

<b>CONNECTED TRANSACTIONS</b>
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## **CONNECTED TRANSACTIONS**

We have entered into a number of agreements with parties who are connected persons of our Company. The transactions under these agreements will continue following the Listing, thereby constituting continuing connected transactions for our Company under the Listing Rules.

**(A) Continuing connected transactions which are exempt from the reporting, announcement and independent shareholders' approval requirements**

*Trademark licenses*

Since 2002, our Group (previously being the registered owner of certain trademarks) has used the "Sound" and "桑德" trademarks for our water and wastewater treatment business. These trademarks were also used by Beijing Sound Enviro for its investments in environmental protection businesses and by its subsidiary, Beijing Sound Water Technology Co., Ltd. for the processing of purified drinking water at no consideration before March 2006.

In March 2006, our Group agreed to transfer the trademarks at no cost to Beijing Sound Enviro pursuant to a trademarks transfer agreement dated March 23, 2006. Beijing Sound Enviro in return granted Beijing Sound a license to use the trademarks for a period of 50 years at nil consideration pursuant to a trademark license agreement dated April 22, 2006 and a supplemental trademark license agreement dated June 18, 2010 (the "**Trademark License Agreement**").

Beijing Sound Enviro is 29% directly owned by our Director, Mr. Wen, and 70% indirectly owned by Mr. Wen and his spouse, and therefore is a connected person of our Company under the Listing Rules.

As the right to use the trademarks is granted to us on a royalty-free basis by Beijing Sound Enviro, the transactions under the Trademark License Agreement will be exempted from the reporting, announcement and independent shareholders' approval requirements under Rule 14A.33 of the Listing Rules.

**(B) Continuing connected transactions which are subject to the reporting, announcement and independent shareholders' approval requirements**

*Provision of EPC services and sales of goods*

Beijing Sound is mainly involved in the provision of EPC services for water and wastewater treatment projects and has the requisite technology, track record, personnel, certifications and environmental qualifications to engage in EPC services and operations of projects. It may from time to time, in the normal course of its business, bid via public tender to provide EPC services and sales of goods for the existing BOT or TOT projects which are invested by the BSE Group or any existing BOT or TOT projects invested by Sound Environmental Resources and its subsidiaries or future BOT or TOT projects within the Designated Locations invested by Sound Environmental Resources and its subsidiaries.

Beijing Sound has been successful in securing EPC and sales of goods contracts from the BSE Group and Sound Environmental Resources and its subsidiaries during the Track Record Period. The aggregate amounts payable by the BSE Group and Sound Environmental

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Resources and its subsidiaries to our Group in respect of the provision of EPC services and sales of goods for the years ended December 31, 2007, 2008 and 2009 were approximately RMB172.6 million, RMB117.6 million and RMB49.4 million, respectively. The contract amounts of new EPC and sales of goods contracts entered into between Beijing Sound and the BSE Group and Sound Environmental Resources and its subsidiaries in the years ended December 31, 2007, 2008 and 2009 were approximately RMB126.6 million, RMB565.0 million and nil, respectively. The contract amount for the year ended December 31, 2009 was nil because Sound Environmental Resources did not secure any new water or wastewater BOT projects in 2009.

Beijing Sound and Beijing Sound Enviro entered into an EPC services framework agreement (“**EPC Framework Agreement**”) on June 18, 2010 which sets out the details to be included in any EPC service agreement to be entered into between our Group and Beijing Sound Enviro and Sound Environmental Resources and their respective subsidiaries (the “**Connected Group**”), in the future. The EPC Framework Agreement is for a term until December 31, 2012 and subject to extension by mutual agreement and shareholders’ approval in accordance with the applicable Listing Rules at that time.

According to the EPC Framework Agreement, the parties agree to set out the basis of the calculation of any payment to be made under any proposed EPC service agreement. Typically, the pricing basis shall be in accordance with the regulations of the PRC Government or the relevant authorities; or if no such price is set by the PRC Government or the relevant authorities, the prevailing market rate, which shall be determined on normal commercial terms.

Prior to entering into any proposed EPC service agreement with the Connected Group, the terms of such agreement will be reviewed by the audit committee of our Board following review procedures established by our Group to ensure that any provision of EPC services or sales of goods to the Connected Group are conducted on normal commercial terms, that is, the transactions are transacted on terms and at prices not more favorable to the relevant member of the Connected Group than if they were transacted with an independent third party and that our Group has not been disadvantaged in any other way.

The review procedures to be undertaken by the audit committee of our Board with respect to the entering into of any proposed EPC service agreement with the Connected Group are as follows:

- (i) when bidding for projects invested by the Connected Group, the terms of the contract in respect of the provision of similar services to at least two other unrelated third parties shall be used as a comparison, wherever possible. The audit committee of our Board shall review these comparables, taking into account all relevant factors including but not limited to:
  - (a) whether the pricing and terms of the contract are in accordance with our usual business practices and policies. The contract with the Connected Group shall not be approved unless the pricing and terms are determined in accordance with our Group’s usual business practices and policies and the price and terms offered to the Connected Group are not more favorable than those extended by our Group to unrelated third parties. In determining the price and terms, all pertinent factors, including but not

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limited to the project requirements, the location and size of the project and the likely tender prices offered by our Group's competitors will be taken into consideration;

- (b) the profitability of the transaction; and
- (c) the past dealings, reputation and credit-worthiness of the Connected Group;
- (ii) in cases where it is not possible to obtain comparable contracts with other unrelated third parties, the audit committee of our Board will consider whether the pricing and terms of the tender are in accordance with our usual business practices and pricing policies and consistent with the usual margins to be obtained for the provision of similar EPC services and sales of goods to determine whether the relevant transactions are undertaken at arm's length and on normal commercial terms. The audit committee of our Board will also consider whether the relevant transactions are being carried out in the interests of our Group and our minority Shareholders;
- (iii) all tender bids for projects with the Connected Group must be approved by the audit committee of our Board prior to our Company submitting a tender for the projects, and any Director with a material interest in such projects will abstain from the review and approval process of the audit committee. Prior to the submission of any tender, the management will inform the audit committee that the review procedures and requirements have been complied with. If necessary, the audit committee may then give additional comments or ask for additional details on the matter. The management will then take the comments from the audit committee into account before officially submitting the tender; and
- (iv) the audit committee of our Board will review all EPC and sales of goods agreements with the Connected Group on a quarterly basis to ensure that they are carried out on normal commercial terms and are not prejudicial to the interests of our Company and our minority Shareholders.

The maximum aggregate annual amounts of new contracts entered into in relation to the provision of EPC services and sales of goods to the Connected Group under the EPC Framework Agreement for each of the three years ending December 31, 2010, 2011 and 2012 shall not exceed RMB100 million, which is estimated based on the average of the contract amounts for the three years ended December 31, 2007, 2008 and 2009, which was RMB230.5 million. The annual caps will be reviewed upon the expiry of the term of the EPC Framework Agreement. Upon the expiry of the term of the EPC Framework Agreement, we will ensure re-compliance with all relevant requirements under Chapter 14A of the Listing Rules.

Our Directors (including our independent non-executive Directors) consider that the EPC Framework Agreement is entered into on normal commercial terms and in the ordinary course of business and is in the best interests of our Shareholders as a whole because it gives our Group flexibility to bid to provide EPC services and supply goods in respect of projects invested by the Connected Group in the ordinary course of our Group's business, without the need to seek Shareholders' approval each time. It is likely that public tenders for EPC projects will occur and could arise at any time and from time to time. Given that the transactions would be entered into on normal commercial terms, our Directors (including our independent non-executive Directors) are of the view that it will be beneficial to our Group to transact or to continue to transact with the Connected Group. This will prevent our Group from being unduly

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restricted in the number of water and wastewater treatment projects to undertake, and thereby allow our Group to explore all potential business opportunities. Should such projects be undertaken, our Group would be provided with an additional revenue source in addition to projects undertaken with Independent Third Parties.

By entering into the EPC Framework Agreement, which eliminates the need for our Company to announce and convene separate general meetings of Shareholders on each occasion to seek Shareholders' prior approval for our Group to enter into EPC service and sales of goods with the Connected Group, it will also enhance our Group's ability to pursue business opportunities which are time-sensitive in nature, and will substantially reduce the expenses associated with the convening of such general meetings of Shareholders from time to time, improve administrative efficacy, and allow resources and time to be focused towards other corporate and business opportunities.

At the extraordinary general meeting of our Company held on April 30, 2010, our Shareholders have approved the renewal of a general mandate to enable our Group to enter into certain types of transactions with "interested persons" for the purposes of Chapter 9 of the Listing Manual (the "**Shareholders' Mandate**"). The Shareholders' Mandate covers the provision of EPC services by our Group to the Connected Group. The Shareholders' Mandate is subject to annual renewal and will (unless revoked or varied by our Company in a general meeting) expire at the next annual general meeting of our Company to be held in 2011.

As at least one of the relevant applicable percentage ratios set out in the Listing Rules for determining the value of a connected transaction (excluding the profits ratio) for the EPC Framework Agreement is more than 2.5% on an annual basis, the transactions under the EPC Framework Agreement constitute continuing connected transactions for our Company which are subject to the reporting, announcement and independent shareholders' approval requirements under Chapter 14A of the Listing Rules.

### WAIVER

As at least one of the relevant applicable percentage ratios set out in the Listing Rules for determining the value of a connected transaction (excluding the profits ratio) for the EPC Framework Agreement is more than 2.5% on an annual basis, the non-exempt continuing connected transactions would be subject to the reporting, announcement and independent shareholders' requirements under the Listing Rules.

As the transactions described in paragraph (B) are entered into in the ordinary course of business on a continuing basis, our Directors are of the view that disclosure and approval of these transactions in full compliance with the Listing Rules would impose unnecessary administrative costs on us and would hence be impracticable. We have accordingly applied for, and the Stock Exchange has granted to us, waivers from strict compliance with the announcement and (where applicable) independent shareholders' approval requirements of the Listing Rules in respect of these transactions subject to the Sponsor and the Directors, including the independent non-executive Directors, confirming that in their views: (i) the transactions have been and shall be entered into in the ordinary and usual course of business of the Group, on normal commercial terms that are fair and reasonable and in the interests of our Shareholders as a whole; and (ii) the aggregate value of these non-exempt

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continuing connected transactions for each financial year will not exceed the relevant annual cap amount stated above and the relevant annual cap amount is fair and reasonable and in the interests of our Shareholders as a whole. The waiver will be revoked immediately if the Shareholders' Mandate is revoked or is not renewed at the annual general meeting of our Company to be held in 2011 or at any annual general meeting thereafter. Apart from the announcement and/or independent shareholders' approval requirements, in respect of which waivers have been granted, we will comply with the relevant requirements under Chapter 14A of the Listing Rules.

### **DIRECTORS' AND SPONSOR'S VIEW**

Our Directors, including our independent non-executive Directors, consider that all the continuing connected transactions in paragraphs (A) and (B) are conducted on normal commercial terms and are fair and reasonable and in the interests of our shareholders as a whole and are in the ordinary and usual course of our business. Our Directors, including our independent non-executive Directors, are also of the view that the annual caps of the non-exempted continuing connected transactions in paragraph (B) above are fair and reasonable.

With respect to continuing connected transactions that fall under paragraph (B), the Sponsor is of the view that such continuing connected transactions have been entered into in the ordinary course of business, on normal commercial terms and in the interest of our Shareholders as a whole, and their respective annual caps are fair and reasonable.