>
<tr>
<td><strong>TOTAL:</strong></td>
<td><strong>5,500,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

2. For the purposes of this Schedule:

   (a) the term “foreign expenditures” means expenditures in the currency of any country other than that of the Recipient for goods or services supplied from the
territory of any country other than that of the Recipient; provided, however, that expenditures in the currency of the Hong Kong Special Administrative Region of the Borrower for goods or services supplied from said region, and expenditures in the currency of the Macau Special Administrative Region of the Recipient for goods or services supplied from said region shall be deemed “foreign expenditures”; and

(b) the term “local expenditures” means expenditures that are not foreign expenditures.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of payments made for expenditures prior to the date of this Agreement, except that withdrawals, in an aggregate amount of not exceeding $275,000 may be made in respect of Categories (1), (2), (3), (4), and (5) set forth in the table in paragraph 1 of this Schedule on account of payments made for expenditures before that date but after April 1, 2005.

4. The Bank may require withdrawals from the Italian Grant Account to be made on the basis of statements of expenditure for expenditures under contracts for: (a) goods costing less than $300,000 equivalent per contract; (b) works costing less than $1,000,000 equivalent per contract; (c) services of individual consultants costing less than $50,000 equivalent per contract; (d) services of consulting firms costing less than $100,000 equivalent per contract; (e) training; and (f) Competitive Research Sub-grants, all under such terms and conditions as the Bank shall specify by notice to the Recipient.

5. If the Bank shall have determined at any time that any payment made from the Italian Grant Account was used for any expenditures not consistent with the provisions of this Agreement, the Recipient shall, promptly upon notice from the Bank, refund to the Bank for deposit into the Italian Grant Account, an amount equal to the amount so used or the portion thereof as specified by the Bank.
SCHEDULE 2

Description of the Project

The objective of the Project is to assist the Recipient to: (i) improve the financial viability of dairy operations in selected areas of Heilongjiang Province; and (ii) demonstrate innovative technologies to reduce greenhouse gas emissions and increase carbon sequestration in selected areas of Heilongjiang Province.

The Project consists of the following parts, subject to such modifications thereof as the Borrower and the Bank may agree upon from time to time to achieve such objectives:

Part A: Dairy Production Development

Carrying out specific dairy production Sub-projects in Heilongjiang as described in paragraph 1 through paragraph 4 in this Part A and providing capacity building for implementation of said Sub-projects as described in paragraph 5 of this Part A:

1. Supporting about 10,000 individual households to engage in dairy production or to increase their dairy herd productivity and size through the purchase by each said household of 1 to 6 dairy cows and a set of farming tools.

2. Establishing about 55 milking stations, including construction of milking sheds, provision of related milking and milk storage equipment, and installation of internet connected computer systems for each milking station for management of cow performance records.

3. Establishing about 50 new dairy parks and upgrading about 20 existing dairy parks, including: (a) construction of the dairy park facilities and required access roads, and (b) purchase and installation of related dairy farming equipment and office equipment for said dairy parks.

4. Establishing about 7 demonstration farms, including: (a) importing of about 600 dairy cattle of high quality for each demonstration farm; and (b) purchase and installation of related dairy farming equipment and office equipment.

5. Carrying out a program of capacity building for implementation of the activities described in the above paragraphs (1) through (5) under this Part A of the Project, through:

(a) strengthening the implementation capacity of various stakeholders involved in dairy production by: (i) the development of training manuals for extension workers, milk processing staff, and farmers; (ii) the provision of training to the staff of
the Heilongjiang Animal Husbandry Bureau, dairy park owners and managers, technicians, and dairy farmers on animal husbandry and breeding, animal nutrition including least cost feed rationing, animal condition scoring, pasture and natural resources management, milk hygiene and environmental protection; and (iii) the provision of vehicles, artificial insemination equipment, and veterinary equipment for the staff of the Animal Husbandry Bureaus in the participating towns; and

(b) supporting the development of village-level dairy farmer associations by: (i) the development of relevant training materials; (ii) the provision of training to members and leaders of farmer associations on association charter development and member rights and obligations; to municipal, county, and township leaders and trainers on participatory approaches in the decision-making process in the farmer associations, Chinese laws and regulations pertinent to agricultural and civic associations, and agricultural business management; and (iii) the provision of study tours for trainers, government officials, and community leaders to understand the farmer association development process.

Part B: Dairy Breed Improvement

Carrying out a program to improve the genetic base of the dairy herd and the efficiency of dairy production in Heilongjiang through establishing a dairy herd improvement program (DHIP), consisting of:

1. Establishing and equipping a DHIP management unit within the Heilongjiang Dairy Industry Association.

2. Providing training to staff in relevant government agencies and farmers on dairy reproductive management.

3. Establishing a milk recording system to record breeding, feeding, milk production and hygiene data for about 150,000 dairy cows, including: construction of a milk testing laboratory and a milk recording administration office, and provision of milk sampling equipment.

4. Accelerating dairy genetic improvement, through: (a) importation of about 840,000 units of semen of proven bulls; (b) construction of an on-station semen storage facility and a long-term semen storage facility; (c) provision of liquid nitrogen storage equipment; (d) preparation of internationally acceptable standards for the accreditation of inseminators, and (e) strengthening technical capabilities of breeding centers participating in the Project.
5. Establishing a genetic evaluation system, including: installation of computer systems for genetic data analysis and management and a duplicate data storage facility, and provision of skills training on dairy breed improvement, and dairy genetic evaluation and analysis.

Part C: Climate Change Mitigation

Carrying out a program to pilot innovative technologies to increase carbon sequestration and mitigate greenhouse gas emissions from livestock production in Heilongjiang, including:

1. Improving pasture management to increase fodder production and carbon sequestration, and to combat desertification.

2. Treating crop residues to improve the quality and usage in animal feeding, to decrease methane emissions, and to reduce on-field burning of residues.

3. Treating animal manure to reduce methane emissions and convert it into salable fertilizers.

4. Carrying out Competitive Research Sub-projects for developing, testing, and transferring technologies that reduce greenhouse gas emissions and increase carbon sequestration.

5. Monitoring and evaluating the financial viability and environmental impacts of the activities described in paragraphs (1) through (4) of this Part C.

Part D: Project Management, Monitoring and Evaluation

Carrying out a program to strengthen the capacities of the agencies participating in the implementation and monitoring of the Project, including:

1. Strengthening the capacities of the Provincial PMO and of local project management offices at the municipal and county levels for implementation of the Project, through provision of office equipment, and vehicles.

2. Supporting the Provincial PMO in undertaking its socio-economic and dairy production surveys.

3. Strengthening the capacity of the Heilongjiang Environmental Protection Bureau to monitor the environmental impacts of the Project.
4. Strengthening the capacities of the Provincial PMO and of the Heilongjiang Finance Bureau with respect to the day-to-day management of the Sub-loans, including appraising Sub-loans and Sub-projects, managing and monitoring the recovery of Sub-loans.

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The Project is expected to be completed by June 30, 2010.
SCHEDULE 3

Special Account

1. For the purposes of this Schedule:

   (a) the term “eligible Categories” means Categories (1) through (5) set forth in the table in paragraph 1 of Schedule 1 to this Agreement;

   (b) the term “eligible expenditures” means expenditures in respect of the reasonable cost of goods, works, and services required for Part C of the Project and to be financed out of the proceeds of the Italian Grant allocated from time to time to the eligible Categories in accordance with the provisions of Schedule 1 to this Agreement; and

   (c) the term “Authorized Allocation” means an amount equal to $600,000 to be withdrawn from the Italian Grant Account and deposited into the Special Account pursuant to paragraph 3(a) of this Schedule.

2. Payments out of the Special Account shall be made exclusively for eligible expenditures in accordance with the provisions of this Schedule.

3. After the Bank has received evidence satisfactory to it that the Special Account has been duly opened, withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:

   (a) For withdrawals of the Authorized Allocation, the Recipient shall furnish to the Bank a request or requests for deposit into the Special Account of an amount or amounts which do not exceed the aggregate amount of the Authorized Allocation. On the basis of such request or requests, the Bank shall, on behalf of the Recipient, withdraw from the Italian Grant Account and deposit into the Special Account such amount or amounts as the Recipient shall have requested.

   (b) (i) For replenishment of the Special Account, the Recipient shall furnish to the Bank requests for deposits into the Special Account at such intervals as the Bank shall specify.

   (ii) Prior to or at the time of each such request, the Recipient shall furnish to the Bank the documents and other evidence required pursuant to paragraph 4 of this Schedule for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Bank shall, on behalf of the Recipient, withdraw from the Italian Grant Account and deposit into the Special Account such amount as the Recipient shall have
requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account for eligible expenditures. All such deposits shall be withdrawn by the Bank from the Italian Grant Account under the respective eligible Categories, and in the respective equivalent amounts, as shall have been justified by said documents and other evidence.

4. For each payment made by the Recipient out of the Special Account, the Recipient shall, at such time as the Bank shall reasonably request, furnish to the Bank such documents and other evidence showing that such payment was made exclusively for eligible expenditures.

5. Notwithstanding the provisions of paragraph 3 of this Schedule, the Bank shall not be required to make further deposits into the Special Account:

   (a) if, at any time, the Bank shall have determined that all further withdrawals should be made by the Recipient directly from the Italian Grant Account in accordance with the provisions of Article V of the General Conditions and paragraph (a) of Section 2.02 of this Agreement;

   (b) if the Recipient shall have failed to furnish to the Bank, within the period of time specified in Section 4.01(b)(ii) of this Agreement, any of the audit reports required to be furnished to the Bank pursuant to said Section in respect of the audit of the records and accounts for the Special Account;

   (c) if, at any time, the Bank shall have notified the Recipient of its intention to suspend in whole or in part the right of the Recipient to make withdrawals from the Italian Grant Account pursuant to the provisions of Section 6.02 of the General Conditions; or

   (d) once the total unwithdrawn amount of the Italian Grant allocated to the eligible Categories, minus the total amount of all outstanding special commitments entered into by the Bank pursuant to Section 5.02 of the General Conditions with respect to Part C of the Project, shall equal the equivalent of twice the amount of the Authorized Allocation.

Thereafter, withdrawal from the Italian Grant Account of the remaining unwithdrawn amount of the Italian Grant allocated to the eligible Categories for Part C of the Project shall follow such procedures as the Bank shall specify by notice to the Recipient. Such further withdrawals shall be made only after and to the extent that the Bank shall have been satisfied that all such amounts remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for eligible expenditures.
6. (a) If the Bank shall have determined at any time that any payment out of the Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Schedule; or (ii) was not justified by the evidence furnished to the Bank, the Recipient shall, promptly upon notice from the Bank: (A) provide such additional evidence as the Bank may request; or (B) deposit into the Special Account (or, if the Bank shall so request, refund to the Bank) an amount equal to the amount of such payment or the portion thereof not so eligible or justified. Unless the Bank shall otherwise agree, no further deposit by the Bank into the Special Account shall be made until the Recipient has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Bank shall have determined at any time that any amount outstanding in the Special Account will not be required to cover further payments for eligible expenditures, the Recipient shall, promptly upon notice from the Bank, refund to the Bank such outstanding amount.

(c) The Recipient may, upon notice to the Bank, refund to the Bank all or any portion of the funds on deposit in the Special Account.

(d) Refunds to the Bank made pursuant to paragraphs 6 (a), (b) and (c) of this Schedule shall be credited to the Italian Grant Account for subsequent withdrawal or for cancellation in accordance with the relevant provisions of this Agreement, including the General Conditions.