

OVERVIEW

To date, the PRC Government has promulgated few laws or regulations specifically applicable to the coal mining equipment manufacturing industry. However, many of the laws, regulations and policies governing the coal mining industry have significant impact on the coal mining equipment manufacturing industry due to the interconnected nature of the two industries. For instance, policies promoting the mechanisation of coal mining operations in China, affect us as a coal mining equipment manufacturing company because they affect our customers' selection of coal mining equipment. In addition, all of our business operations in China are subject to fees and taxes, as well as safety and environmental protection laws and regulations.

Due to the close relationship between the coal mining equipment manufacturing industry and the coal mining industry, we are subject to the supervision and regulations of the State Administration of Coal Mine Safety, or SACMS, which sets standards for coal mining equipment. In addition, we are also regulated and supervised by other government authorities in various aspects of our business.

THE COAL MINING EQUIPMENT MANUFACTURING INDUSTRY

Principal Legislations

Under the guidance of the Outline of the Eleventh Five-Year Plan for National Economic and Social Development of the PRC issued in March 2006, the NDRC further issued guidance for the development of the coal industry. The PRC Government plans to accelerate consolidation by selectively granting mining rights only to coal mining projects that meet the threshold level of production. During the Eleventh Five-Year Plan which is from 2006 to 2010, the PRC Government will not grant mining rights to any new coal mining project that cannot produce 300 thousand tonnes of coal per year. Furthermore, in response to the high accident rate, the PRC Government has increasingly tightened regulatory standards to promote safety in mines and has been actively enforcing these standards by shutting down mines that fail to meet government safety standards. Under the Eleventh Five-Year Plan, the PRC Government requires the fatality rate per million tonnes of coal to be reduced to below 2.0. To achieve this goal, the PRC Government requires mechanisation levels of large and medium-scale coal mines to reach 95% and 80% respectively by 2010.

The NDRC also issued the *Coal Industry Policy*, or the Policy, on 23 November 2007 to promote the adoption of integrated and mechanised coal mining technologies as well as the use of long-wall mining methods. In addition, the Policy encourages reform in the mining technology and roof supports used in small-scale coal mines and the development of safe and efficient conveying technology and equipment.

The Amended Catalogue for the Guidance of Foreign Investment Industries, which took effect from 1 December 2007, or the Catalogue, was approved by the State Council in October 2007. According to the Catalogue, foreign investment that promotes the development and application of new technologies that improve the recovery rate at mining sites such as the shearers with power of more than 2000KW are encouraged. In addition, pursuant to the *Guideline for Present Priority Development of High-tech Indoctrination Key Areas (2007)* published by the NDRC, Department of Science and Technology, the Ministry of Commerce of the People's Republic of China, or MOFCOM, and the State Intellectual Property Office of China, or SIPO on 23 January 2007, the development of integrated, large-scale shearers and roof support systems for coal mining is also encouraged by the PRC Government.

Other Legislations

The Standing Committee of the National People's Congress promulgated *the Coal Law of the PRC*, or the Coal Law, on 29 August 1996, which became effective on 1 December 1996, to specifically address the exploration, exploitation and mining of coal. The Coal Law sets forth requirements in many areas of coal production, including, among others, exploration, the approval of new mines, the issuance of production permits, the implementation of safety standards, the trading of coal, the protection of mining areas from destructive exploitation, the protection of miners and administrative supervision.

On 14 March 2005, the NDRC announced the PRC Government's decision to revise the Coal Law of the PRC promulgated in 1996 by the National People's Congress. The NDRC concluded the comment-seeking process on 15 October 2005 and has begun the rulemaking process. This decision was made in response to concerns over the lack of a well-coordinated development plan for mining, which contributed to a significant amount of waste of valuable coal resources. The lack of effective penalty provisions or the lenient enforcement of existing provisions in the Coal Law has been cited as another important reason for the current rulemaking effort.

The revised Coal Law is expected to strengthen the administration and management of coal reserves, to facilitate and institutionalise coal trading and to promote safe operation of coal mines in China. Additionally, to ensure optimal utilisation of coal resources, the NDRC may evaluate the mining techniques and coal extraction capabilities of coal mining operators when allocating new coal reserves. The PRC Government may prefer to allocate larger coal reserves to large coal mining operators with sufficient funding and advanced mining and coal extraction techniques to ensure optimal extraction of coal reserves and mining safety.

On 7 June 2005, the State Council promulgated *Several Opinions on Promoting the Healthy Development of the Coal Industry*, or the Opinions, announcing the PRC Government's policies with respect to the development and restructuring of the coal industry. The Opinions resonated with the NDRC's announcement on the revision of the Coal Law and reiterated the PRC Government's policies with respect to the administration of coal reserves, enhancement of coal mine safety, encouragement of industry consolidation among coal producers, acceleration of the construction of large coal production bases, improvement of mining techniques and equipment for coal production and the organisation and regulation of small coal mines.

Safety

The *Provisional Regulation of Safety Mark Management for Coal Mining Products*, which was promulgated by the SACMS on 26 November 2001 and became effective on 1 January 2002, requires coal mining products that may endanger the safety and health of coal miners to obtain product safety marks certified by the SACMS. No person or entity is allowed to sell, purchase or use coal mining products that require safety marks prior to obtaining them. The SACMS has authorised coal mining product safety mark certification organisations to review and approve equipment to be granted product safety marks. Roadheaders, shearers, armoured-face conveyors and related products all fall under the product categories that require safety marks. Our maintenance services business is subject to the *Management Regulation of Coal Principal Equipment Maintenance and Overhaul License*. In addition, the production of certain of our products requires the National Production License for Industrial Products and some of our products require certain safety qualification certificates. We have obtained all such licenses and certificates other than three product safety marks

which are under renewal. The three products whose safety marks are under renewal have passed technical examination and are undergoing functional examination and other required examinations. The renewal is to be completed in one or two months. There is no material legal impairment in obtaining the relevant safety marks as long as the products meet all requirements of the examinations. Jixi Machinery has not and will not sell such products before the renewed safety marks are granted. Our PRC legal counsel, King & Wood has confirmed that the continued business operation would not breach any PRC laws and regulations as long as the Group does not sell such products before the renewal is approved.

Environmental Protection

The Environmental Protection Law, promulgated by the National People's Congress on 26 December 1989, is the basic law for environmental protection in China. The law establishes the basic principle for coordinated advancement of economic growth, social progress and environmental protection, and defines the rights and duties of governments at all levels.

Pursuant to *the Environmental Protection Law*, the Ministry of Environmental Protection is empowered to formulate national environmental quality and discharge standards and to monitor China's environmental system at the national level for the purpose of preventing and eliminating environmental pollution and damage to ecosystems. Environmental protection bureaus at the county level and above are responsible for environmental protection within their areas of jurisdiction. Local environmental protection bureaus may set more stringent local standards on discharging pollutants than the national standards and enterprises are required to comply with the more stringent of the two sets of standards. The PRC Environmental Protection Law requires any entity operating a facility that produces pollutants or other hazards to incorporate environmental protection measures into its operations and to establish an environmental protection responsibility system, which must adopt effective measures to control and properly dispose of waste gases, waste water, waste residue, dust or other waste materials.

New construction, expansion or reconstruction projects and other installations that directly or indirectly discharge pollutants to the environment are subject to relevant provincial regulations governing environmental protection for such projects. Entities undertaking such projects must submit a pollutant discharge declaration statement detailing the amount, type, location and method of treatment to the competent authorities for examination. The authorities will allow the construction project operator to release a certain amount of pollutants into the environment and will issue a pollutant discharge license for that amount of discharge subject to the payment of discharge fees. The release of pollutants is subject to monitoring by the competent environmental protection authorities. If an entity discharges more than the amount permitted by the pollutant discharge license, the local environmental protection bureau can fine the entity up to several times the discharge fees payable by the offending entity for its allowable discharge, require the offending entity to close its operations, or take other measures to remedy the problem.

In the environmental impact statement of a construction project, the project operator is required to make an assessment regarding the pollution and environmental hazards the project is likely to produce and its impact on the ecosystem, and measures for their prevention and control. The operator is required to submit the statement according to the specified procedure to the competent environmental protection authority for examination and approval. The building of sewage outlets

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within any water conservancy projects, such as canals, irrigation channels and reservoirs, is subject to the consent of the competent authority in charge of water conservancy projects.

The facilities for the prevention and control of pollution are required to be designed, constructed and put into use or operation simultaneously with the main part of a construction project. Such facilities must be inspected by the competent environmental protection authority. If they do not conform to the specified requirements, the operator is not permitted to put the new facility into operation or use.

Pursuant to the requirements under the amended *Law on Prevention of Water Pollution of the PRC*, which became effective as of 1 June 2008, *Law on Prevention of Air Pollution of the PRC*, which became effective as of 1 September 2000 and *Administrative Regulations on Levy and Use of Discharge Fees*, which became effective as of 1 July 2003, enterprises which discharge water or air pollutants are required to pay discharge fees pursuant to the types and volume of pollutants discharged. The discharge fees are calculated by the local environmental protection authority which assess and determine the types and volume of pollutants discharged.

Violators of the *Environmental Protection Law* and various environmental regulations may be subject to warnings, payment of damages and fines. Any entity undertaking construction work or manufacturing activities before the pollution and waste control and processing facilities are inspected and approved by the environmental protection department may be ordered to suspend production or operations and may be fined. The violators of relevant environment protection laws and regulations may be subject to criminal liability if violations resulted in severe loss of property, personal injuries or death.

Pursuant to *Law of the People's Republic of China on Evaluation of Environmental Effects and Environmental Protection Management Regulation for Construction Projects*, enterprises are required to take precautions against adverse effects on the environment after the implementation of operational plans and the completion of construction projects and to promote the coordinated development of the economy, society and environment.

In addition to the PRC environmental laws and regulations, China is a signatory to the 1992 United Nations Framework Convention on Climate Change and the 1998 Kyoto Protocol, which propose emission targets to reduce greenhouse gas emissions. The Kyoto Protocol came into force on 16 February 2005. At present, the Kyoto Protocol has not set any specific emission targets for certain countries, including China.

TAXATION AND FEES

Historically, business enterprises in China were, in general, subject to enterprise income tax at the rate of 33.0%. However, PRC state and local tax laws provide for a number of preferential tax treatment schemes applicable to various enterprises, industries and locations. Starting in April 2006, Jixi Machinery and Jiamusi Machinery were exempted from enterprise income tax as a result of a preferential tax treatment granted by their local tax authority due to their status as foreign-invested manufacturing enterprises.

On 16 March 2007, China passed the Enterprise Income Tax Law, which took effect on 1 January 2008, imposing a tax rate of 25.0% on all businesses. According to the notice on the

implementation of the Enterprise Income Tax Law issued by the State Council on 26 December 2007, Jixi Machinery and Jiamusi Machinery will be subject to preferential tax rate of 12.5% from 1 January 2008 to 31 December 2010. From 1 January 2011, Jiamusi Machinery and Jixi Machinery will be subject to an enterprise income tax rate of 25.0%. In 2009, both Jixi Machinery and Jiamusi Machinery were granted the qualification as “High and New Technology Enterprise” by the State Administration of Taxation. This status must be applied for annually and, if granted, will reduce the enterprise income tax rate by 50% for the year of the grant.

In addition, the coal mining equipment industry is one of the 16 key sectors in the equipment manufacturing industry that the State Council has targeted for development. On 14 January 2007, the Ministry of Finance of PRC, NDRC, the General Administration of Customs and the National Tax Bureau effectively cancelled certain import tariffs or related import value-added tax on components to large scale mining equipments and the like. Domestic manufacturers of mining excavation equipment will benefit from the cancellation of this import tariff on components. The PRC encourages all domestic industries, including coal mining, to purchase domestic equipment and technology and has set target of localisation rates for the industry.