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Att: CDM Executive Board

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Response to requests for review of the project "Liaoning Changtu Quantou Wind Power Project" (CDM Reference No. 2219)

Dear Members of the CDM Executive Board,

We refer to the issue raised by the requests for review by three Board members regarding project activity "Liaoning Changtu Quantou Wind Power Project" (UNFCCC reference number 2219) and would like to provide following initial responses to the issue raised.

Comment 1:

The PP should explain and the DOE should validate the basis and rationale for the change of the electricity tariff assumed in the FSR (approved in Sept. 2006, resulting in an IRR higher than the benchmark due to tariff of 0.5998 RMB/kWh) to the lower tariff (0.5714 RMB/kWh), which has been taken from the Propositional letter of on-grid electricity tariff issued by the local DRC on 08 Jan. 2007, since this sudden change raises doubts on whether this tariff reduction was induced to enable the project to demonstrate additionality.

DNV response:

The feasibility study report (FSR) for the project was prepared by Xinjiang Windpower Design Institute which has been accredited by National Construction Ministry (Annex 1). The tariff in the FSR was estimated by Xinjiang Windpower Design Institute based on project assessment criterion and considering national and local economic development situation and specific circumstances of the proposed project. However, the electricity tariff in China for renewable energies such as wind power is regulated according to the "notice on tariff determination method" (NDRC2005, No.514), by the government tariff bureau, the regulation is in respect of market principle covering the cost and ensuring a certain level of profit. Therefore, the final (actual) tariff of a project is defined ex-post when considering the circumstance of local and central government policy, economic situation and consumption status.

The timeline for the selection of the electricity tariff can be described as follows:

- July 2006: the FSR dated July 2006 was developed by a third party, Xinjiang Windpower Design Institute. The FSR indicates a tariff of 0.5998 RMB/kWh.
- September 2006: The FSR approval letter dated 5 September 2006 for Liaoning Changtu Quantou Wind Power Project was issued by the government.

- January 2007: Letter from the local DRC, dated 8 January 2007, proposed a reduced electricity tariff of 0.5714 RMB/kWh

Base on the fact of the tariff for the proposed project (i.e. 0.5714 RMB/kWh) sourced from the "Propositional letter for tariff" issued by the local Development and Reform Bureau on 8 January 2007[1] (which is prior to the start of the project activity dated 8 February 2007), the project became financially unattractive (IRR 7.17%, the IRR calculation with exclusion of the cost of financing expenditures, i.e. loan repayments and interest). Hence, the same has been considered for the IRR calculations. It should also be noted that the Directorate decision was made for CDM project development on 15 January 2007 (as mentioned in the validation report) prior to project start date of 8 February 2007.

The IRR calculations were provided in a spreadsheet. The calculations were verified and found to be correct and in accordance with the EB's latest guidance on the assessment of financial calculations (EB38 - EB41). The assumptions used in the calculations were deemed to be correct by DNV. The project IRR without CDM revenues is 7.17%, which confirms that the project in the absence of CDM benefits and compared to the benchmark of 8% is not financially attractive. With CER revenues the project IRR increases to 9.77%, which is above the benchmark

Comment 2:
The DOE should explain the basis for the tariff assumed in the FSR and whether the change in the electricity tariff has not been considered as an E+ policy, according to EB 22, Annex 3, paragraph 6

DNV response:
The basis for the tariff assumed in the FSR is explained above.

According to EB 22, Annex 3, para 6, an E+ policy is:

'National and/or sectoral policies or regulations that give comparative advantages to more emissions-intensive technologies or fuels over less emissions-intensive technologies or fuels'.

Therefore, the type E+ policy would result in increase in GHG emissions.

The change of the assumed tariff (0.5998 RMB/kWh) in the FSR into a realistic tariff of 0.5714 RMB/kWh does not contradict Chinese policy in favour of renewable energy industry. DNV has verified that the tariff of thermal power plants is levelized at 0.3094 RMB/kWh (excl. VAT)[2] in Liaoning Province; and also ascertained by the government that the tariff of renewable energy technologies is composed of two parts: 1) levelized tariff of thermal power; and 2) the subsidy above levelized tariff from central government. The reduction from the assumed tariff of 0.5998 RMB/kWh to the realistic tariff of 0.5714 RMB/kWh (still above the levelized tariff of thermal of 0.3094 RMB/kWh) falls within the subsidy range. The conclusion is that those subsidies still pertain for renewable energy technologies such as wind projects to be supported by national and/or sectoral policies or regulations.

[1] The propositional letter on the expected tariff of the proposed project from local Development and Reform Bureau on 8 January 2007.
[2] Notice on Tariff of Northeast China Power Grid issued by NDRC in 2006（ http://china.findlaw.cn/fagui/jj/26/104270.html）

Comment 3:
The data used to calculate the grid emission factor in the PDD submitted for registration was not available at the commencement of validation (May 2007). The PP and DOE are therefore requested to amend the grid emission factor using data which was available at this date.

DNV response:
The PDD was published for comments on 31 May 2007 and the following data was available at the time of submission of the PDD to DNV:

1. China Electric Power Yearbook 2006 was published in Nov. 2006
2. China Energy Statistical Yearbook 2006 was published in March 2007
3. IPCC 2006 was published in April 2007

Hence, the data used to calculate the grid emission factor in the PDD submitted for registration was available at the commencement of validation. Nonetheless, the PP has now again adopted the emission factor included in the PDD initially received for validation which was applying the emission factor that is calculated based on data issued by the Chinese DNA in December 2006. This emission factor is more conservative than the emission factor included in the PDD originally submitted for registration.

The emission reduction factor calculation correction is verified and the validation report is updated according to the revised PDD.

We sincerely hope that the Board accepts our aforementioned explanations.

Yours faithfully
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Michael Lehman
Technical Director
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Annex 1: the certificate of the project design of Xinjiang Windpower Design Institute