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)
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

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
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
  - 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.
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.

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.
### 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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**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)
### 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

### 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
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


- 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.
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

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
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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