



China Update

China's Renewable Energy Law begins

Following the Standing Committee of the National People's Congress of China endorsement on February 28 2005 of the Renewable Energy Law ('Law'), four months earlier than expected, the new Law came into operation on 1 January 2006.

The Law is China's first on developing renewable energy and continues the Chinese government's attempts to restructure and develop its economy using more sustainable methods. It offers a broad guideline of the requirements needed to undertake a renewable energy project and how the Law, its regulations, measures and guidance catalogues are to be prepared and promulgated in the future.

The Law refers to renewable energy as non-fossil energy including wind, solar, water, biomass, geothermal and ocean energy (art. 2) and aims to develop renewable energy by providing preferential treatment to the promotion, construction and development of renewable energy projects and a renewable energy market.

Grid enterprises are also required to enter into grid connection agreements for the purchase of power from renewable power generation companies under the Law (art. 14) and if there is more than one applicant for a project licence, then the licensee will be determined by tender (art. 13).

As with many infrastructure projects in China, the price authorities of the State Council will determine the price paid by energy distributors for the renewable energy generated (art. 19). However, renewable energy projects will be eligible for various tax concessions (art. 26).

The new Law also allows Chinese banks and other financial institutions the opportunity to offer low interest loans for renewable energy projects (art. 25). To qualify for these loans, a project will need to be listed in the national renewable energy industry catalogue, which is yet to be published.

The success and effectiveness of the Law will depend on many things, namely its implementation and interpretation at national, provincial and local levels and the rules and regulations issued to implement the Law.

Renewable Energy Quotas in China

The China Daily newspaper recently reported that the Chinese government has set a quota on renewable energy use for large domestic power companies in an effort to diversify energy sources and to improve the environment.

Chinese power companies with an installed capacity of over 5 gigawatts must ensure 5% of their power generators are fuelled by renewable energy sources by 2010. That proportion will rise to 10% by 2020.

Mr Zhang Guobao, vice minister of the National Development and Reform Commission ('NDRC'), China's top economic planning agency, was reported as saying that renewable energy sources included non-fossil fuels such as wind and solar power, however, hydro and nuclear sources weren't on the list of renewable energy sources that power companies must develop.

China has around 15 power companies with installed capacities exceeding 5 gigawatts, according to the report.

The government has also put into effect 12 supporting regulations to supplement the Renewable Energy Law, which came into effect on 1 January 2006.

They include higher power tariffs for grid companies that buy electricity generated from renewable energy sources, and tax reductions on equipment procurement and plant construction for renewable energy-fuelled power generation.

The government has pledged to use renewable energy sources to supply 15% of the nation's power needs by 2020, compared with 7% currently.

In another development, domestic grid companies will be able to pass the cost of higher tariffs on electricity generated from renewable sources on to end users across the nation, according to a statement posted on NDRC's website. It is expected that provincial power grid firms will share the surcharges according to the proportion of their sales volume in the national total.

Clean Development Mechanism

What is it?

The Clean Development Mechanism (CDM) is one of the three flexible mechanisms established under the Kyoto Protocol¹.

The CDM allows developed countries listed in Annex 1 of the United Nations Framework Convention on Climate Change (UNFCCC) (which includes Australia) to invest in greenhouse gas (GHG) emission reduction projects in non-Annex 1 developing countries (which includes China), and to claim the resulting Certified Emission Reductions (CERs) to assist them in compliance with their binding GHG emission reduction commitments under the Kyoto Protocol.²

At the same time, CDM project activities contribute to sustainable development in the host developing countries. The CDM aims to be a project-based win-win mechanism that can provide increased flexibility (temporal, geographical and sectoral) to developed countries, which can reduce their overall cost of compliance with Kyoto Protocol commitments, while providing the CDM project hosting partners with additional funds and advanced technology.³

How does it apply to China?

On 12 October 2005, the Measures for Operation and Management of Clean Development Mechanism Projects in China (Measures) came into effect, replacing the earlier Interim Measures (2004).

The Measures outline general CDM project principles, and its participants (art. 6 to 12), project management and responsible government authorities (art. 13 to 17), project application procedures (art. 18 to 20) and miscellaneous provisions (art. 21 to 26), including allocation of revenue derived from CER transfer (art. 24) and the government authorities responsible for interpreting the Measures (art. 25).

Priority areas for CDM projects in China include:

- > afforestation and reforestation;
- > energy efficiency improvement;
- > development and utilisation of new and renewable energy; and

- > methane recovery and utilisation.

According to the Measures, the CDM project owner must be a Chinese invested or Chinese investment holding enterprise. While foreign parties can cooperate in a Chinese CDM project, the foreign party cannot wholly or majority own the CDM project company.

The Chinese Government and the CDM project owner shall jointly own revenue generated from the transfer of CERs. The royalties, to be paid to the government, are:

1. 2% on the transfer of CERs relating to afforestation and reforestation, energy efficiency and improvement, development and utilisation of new and renewable energy;
2. 30% on the transfer of CERs relating to nitrous oxide; and
3. 65% on the transfer of CERs relating to hydrofluorocarbons and perfluorocarbons.

See figure 1 at the end of this newsletter for a diagram showing the approval process for CDM projects in China.

China to deregulate some power prices by the end of 2006

The Shanghai Securities News recently reported that China plans further electric power price reforms by letting market forces determine some electricity prices by the end of 2006, citing a source from the State Grid Corporation.

The Chinese government currently dictates power plant output and prices allowing only surplus power to be sold at market prices. But the Chinese government now hopes that all prices for electricity used on the electric power grid will be determined by market rates. However, prices to end-users will remain under government regulation.

The report said the Chinese government will allow power plants to sell all their output at competitive market prices by the end of 2006, as power supply is expected to be sufficient to allow for such deregulation of the market.

The reform is also designed to provide greater incentives for China's power plants to increase efficiency and cut costs.

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Relevant Provisions for the Administration of the Generation of Electricity using Renewable Energy Resources

Following the commencement of the Renewable Energy Law ('Law') on 1 January 2006, the NDRC issued the Relevant Provisions for the Administration of the Generation of Electricity using Renewable Energy Resources ("Provisions") on, and effective as of, 5 January 2006.

The aim of the Provisions is to supplement and further clarify the Law (as discussed in this Newsletter above) with regards to grid access and connection. The Provisions apply to projects which generate electricity using renewable energy resources (as outlined in art. 2 of the Provisions and which is in accordance with art. 2 of the Law) for which government approval has been obtained, and to projects for the stand alone generation of electricity using renewable energy resources in regions not yet covered by the grid (art. 3).

Article 6 of the Provisions requires Hydroelectric projects constructed on main water courses, hydroelectric projects of 250,000 kW and above and wind power projects of 50,000 KW and above to be subject to the examination and approval of the NDRC (which is in accordance with the "Decision of the State Council on Reform of the Investment System [Guofa Paper No. 20, 2004]").

The State Electricity Regulatory Commission ("SERC") will be responsible for regulating the operation of enterprises that use renewable energy resources to generate electricity. SERC will also be the responsible government authority for coordinating the relationship between electric power generation enterprises and electricity grid enterprises and for regulating the generation of electricity using renewable energy resources and the uploading of such electricity to a grid (art. 9).

Pursuant to article 10 of the Provisions, a grid enterprise at the provincial level and above is required to formulate plans for the construction of ancillary grid facilities to accommodate electricity generated using renewable energy resources and the grid enterprise is responsible for the construction and management of access systems to the grid for electricity generated using renewable energy resources (art. 12).

Furthermore, the access system for medium and large projects using renewable energy resources (such as hydropower, wind power, biomass, etc). to generate electricity that is connected to a grid shall be funded by the grid enterprise and the ownership of the access system will vest in the grid enterprise from the first pole/tower outside the transformer/booster station of the power plant/station.

Article 18 of the Provisions requires an enterprise that uses renewable energy resources to generate electricity to install certified power generation metering systems and to report to the applicable energy department of the relevant provincial people's government of its installed capacity, electricity output and quantity of electricity uploaded to the grid during the previous year, by January 15 of each year.

It should be noted that the Provisions prohibit a renewable energy generation project from being transferred, sold or otherwise disposed of without the consent of the original department which granted permission for the project (art. 16).

In the event of a dispute between a grid enterprise and an enterprise that uses renewable energy resources to generate electricity, an application by either party may be submitted to the NDRC or the SERC for mediation (art. 19). If an enterprise or the State incurs a loss due to a failure to act in accordance with the Provisions, an audit firm appointed by the NDRC or the relevant provincial people's government will conduct an audit to determine the loss (if any) and compensation (if any) to be paid (art. 20). The measures for formulating fines will be subject to the implementation of further provisions.

The NRDC is in charge of interpreting the Provisions.

Drafting of energy law initiated

Recently the State Council, State Energy Office, NDRC and the Legislative Affairs Office of the State Council held a conference in Beijing to establish a team to draft a new energy law.

China lacks a basic Energy Law and one of the aims of the new Energy Law will be to establish an energy strategy and policy orientation that coordinates ties between energy availability and energy-related activities. Other objectives of the Energy Law will include:

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- > upgrading the national energy development strategy to complement laws and regulations supported by state sanction;
- > confirming the legal status of medium and long-term energy development planning;
- > promoting energy exploration and development;
- > increasing energy production safety requirements;
- > improving energy conservation systems and energy emergency systems;
- > building a conservation-oriented and environment-friendly society,
- > implementing clean energy production; and
- > promoting an economic growth model that features low input, low consumption, low pollution and high efficiency use of energy.

As yet, the State Council has not given any indication when the draft Energy Law is to be completed or implemented.

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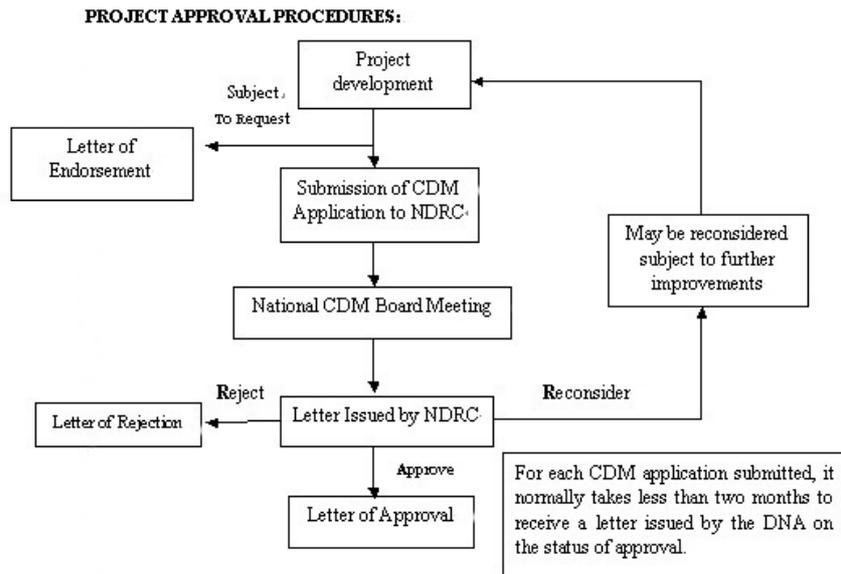


Figure 1. Approval process for a CDM project in China. (source: Office of National Coordination Committee on Climate Change)

Where "NDRC" means the National Development and Reform Commission and "DNA" means the Designated National Authority which, in China, is also the NDRC.

Footnotes

¹ Australia is not a party to the Kyoto Protocol. It is a member of the Asia Pacific Partnership on Clean Development and Climate, which is a collaboration between six developed and developing countries to address energy, climate change and air pollution issues within a paradigm of economic development. Partnership countries include Australia, China, India, Japan, Republic of Korea and the United States.

² The International Bank for Reconstruction and Development "Clean Development Mechanism in China - Taking a Proactive and Sustainable Approach – 2nd Ed." 2004, p. xix.

³ Ibid



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