



China Finance Bulletin

Welcome to this month's issue of White & Case's China Finance Bulletin. The bulletin offers you regular updates of the PRC finance sector ensuring you stay up to date with the latest legal, regulatory and practice developments.

Government Introduces New Restrictions on Land Use to Re-Balance Supply and Demand in Target Industries

On November 12, 2009, the Ministry of Land and Resources and the National Development and Reform Commission jointly issued the *Supplementary Catalogue of Restricted Project Land Use* and the *Supplementary Catalogue of Prohibited Project Land Use* (together the "Supplementary Catalogues"), which took immediate effect. As compared to the 2006 version of the catalogues, the Supplementary Catalogues have added many industry-specific land use restrictions. Restrictions introduced by the Supplementary Catalogues are seen as a mechanism by which the government authorities seek to re-balance supply and demand in target industries.

Highlighted below are the key changes introduced by the Supplementary Catalogues:

- **Residential Development** – The Supplementary Catalogues impose caps on the maximum size of land parcels that can be offered by the local land bureaus for public bidding. These caps vary according to the location of the land parcel at issue. For example, the maximum size of any single land parcel in large cities such as Beijing and Shanghai that is made available for public bidding is capped at 200,000 square meters. Similarly, the applicable caps for any single land parcel in a medium-sized city and any single land parcel in a small city are 140,000 square meters and 70,000 square meters, respectively. It is felt that many small or medium-sized developers were not able to participate in land bidding in the past 6 to 12 months because during this period, the land parcels made available for bidding were very large in size, which meant the starting bid price for these parcels were beyond the reach of these developers. By reducing the size of each land parcel for bidding purposes, it is hoped that more bidders can participate in bidding and the smaller or less capitalized players will no longer be operating at a disadvantage. Of course, having more bidders compete for land is likely to drive up the per square meter land premium that the winning bidders will have to pay to acquire the land use rights.
- **Industrial Development** – The Supplementary Catalogues identify a number of industries such as coal, steel and polycrystalline silicon as ones that are suffering from an oversupply and a severe shortfall in demand. To address this imbalance between supply and demand, the Supplementary Catalogues impose restrictions that are intended to discourage the use of land for construction of production facilities in industries that are seen as having an oversupply. For these industries, the Supplementary Catalogues require that no land parcel can be granted unless the grantee ensures that the facility built upon the granted land will meet the specified minimum production capacity. For example, new facilities built to produce polycrystalline silicon (a vital part of solar power devices) must have a projected minimum production capacity of no less than 3,000 tons per year. In addition, the Supplementary Catalogues impose land use efficiency thresholds on some industries. For example, the land used to produce every 1,000 tons of polycrystalline silicon must be smaller than 60,000 square meters. Undoubtedly, these

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If you have questions or comments regarding this bulletin, please contact:

Karen Tang
Partner
+ 86 21 6132 5916
ktang@whitecase.com

Steve Payne
Partner
+ 86 10 5912 9602
spayne@whitecase.com

John Shum
Partner
+ 852 2822 8748
jshum@whitecase.com

new restrictions will manifest themselves in the land bidding requirements and subsequently, the terms and conditions of the land grant contracts.

- **Prohibited Industries** – The Supplementary Catalogues include five categories of production facilities as “prohibited projects” so that no land can be granted for the construction or development of such prohibited projects. These categories include, among others, facilities used to manufacture wind power equipment and certain other machinery, as well as facilities used for shipbuilding.

Please see the full texts of the two catalogues via the following Chinese language link:

http://www.gov.cn/gzdt/2009-11/12/content_1463187.htm

Draft Amendments of China’s Renewable Energy Law - a Hollow Promise or a Real Solution?

On August 24, 2009, draft amendments (the “**Draft**”) to China’s three-year-old Renewable Energy Law (the “**Existing RE Law**”) were introduced for public comments. Currently, the Draft, together with the public comments, are being reviewed by the Standing Committee of the National People’s Congress, and the Draft will take effect only following the approval of the Standing Committee.

Grid Connection Bottleneck

Since the introduction of the Renewable Energy Law, China’s nascent renewable energy industry, particularly solar energy and wind energy, has experienced explosive growth in terms of the overall capacity of energy production. For example, the wind energy sector has seen its generation capacity double for four consecutive years and the aggregate capacity reached 8.94 million kilowatts at the end of 2008. Projects that are capable of generating huge amounts of energy from sources such as wind and solar have sprung up over many parts of China. However, many of these projects are waiting for connection to the existing power grid and without connections to the grid, these projects are sitting idle currently. In 2008, over 20 percent of the existing wind farms had not yet connected to the national electric grid due to a lack of transmission lines in the remote northern regions where many wind farms are located. Grid companies have been reluctant to provide grid connection due to the instability of the electricity supply from renewable energy power plants and the costs involved in upgrading and expanding the transmission lines. Idle projects are posing a serious threat to the continued development and viability of China’s nascent renewable energy industry and the Draft was introduced to address some of the challenges faced by the industry.

Mandatory Annual Purchase Quota

Under the Existing RE Law, the state-owned grid companies are required to purchase the full amount of electricity generated from power projects that are within the coverage of their existing grids

and they are obligated to facilitate grid connection for these companies. Many of the projects that are awaiting grid connection do not fall within coverage area of the grid companies; therefore, under the Existing RE Law, they do not have the right to demand that grid companies provide them with grid connection. To address this problem, the Draft proposes that the basis of the grid companies’ obligations vis-à-vis power generation companies should not be based on the existing coverage areas but rather, such obligations should be defined in terms of mandatory purchase quota assessable against the grid companies as determined by the government authorities. Under the Draft, the annual mandatory purchase quota applicable to each of the state-owned grid companies will be jointly determined by the national administration agencies of energy, electricity regulation and finance. The mandatory purchase quota assessed against the grid companies obligate them to purchase power from power generation companies that are not located in the grid companies’ current coverage areas; therefore, the Draft requires grid companies to (i) provide “connection services” to these power companies, (ii) “intensify [their] planning and construction of the grid”, and (iii) expand their grid coverage to accommodate renewable energy transmission.

Enforcement of Regulations

In general, the Draft reinforces the penalty provisions under the Existing RE Law. Specifically, the Draft states that if a grid company’s failure to comply with its mandatory purchase obligation results in economic losses suffered by the affected renewable energy companies, then the grid company can be held liable for paying the renewable energy companies compensatory damages. In addition, if the grid company fails to remedy this non-compliance by any deadline imposed by the authorities, then on top of the payment of compensatory damages, the grid company can be assessed a fine in an amount that is less than double the amount of compensatory damages awarded to the renewable energy companies.

The Draft only provides the general requirement of mandatory purchase quota, so it is not yet clear how such quota would be determined, how such quota would be allocated to the grid companies and from which renewable companies the grid companies are required to purchase. Therefore, until the Draft is approved by the Standing Committee and detailed implementation rules are promulgated in the near term, it remains questionable whether the Draft would be an effective means to remedy the current grid connection bottleneck and other challenges faced by China’s renewable energy industry.

Please see the full texts of the draft amendment via the following Chinese language link:

http://www.npc.gov.cn/npc/xinwen/lfgz/flca/2009-08/28/content_1516272.htm

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