A French Water Companys Cautionary Tale in China

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Paris-based Suez Group (SZE) is a global player in the business of water treatment plants—those elaborate systems built to purify water and deliver it to a local utility or directly to customers. Suez has targeted China for a major drive. That makes sense: 312 million Chinese, or a quarter of the population, do not have clean water to drink.

By and large the venture has been successful. But in Siping, an urban area of 3 million in China's impoverished northeast, Suez can't get paid despite years of trying. Its project in Siping, though small (Suez invested less than $3 million), has turned into a cautionary tale not just for investors interested in China's water treatment industry but also for all foreigners doing business in China—even in a surefire business like water.

Like many local governments throughout China in the late 1990s, Siping welcomed foreign investors with open arms, hoping they could help build infrastructure projects the local government couldn't afford to build. In 2000, Suez signed a deal to set up a joint-venture water treatment plant in Siping. The French secured a written guarantee from the Siping municipal government promising that Suez's state-owned Chinese partner, Siping Municipal Water Co., would buy a fixed amount of water from the joint venture every year.

City Customer Files for Bankruptcy

The authorities also pledged to close down the city's underground wells within three years. Factories had long been illegally digging the wells to get free water, so shutting them down was key to the profitability of the Suez venture. "A lot of industries and customers in Siping itself take water from underground wells. So they are not buying it from Siping Water Co., which reduces the amount that they sell, so that impacts them financially," says Steve Clark, executive director of Sino French Water Development.

But after the first year, in 2001, Siping Municipal Water failed to pay Suez's joint venture for water, claiming to be financially strapped. Without the money, Siping Sino French Water Supply, the joint venture, has been unable to pay taxes, repair equipment, or pay wages. .

Suez is now having trouble figuring out who to pressure to get its money. Siping Municipal Water's management began privatizing the state-owned enterprise in 2001 and eventually transferred all of its assets to a newly restructured company called Siping Longyuan Water. The new entity actually competes head-to-head with Suez's joint venture in offering water treatment services. Without operating assets, Siping Municipal Water applied for bankruptcy in 2006, claiming it owes creditors, including the Suez joint venture, $2 million.

Free Well Water, Tepid Demand

But Siping Longyuan Water, the new entity, is not honoring the creditors' claims. "It's not us that owes the joint venture money. It was the government that made the promise. The government owes them money," says Liu Xiaodong, general manager of Siping Longyuan Water. Efforts to reach the Siping mayor or his representatives were unsuccessful. Besides, Siping Longyuan Water argues, it hasn't been able to buy the agreed upon amount of water from Suez's joint venture due to tepid demand from its own customers.

One cause of that poor demand is all the illegal wells dug in the city. Despite numerous promises and edicts, the local government has failed to shut down the wells out of fear local companies will close or go elsewhere if they actually have to pay for water. The government has hoped to smooth over the problem in the short term by compensating Sino-French Water so it doesn't not lose too much money on the joint venture. "Because the government did not close down the underground wells, [it] has agreed to give Sino-French Water Development a subsidy to cover their losses," says Zhang Zhiyong, head of Siping Municipal Public Utilities Bureau. "But because some of the subsidy still hasn't been paid, the French aren't very happy."

Suez has tried quietly to resolve its problems in Siping. The company's senior management gained a private audience with the provincial governor. Soon after, Siping's mayor renegotiated the contract with the French, who granted the Chinese more lenient terms. But even with the renegotiated contract, Siping has not paid. "It's the difference between can't and won't. We [had] assumed that they couldn't pay because of the financial difficulties, so we appreciated that," says Clark. "Now, I'm sure they can pay."

Asking for a Fair Price

Suez could sue or take its Chinese partners to arbitration, but the French company has 21 joint-venture water treatment facilities in China, including Siping, and is wary of how its other Chinese partners may react if lawyers get involved. "They don't want to be the pioneer to bring the government and Chinese partner either to court or to arbitration. It may have a negative image for them," says attorney Leo Zhou, who worked for Suez trying to resolve its dispute in Siping.

This is not the first time foreign investors have tried investing in China's water treatment industry and suffered. Thames Water Utilities of Britain, Hong Kong's China Water, and several financial investors have already pulled out of China's water treatment industry after going through similar experiences. In the best-case scenario, the local government will buy out the foreign partner, as the Shanghai municipal government did with Thames' water treatment project in

2004. Suez would happily sell its stake to the Siping municipal government if it could get a fair price for it.

Bad for the Region

For now, Suez is shying away from making further investments in northeastern China and other smaller, poorer Chinese cities. "Quite frankly, our experience in Siping means that we are very careful about which areas of China we go into," says Clark. He adds that Suez is making money on its other water treatment projects in China, particularly in the wealthier coastal regions. During French president Nicolas Sarkozy's state visit to China in late November, Suez signed new deals with Chongqing and Tianjin. The company's experience in Siping—which has an annual per-capita gross domestic product of $1,279—illustrates why Beijing's efforts to revive the northeast have been frustrated.

Based on Suez's original projections of Siping's demand for water, the joint venture hoped to build a second water treatment plant in the city. Now Suez won't go near Siping or anywhere in northeastern China. "This is an extremely huge loss for Siping, because if the Siping municipal government has lost its creditworthiness, not just investors in the water industry but no other investor will dare invest there now," says Chen Jining, professor at Tsinghua University's Water Policy Research Center.

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