

To: **UNFCCC Secretariat**
Martin-Luther-King-Strasse 8
D-53153 Bonn
Germany

18 August 2008

Dear Members of the CDM Executive Board,

Please find below our responses to the issues raised by requests for review of the “Project 1621: Inner Mongolia Bayannaoer Chuanjingsumu 49.3MW Wind Power Project”.

1. Further clarification is required on how the DOE has validated the suitability of the input values used in the investment analysis, as per the guidance of EB 38 paragraph 54(c).

R: It is our understanding that this question is related to the effectiveness of the additional 18 million Yuan investment on the 220 kV transmission line, on the basis of that the other input values used in the investment analysis in PDD are all sourced from the FSR.

The FSR of the proposed project was finished in December 2005, where the total static investment was 468.86 million Yuan, and based on this investment the tariff needed to reach a project IRR of 8% benchmark should be 0.5978 Yuan/kWh (including VAT). But it was also mentioned in the FSR that a 50 km 220 kV transmission line should be constructed because the proposed project is located in a remote area and far away from the substation of the grid, and if this investment for the transmission line is included then the total investment should increase by 18 million Yuan¹. In this sense, the input value on the total investment used in the investment analysis in PDD is also sourced from the FSR.

As will be clarified on the second issue on the tariff below, the project owner was aware that the actual tariff expected for the project would be lower than the needed tariff in the FSR, and accordingly the project IRR would be lower than 8%. Therefore, CDM was seriously considered to address the low financial attractiveness of the project, as clearly demonstrated by the evidence of the loan guarantee from the bank².

Here below is to justify that the additional 18 million Yuan investment on the 220 kV transmission line can not be ignored though it was not clearly decided in the FSR whether or not it should be included in the total investment for the project. In fact, the construction of a 220 kV transmission line was found absolutely necessary for the whole project soon after the FSR was finished, which would further lower the financial prospect of the project. On 27

¹ FSR of the project

² Loan guarantee letter from the bank

March 2006, the Board of Directors of the project held a meeting³ and concluded that an additional investment of 18 million Yuan at minimum for the 220 kV transmission line should have to be considered if the project should proceed which consequently would have a negative impact on the project IRR and, to address the lower project IRR caused by the additional investment plus the tariff, real action on CDM development must be immediately taken for the successful implementation of the project. The reference to the contract on the construction of the transmission line signed with the Transmission & Transformation Co., Ltd. in the PDD of the project is only to justify that this investment would occur and should be included in the total investment.

By adding the additional investment for the construction of the 220 kV transmission line, the total static investment should reach up to 486.86 million Yuan. It is reasonable that this amount of investment should be added into the original static investment in the FSR to reflect the real situation, as per the guidance of EB 38 paragraph 54(c). It is highlighted that all this happened before the start date of the project, that is, 28 July 2006⁴ when the final investment decision for the whole project was considered to be made.

2. Further clarification is required how the DOE has validated that the tariff will remain constant over the 21 year period.

R: The question is related to the general pricing policy for wind power projects in China. In China there have been two kinds of wind power projects since 2002, one is tendering project and the other is un-tendering project. The tariff of the tendering project is determined by tendering process among a number of the investors, whichever with the lowest tariff would obtain the development right of the project. Un-tendering wind power project is first proposed under an agreement between the investor and the local government, of which the tariff should be the government-guided tariff which is determined by the government with reference to the tariff of tendering wind power projects, and the un-tendering wind power projects within the same grid should enjoy the same tariff. Through this scheme of tendering for wind power projects which had begun in 2002, China has been gradually reducing the tariff of wind power projects, as is shown by examining the tariff trend in Inner Mongolia grid where the proposed project is located. It is found that the government-guided tariff for wind power projects had been maintained at a level of 0.54-0.5325 Yuan/kWh (including VAT)⁵ from the year 2002 to 2006 and in 2007 this government-guided tariff had decreased to 0.5100 Yuan/kWh (including VAT). Would the tariff of wind power projects in Inner Mongolia grid like to have an increase in the future? Just on 4 September 2007, in a press conference held by the State Council Information Office, Chen Deming, vice minister of NDRC, stated that China would continue to use the scheme of tendering for wind power projects, because "in this way can the tariff of wind power generation projects gradually lower down". Therefore, the answer to the above

³ The resolution of the Board of the Directors

⁴ The construction start permission letter of the project

⁵ <http://www.86wind.com/info/detail/37-6774.html>

question is definitely no.

In addition, the tariff for both of the tendering wind power projects and the un-tendering wind power projects in China implement two-phase tariff, namely that within 30000-hour operation (first phase tariff) and after 30000-hour operation (second phase tariff). The above government-guided tariff in Inner Mongolia grid is only for the first phase, the second phase tariff of wind power projects should be the average tariff of the local grid (i.e. Inner Mongolia grid). The proposed project is an un-tendering project, and as per the FSR, the needed tariff to reach the 8% benchmark both at the first phase and the second phase should be 0.5978 Yuan/kWh (including VAT), which is much higher than the government-guided tariff and obviously can not be expectable. Furthermore, the second phase tariff should be the average tariff in the grid. Since Inner Mongolia power grid is dominated by thermal power plants, where thermal power generation accounts for more than 98% of the total power generation⁶, the average tariff in the grid should also be dominated by thermal power tariff. The benchmark thermal power tariff in Inner Mongolia grid is only 0.2509 Yuan/kWh (including VAT)⁷. Therefore, it is very unlikely for the average tariff in the grid to reach 0.5978 Yuan/kWh (including VAT). Given above, the adoption of the tariff value in FSR (i.e. 0.5978) as the tariff in the whole operation period for IRR calculation in the PDD is highly conservative, and the proposed project is unquestionably financially unattractive (The relevant evidences have been provided to DOE). Furthermore, It is kindly reminded that the actual tariff for the proposed project is 0.51 Yuan/kWh (including VAT) at the first phase and the average tariff of local grid at the second phase, which was issued by the government on 3 December 2007, which had been expected at the time when the investment decision was made.

As explained above, using the constant tariff value from the FSR is much more conservative for the demonstration of the additionality of the proposed project.

Best regards,

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⁶ China Electric Power Yearbook 2007

⁷ Notice on adjustment of the tariff in NCPG issued by NDRC in 2006