

REGULATORY OVERVIEW

REGULATORY MATTERS OF THE PRC AIR CONDITIONER INDUSTRY

The following laws, rules and regulations are relevant to the manufacture and sale of the Group's products and the operation of the Group's principal business.

The Regulations on the Administration of Compulsory Product Certification (強制性產品認證管理規定), which was promulgated on 21 November 2001 and became effective on 1 May 2002, provides that the State shall publish Catalogues of Products under Compulsory Production Certification (the "Certification Catalogues"), and the products listed in the Certification Catalogues must only be sold, imported or used in the business activities with the sign of such certification after having obtained the certificate issued by the certification institution designated by the State.

Energy Label Management Rules (能源效率標識管理辦法), which was promulgated on 13 August 2004 and became effective on 1 March 2005, provides that the State shall publish Catalogues of Products for Implementing Energy Label in the PRC (the "China Energy Label Catalogues"), and the products listed in the China Energy Label Catalogues shall be marked with the unified China energy labels on the obvious parts of the products or on the smallest package of the products. Manufacturers must file energy labels and the relevant information with the institution authorised by the competent authorities within 30 days after having used the energy labels.

Regulations for the Implementation of the Energy Efficiency Label for Variable Speed Room Air Conditioners ("轉速可控型房間空氣調節器能源效率標識實施規則"), and Catalogues of Products for Implementing Energy Efficiency Label in the PRC (the Fourth Batch) ("中華人民共和國實行能源效率標識的產品目錄(第四批)"), which became effective on 1 March 2009, require that variable speed room air conditioners shall be marked with energy labels. According to the National Development and Reform Commission, the General Administration of Quality Supervision, Inspection and Quarantine and the Certification and Accreditation Administration of the PRC's Announcement No. 64 of 2008 ("2008年第64號公告") promulgated on 17 October 2008, the deadline for marking such energy labels for the products with ex-factory date before 31 December 2008 is postponed until 1 March 2010.

The PRC Administration Rules of Industrial Product Production Licenses Regulations (中華人民共和國工業產品生產許可證管理條例), which was promulgated on 9 July 2005 by the State Council and became effective on 1 September 2005, provides for the State to implement a production licensing system on enterprises that engage in the production of important industrial products listed in the Catalogue for Industrial Products Implementing Products Licensing System (the "Industrial Products Catalogue") promulgated by the department in charge (currently the General Administration of Quality Supervision, Inspection and Quarantine, hereinafter referred to as "AQSIQ"). No enterprise may produce any products in the Industrial Products Catalogue, without obtaining an industrial product production licence (the "Production Licence"). No work unit or individual may produce, sell or use products in the Industrial Products Catalogue for which the relevant Production Licence has not been obtained.

Pursuant to the Notice on intensifying the implementation of the policy of home appliances going to the countryside (No. 48 of 2009 of the Ministry of Finance) ("加大家電下鄉政策實施力度的通知"財建[2009]48號) promulgated on 26 February 2009 by the Ministry of Finance, the Ministry of Commerce and the Ministry of Industry and

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Information Technology, the basis of fully implementing the current categories for receiving rebate which previously permitted each province (or region, municipality) to have the autonomy to select two in the four categories of motorbikes, computers, water heaters and air conditioners going to the countryside was now uniformly implemented nationwide by permitting all four categories above going to the countryside. On 16 April 2009, the Ministry of Finance together with the Ministry of Commerce, the Ministry of Industry Information Technology, the National Development and Reform Commission and other members of Joint Meeting of Home Appliances Going to the Countryside promulgated the Detailed Operation Rules for Home Appliances Going to the Countryside (“家電下鄉操作細則”) (“the Detailed Operation Rules”). According to the Detailed Operation Rules which came into force on the same day, each rural household could buy a maximum of two sets of home appliances which receive rebates for each category of home appliances that go to the countryside. The ceiling prices for the home appliances going to the countryside are as follows: Wall-mounted type air-conditioners (壁掛式空調) is RMB2,500, and Floor-standing type air conditioners (落地式空調) is RMB4,000. The farmers buying home appliances going to the countryside could enjoy a 13 per cent rebate as to the sales prices, which will be borne jointly by central treasury and local treasury. The implementation period for home appliances going to the countryside in all the regions is uniformly set for 4 years temporarily. Enterprises selling home appliances going to the countryside shall be decided by bidding invitation, and the competent provincial department of commerce and finance shall recommend sales enterprises according to the physical circumstances in the region. The chain outlets, or franchise outlets or authorised outlets of sales enterprises could not sell home appliances going to the countryside without reporting to the competent local department of commerce at the county for local filing.

The Law of the PRC on Environmental Protection (《中華人民共和國環境保護法》) (the “Environmental Protection Law”), which was promulgated and became effective on 26 December 1989, forms the legal framework for environmental protection in the PRC. The Environmental Protection Law is formulated for the purpose of protecting and improving living environment and ecological environment, preventing pollution and other public hazards and safeguarding human health.

According to the *Administration of Construction Project Environmental Protection Regulations* (《建設項目環境保護管理條例》), which was promulgated and became effective on 29 November 1998, environmental impact assessments (EIAs) must be carried out by qualified work units on construction projects. If a construction project will have a major effect on the environment, the EIA must contain a complete and detailed assessment of the pollution to be caused and the effect on the environment. A construction project environmental impact report must then be submitted by the relevant work unit. If the construction project will have minor effect on the environment, the EIA must analyse or assess the pollution to be caused and its effect, and a construction project impact statement must then be submitted by the relevant work unit; and if the construction effects will be minimal, no EIA is needed, but an environmental impact form must be completed and submitted. Construction project environmental impact reports, environmental impact statements or environmental impact registration forms shall be submitted by the construction units to competent authorities of environmental protection administration for approval.

On 27 April 2006, the General Bureau of the Environmental Protection of the PRC, the Ministry of Science and Technology of the PRC, the Ministry of Information Industry of the PRC and the Ministry of Commerce of the PRC jointly promulgated the Prevention and

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Cure Technology Policy for Abandoned Home Electrical Appliances (《廢棄家用電器與電子產品污染防治技術政策》, the “Technology Policy”) which became effective on the same date. The Technology Policy was introduced so as to reduce the number of abandoned home appliances (including air-conditioners) and electronic products, to improve the use efficiency of resources and to control environmental pollution in the process of reuse and disposition. The Technology Policy is applied to the environmental design of home electrical appliances and electronic products, the process of collection, transportation, storage, reuse and disposition of abandoned products, and provides the technological guidance for the planning, design, construction, operation and management of reuse and disposition facilities for abandoned home electrical appliances and electronic products.

According to the PRC Civil Law, if a poor quality product causes property damage or physical injury to others, the manufacturer or seller of the product shall bear civil liability. If the transporter or warehousing provider is responsible for the property damage or physical injury, the manufacturer or seller shall have the right to claim damages. Limitation of action shall be one year in cases concerning the sale of substandard goods without proper notice to that effect.

According to the Product Quality Law, products must pass quality inspections and no unqualified products may be used as qualified products. A supervision and inspection system based on random inspection is implemented by the State to test those products that may threaten physical health or personal or property safety, those important industrial products that have a material bearing on the national economy and those products that have been reported by consumers or relevant organisations as defective in quality. Producers may be liable to provide compensation, under certain circumstances. Producers will not be responsible if they can prove one of the following cases:

- (1) the products have not been put into circulation;
- (2) the defects are non-existent when the products are put into circulation; and
- (3) the defects cannot be found at the time of circulation due to scientific and technological reasons.

According to the Consumers’ Protection Law, where a consumer’s legal rights or interests are harmed as a result of the purchase or use of a commodity, he or she may demand compensation from the seller. Where the liability lies with the manufacturer or another seller which provides the commodities to the seller, the seller, after paying compensation to the consumer, shall have the right to recover such compensation from that manufacturer or that other seller. Where a consumer sustains property damage or personal injury due to the defect of a commodity, he or she may demand compensation from the seller and/or the manufacturer. Where the liability lies with the manufacturer, the seller, after paying compensation, shall have the right to recover such compensation from the manufacturer. Where the liability lies with the seller, the manufacturer, after paying compensation, shall have the right to recover such compensation from the seller. In the event of disputes with the manufacturer regarding consumers’ rights and interests, consumers may pursue the following avenues in settling the disputes:

- (1) holding reconciliation talks with the manufacturer;
- (2) requesting consumers’ associations to help in mediation;

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- (3) filing petitions with relevant administrative departments;
- (4) applying to arbitration bodies for arbitration proceedings pursuant to the relevant agreements reached with the manufacturer; and
- (5) instituting legal proceedings in people's courts.

The Provisions on the Liabilities of the Repair, Replacement and Return of Goods (《部分商品修理更換退貨責任規定》) which was promulgated and became effective on 25 August 1995 provides, among others, the relevant liabilities in relation to the repair, replacement and return of certain products, including but not limited to, air-conditioners. The major provisions are as follows:

- (1) If there is a malfunction of products within 7 days after they are sold, consumers have the right to choose to return, replace or repair the products. The seller shall have the right of recourse to the producers or distributors, or the matter must be settled according to the relevant purchase agreements after the producers or distributors pay back the purchase price according to the amount stated in the sales invoices;
- (2) If there is a malfunction of products within 15 days after they are sold, consumers have the right to choose to replace or repair the products. The seller shall have the right of recourse to the producers or distributors, or the matter must be settled according to the relevant purchase agreements after the producers or distributors replace the products for the consumers; and
- (3) For products which cannot function properly after having been repaired twice within a specified period, the seller must replace the products for the consumers upon production of evidence of repairing or shall pay back the purchase price to the consumers. The seller shall have the right of recourse over the producers or distributors, or the matter must be settled according to the relevant purchase agreements after the producers or distributors replace the products for the consumers or pay back the purchase price to the consumers.

According to *the Production Safety Law of the PRC* (《中華人民共和國安全生產法》), which was promulgated on 29 June 2002 and became effective on 1 November 2002, companies conducting production activities must meet the conditions for safe production stipulated by the laws and regulations. Companies conducting production activities that have more than 300 employees must form a management department for production safety or have personnel solely responsible for production safety. Companies conducting production activities that have less than 300 employees must have personnel solely responsible for production safety or have part-time personnel responsible for the management of production, or entrust engineering technicians with qualifications stipulated by laws and regulations for such purpose. Companies conducting production activities must place warning signs in the working place or on the equipment which is comparatively more hazardous. Companies conducting production activities must take out job-related injury insurance in accordance with applicable laws and regulations.

Pursuant to *the Labour Contract Law*, *the Decision in relation to the Establishment of Unified Basic Pension Insurance System for Employees working in Enterprises* (《關於建立統一的企業職工養老保險的決定》), *the Decision in relation to the Perfection of Basic*

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Pension Insurance System for Employees Working in Enterprises (《關於完善企業職工基本養老保險的決定》), *the Decision in relation to the Establishment of Basic Medical Insurance System for Employees in Urban and Town Areas* (《關於建立城鎮職工基本醫療保險制度的決定》), *the Regulations on the Job-related Injury Insurance* (《工傷保險條例》), *the Regulations on the Housing Provident Fund* (《住房公積金管理條例》), and other relevant national laws and regulations and local rules, except where there are different provisions, the Group's PRC subsidiaries shall participate in the relevant PRC basic pension, basic medical insurance, job-related injury insurance, unemployment insurance, maternity insurance and housing provident fund system. According to the confirmation letter issued by the Nanhai Branch of Foshan Municipal Social Insurance Fund Management Bureau (佛山市社會保險基金管理局南海分局), since the establishment of Guangdong Chigo, Guangdong Chigo has complied with all laws and regulations then effective in relation to social insurance, and has paid all social insurance fees timely and fully.

In relation to exports of the Group's products, the Group is responsible for clearance of PRC customs. It is the responsibility of the Group's customers in those countries to which the Group export its products to comply with the rules and regulations of those countries such as the rules and regulations for the clearance of customs of those countries, sale of the Group's products in those countries, and they are also responsible for providing after sales services to their end-user customers and product liability claims, if any. Up to the date of the relevant PRC legal opinion obtained by the Company, the PRC legal advisor of the Group was of the opinion that the Group had not been punished due to any non-compliance with any PRC customs and/or import and exports management related rules and regulations in the PRC.

A meeting to be held in Copenhagen in December 2009 may reach a protocol on new arrangements on the actions to prevent climate change after 2012, and may require the state parties to take actions including further reducing the release of greenhouse gas to prevent climate change. If a protocol is reached and if the PRC and the relevant countries where the Group's products are exported to are signatory parties to the protocol, and such detail requirements for reducing greenhouse gas were implemented in the air-conditioning industry by the PRC and these countries, the Group may then need to make necessary adjustments in the manufacturing of its products such as to ensure its products will release reduced greenhouse gas and comply with the requirements of the laws and regulations of the PRC as well as the laws and regulations of the countries where the products of the Group are exported to. However, currently, different countries have different stance on this issue. Pending the implementation of the requirements of the Copenhagen Protocol on the developed countries and the developing countries, it is difficult for the Company to predict the detailed impacts of the Copenhagen Protocol on the Group. However, the Company will continue to monitor the progress of the meetings on the Copenhagen Protocol, and will take necessary actions to ensure the Group's operations could comply with the relevant laws and regulations after the implementation of the Copenhagen Protocol in the future.

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The PRC legal advisors to the Company has confirmed that, save as disclosed in the sections headed “Risk factors – Risks relating to the Group – Potential loss of preferential tax treatments” and “Business – Property” of this prospectus, Guangdong Chigo and its two PRC subsidiaries have complied with all relevant PRC regulatory requirements for its operations in all material aspects. The Group has adopted the following main measures to ensure on-going compliance with the relevant PRC regulatory requirements:

- (1) the Group’s legal affairs department will constantly monitor both the current and newly promulgated laws and regulations applicable to the Company’s PRC subsidiaries, the intellectual properties affairs of Company’s PRC subsidiaries, and all the other legal affairs of Company’s PRC subsidiaries;
- (2) consult external legal advisors for further advice, where necessary.