

# Renewable Energy Finance Forum

## Is the Renewable Energy Law attracting foreign investment?

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## Background

- The situation before the introduction of the Renewable Energy Law.
- Development and investment in renewable energy was guided by:
  - *Several Recommendations on Promoting the Development of Rural Energy, State Council, 1983*
  - *Several Recommendations on the Construction and Management of Wind Farms, Ministry of Power, 1994*
  - *Electric Power Law of the PRC, 1995*
  - *Several Policy Recommendations on Promoting the Development of Renewable Energy, 1999*
  - *Catalogue Guiding Foreign Investment in Industries, 2004 (amended)*

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## Background

- Some factors that have contributed to the increased uptake in renewable energy:
  - strengthening Chinese government policy support: *Ninth Five Year Plan, 2010 Long Term Program for National Economic and Social Development of the PRC, 1996, Eleventh Five Year Plan, Volumes 1 and 6*
  - improving regulatory environment and government oversight
  - real and rapid deterioration in the environment
  - increasing competitiveness of renewable energy sources

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## Background

- export credit and international assistance programmes
- carbon financing through the Clean Development Mechanism of the Kyoto Protocol
- WTO accession
- the largest market for renewable energy
- the fear of being left behind

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## What is the law directed at?

- It is a framework law. It is not meant to be complete in itself, so it is not prescriptive and provides only general direction.
- The key aspects of the *Renewable Energy Law* are to:
  - renewable energy is a “state priority”
  - allow for the formulation of national long and medium term targets, guidance catalogues, technical standards for renewable energy power, technology and products

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## What is the law directed at?

- mandate grid enterprises to enter into grid connection agreements with renewable energy generators and to buy all electricity generated by approved renewable energy facilities at a price determined by the pricing authorities of the State Council. Civil liabilities may be imposed for failing to buy qualified grid connected renewable power
- list scientific and technological research in the development of renewable energy as a preferred area for hi-tech development. Funding is to be allocated for research, demonstration and development of renewable energy to promote technical advancement and to reduce production costs
- provide for economic incentives to encourage the development of renewable energy, including the allocation of special capital for assessments, research, surveys, loans, subsidies and tax benefits.

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## What is the law directed at?

- The success of the law will depend on:
  - clear and consistent national, provincial and local policies
  - clear and consistent implementation at national, provincial and local levels
  - the issue and implementation of detailed rules and regulations to support the law.

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## What is the law directed at?

- 12 regulations to eventually support the Renewable Energy Law. A guidance catalogue and two regulations have been issued to date:
  - *Guidance Catalogue for Development in the Renewable Energy Sector*
  - *Trial Measures on Pricing and Cost Sharing Management for Renewable Energy*
  - *Administrative Provisions on Renewable Power Generation*
- While these supporting laws are important and encouraging developments, they are untested. Some concerns include:
  - the Pricing Measures do not apply to hydro power. Likely to be of considerable concern to developers of small hydro

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## What is the law directed at?

- *government guided pricing* applies to grid connected wind power project which is pricing selected through a public request for tenders (Article 5 and 6 of the *Pricing Measures*) rather than a feed in tariff. Note also: Price Law of the PRC, 1997 and the Bid Invitation and Bidding Law of the PRC, 1999
- the power price for off grid renewable energy power systems which depend on the *classified sale price* local provincial power grid. What this *classified sale price* is less than clear
- the application and assessment of the surcharge for renewable energy power to be collected from end users (Articles 12-19 of the *Pricing Measures*). This may cause difficulties in practice, although recent media reports have indicated that the surcharge is likely to be quite small

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## What is the law directed at?

- overall, pricing control for energy and indeed renewable energy, is still a grey area, with the application and interaction between the renewable energy regulations, the Price Law and the Bidding Law is not entirely clear
- overlap in oversight and supervision functions of the National Development and Reform Commission (“NDRC”), the pricing agency of the State Council, the State Electricity Regulatory Commission
- apparently limited scope for the import of hardware and technology (see *Guidance Catalogue*). On the other hand, development status of different renewable energy applications offer considerable scope for foreign direct investment
- consequences of non-compliance, remedies and enforcement.

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## Attractive to investors?

- The transparency and support of laws and regulations are critical to investment decisions
- The way investment “attractiveness” is assessed does not depend entirely on the quality of laws and regulations and the agencies administering them
- Their existence and quality is critical to the assessment of risk which does have an effect on the attractiveness of investment in the Chinese renewable energy market

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## Attractive to investors?

- Some insight on the subject is to look at the characteristics of policies and laws that encourage renewable energy investment. These characteristics include:
  - clear and consistent supervision and implementation (no sudden changes or reversals)
  - preferential pricing such as feed in tariffs
  - tax incentives
  - indirect tax incentives by taxing fossil fuels and emissions
  - subsidies
  - support for carbon finance

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## Attractive to investors?

### *Clarity and consistency*

- Tremendous progress in advancing renewable energy but there have been a number of institutional changes
- Supervision and management of the Chinese energy industry is consolidating under the NDRC
- Creation of the State Energy Office (“SEO”) in April 2005 and an executive task force headed by Premier Wen Jiabao in May 2005

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## Attractive to investors?

- The national, regional and local commitment to the development of renewable energy
- Uncertainty, as to which government agency to refer to in a given situation is not uncommon
- Well advised to check policies, laws and regulations carefully at all levels of government
- Regular updates and checks are also recommended to ensure that they are not caught out by changes.

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## Attractive to investors?

### *Preferential pricing*

- No standard pricing mechanisms for renewable energy
- *Government fixed pricing* and *government guided pricing*
- *Pricing Measures* do not explain the tendering or bidding process
- Whether pricing for renewable energy under the *Pricing Measures* and associated laws will be truly and effectively preferential is more of a policy and economic matter
- bidding process for wind power
- ultimately, whatever the pricing process, it must incentivise the development of renewable energy over traditional energy

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## Attractive to investors?

### *Tax incentives*

- *Article 26 of the Renewable Energy Law* allows the Chinese government to grant tax benefits to projects listed in the *RE Catalogue*. No tax incentives have been granted under the law at present
- There are very limited tax incentives in place at present. These are limited to:
  - reduced VAT from 17% to 13% (biogas), wind (8.5%) and small hydro (6%)
  - import duty reductions (high technology wind, photovoltaics and biogas equipment)

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## Attractive to investors?

- This contrasts with international practice which includes:
  - investment tax incentives
  - production tax incentives
  - property tax reductions
  - accelerated depreciation
  - tax credits for research and development, and renewable energy equipment manufacturers
  - tax holidays

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## Attractive to investors?

*Indirect incentives, taxing fossil fuels and emissions*

- Taxing of fossil fuels or the emission of pollutants

*Subsidies*

- Central and local government subsidies have been provided:
  - to support research and development
  - to support capacity building and training
  - through low interest loans

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## Attractive to investors?

- Article 25 of the *Renewable Energy Law* allows financial institutions to offer preferential loans with financial interest subsidies to renewable energy projects listed in the *RE Catalogue*
- Article 24 of the *Renewable Energy Law* empowers the Chinese government to establish a renewable energy development fund

### *Support for carbon finance*

- The *Measures for Operation and Management of Clean Development Mechanism Projects in China* on 12 October 2005
- CDM projects may potentially generate a profitable revenue stream from the sale of carbon credits known as Certified Emission Reductions (CERs)

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## Attractive to investors?

- Domestic and international process
- Simplified procedures for small scale CDM projects (generally under 15 MW)
- CDM facilitates the production of CERs for sale to foreign buyers. An option that should be carefully considered to increase the attractiveness of a renewable energy project to investors. If the CDM route is not chosen, consider the sale of emission reductions generated as verified emission reductions or VERs

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## Closing observations

- The answer to the opening question is a qualified yes
- The Renewable Energy Law builds on the momentum of policies implemented by the Chinese government to promote and develop renewable energy
- A dedicated law for renewable energy which did not exist previously

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## Closing observations

- Consolidation of institutional control of renewable energy and carbon finance under the NDRC is a positive development. There are however significant challenges which include:
  - untested new laws and regulations
  - new interrelationships between those new laws and regulations and existing laws
  - persuading international investors that policies and laws will be predictable and consistently applied
  - potential uncertainty on pricing
  - the current lack of tax incentives to encourage investment further

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## Closing observations

- How these challenges are met will dictate how and what kind of investors invest as well as the project structure and method of finance deployed
- Commercial, financial and legal risk management are the business of foreign investors and their advisors
- Engagement of foreign investors and their know how in the development of the renewable energy sector is a key priority of the Chinese government and crucial to the healthy development of the industry

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