10 June 2019

Amendments to Renewable Energy Act of Mongolia adopted by the Parliament on 6 June 2019

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On 6 June 2019 the Mongolian Parliament has passed amendments to the Renewable Energy Act of Mongolia (the "**Amendments**"). The Amendments have come into force immediately – on 6 June 2019. FYI - the Renewable Energy Act of Mongolia was first adopted in 2007 (as amended from time to time) (the "**REL**").

This summary highlights some of the key features of the Amendments.

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1. The feed-in-tariffs ("FIT") have been reduced as follows:

Renewable energy	FIT under existing REL (USD per 1 kWh)		FIT under the Amendments (USD per 1 kWh)	
	Grid-connected	**Off-grid**	**Grid-connected**	**Off-grid**
Wind	0,08 - 0,095	0,1 - 0,15	Up to 0,085	n/a[2]
Solar	0,15 - 0,18	0,2 - 0,3	Up to 0,12	
Hydropower	0,045 - 0,06 (up to 5000 kW)	0,08 - 0,1 (up to 500 kW)	0,045-0,06 (no change)	
		0,05 - 0,06 (501 – 2 000 kW)		
		0,045 - 0,05 (2001 – 5 000 kW)		

Thus, the Amendments have discarded the previous tariff regime which consisted of the minimum and the maximum tariffs. Instead, the Amendments have instituted a cap for renewable energy tariffs with no minimum (floor) tariff.

[1] This advisory is an update of our advisory on the same subject issued in November 2018.

[2] "*Off-grid*" tariff system has not been implemented since adoption of the REL first in 2007. This was due to several reasons such as lack of private investments into off-grid projects and publicly funded connection of most towns and villages to the grid. Therefore, the Amendments eliminate altogether the "off-grid" tariff system for any renewables. Instead, the ERC would each year set tariffs for spare electricity that users with renewable generators wish to sell to the grid.

2. Prospective power purchaser must submit evidence of availability of financing

According to the Government, over 50 (fifty) licenses for construction of renewables facilities to produce more than 1500 MW have been issued to date since 2007 when the REL was first enacted. However, only 120 MW (out of 1500 MW) have been built and operationalized so far.

By comparison, the total installed energy capacity of Mongolia as of the time of this paper is less than 1300 MW.

The MOE views such over-licensing unsustainable. It, in the opinion of the MOE, is the reason that most of the license holders have struggled to procure financing for their projects.

Therefore, under the Amendments, any renewable power purchaser would need to submit to the Energy Regulatory Commission, Mongolia's energy regulator, evidence (assurance) of availability of financing necessary to build, and to launch, the facilities to produce power.

To this end, the Amendments have introduced the definition of a "guarantee of project implementation" – "*the guarantee of project implementation" means a deposit in the bank[3] made, or a bank guarantee provided, guaranteeing the project participant's full implementation of the agreement[4]"*. It appears to be left up to the parties to the PPA – i.e., the seller and the purchaser (National Dispatch Center SOE) to negotiate and reflect the terms of "*the guarantee of project implementation*" in the PPA.

The Amendments do not prescribe any other details – e.g., requirements as to the amount or term of the guarantee.

According to the informal discussion of KhanLex Partners with some of the sponsors of the Amendments, it is understood that (i) the objective of "*the guarantee of project implementation*" is to ensure complete construction and connection of the renewable generator in compliance with the COD set out in the PPA, (ii) the amount of the guarantee would probably be based on capacity of the future generator, and (iii) USD50 per 1kW could potentially serve as reference figure.

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[3] KhanLex: "*deposit in the bank*" seems to be referring to an escrow arrangement.
[4] KhanLex: "*implementation of the agreement*" seems to be referring to "implementation of the PPA"

3. Cost of building substations would be transferred from transmitter to power producer

At the moment, it is the transmitter who has a statutory responsibility to bear the cost of connecting a power plant to the transmission network.

In practice, however, the transmitter, being a state-owned public utility, often lacks funds to finance interconnection works, which usually include building/upgrading a transmission substation. As a result, such costs have in practice been borne by the IPPs (or sometimes even financed through grants from MDBs).

The Amendments require the producer to share some of above costs – the producer will now be responsible for financing technical connection of its generation facilities to the nearest connection point (i.e., substation) of the transmitter. The foregoing Amendment, in our view, still requires clarification as to who will finance upgrading the substation (or building an entirely new substation) of the transmitter which has oftentimes been the case given the low capacity of the existing substations.

4. Power purchase agreement would be entered into with the National Dispatch Centre

A power producer (seller) would enter into a PPA with the Mongolia's grid operator (purchaser) - the National Dispatch Centre (the "**NDC**").

At present, under the Mongolian legislation there exists inconsistency as to who the power purchaser under a PPA is – whether the NDC or the National Power Transmission Grid (the state-owned electricity transmitter).

To comply with the Mongolian law, power producers have often in practice chosen to conclude PPAs with both the NDC *and* the transmitter, under implicit approval of the authorities. This practice of entering into a PPA with both the NDC *and* the transmitter ignored the fact that since 2015 the NDC has by law been managing the zero-balance account effectively performing the duties of a power buyer.

The Amendments reconcile these inconsistencies by expressly designating the NDC to act as the sole purchaser of power under the PPA.

5. Renewable would be competitively procured by MOE

Last not least, the Amendments introduce the concept of competitive procurement of renewables – specifically, procurement will be done by way of auctioning. According to the definition of "competition of project proposals", renewables would be procured via competitive process - "*competition of project proposals" means a selection process of construction projects of renewable generators (to be connected to the grid) based on evaluation of technical specifications and price offers*".

Further according to the Amendments, it will be the MOE who will (i) adopt the procedures regulating the competition and (ii) carry out the procurement.

Presumably, (ii) above means that the MOE will act as a party to, *among others*, announce the call for project proposals, lead the evaluation and eventually award the project.

The competition must be conducted under the following principles:

- The site, type of ER, capacity and the annual amount of energy to be purchased must be pre-determined in accordance with the state energy policy and in a manner conducive to the stable central grid,
- The technology to be deployed and the selling price must be competitive, and
- The competition must be transparent, fair and non-discriminatory.

Further according to the MOE, competitive procurement rules are being designed under a technical assistance project funded by EBRD. From our discussions with the authorities, it is understood that a buyer (Government of Mongolia) would announce, each year, an amount of electricity (kWh) that it would buy per year and the project site. The Government would also offer risk mitigation plans as well as terms of a PPA to potential developers. The project would then be awarded to the developer who offers the lowest selling price.

We further understand from the MOE that the Grid Code, which is currently not exactly suited for intermittent renewable, is being renewed. It is expected that the new Grid Code would be approved prior to the first tender under the amended REL. While we have not seen the drafted Grid Code, it is our understanding from discussions with stakeholders that the draft Grid Code establishes demanding conditions for RE energy – it, for instance, may impose some requirements only achievable with storage facilities which would increase the cost of renewable energy projects and may act as a barrier.

According to the informal discussion of KhanLex Partners with some of the sponsors of the Amendments, it is understood that (i) the objective of "competition for project proposals" is to ensure an "*adequate share of renewables in the overall energy* output" of Mongolia, and (ii) as a result, the state will procure renewables based on a demand-based long-term plan, which would specify, among others, location and capacity of future wind or solar generators.

Similar to the "*guarantee of project implementation*", the Amendments do not shed further light on the competitive process – in particular, the types and design of competition, requirements and qualifications for bids/proposals, compliance and evaluation rules. The Amendments appear to suggest that the two main selection criteria in awarding the renewable projects appear to be (i) technical specifications (technology, innovation, environment friendliness?) and (ii) price offer of the project (selling price to the grid?).

Overall, KhanLex Partners are of the view that the above Amendments would affect attractiveness of investments into renewables, in particular wind and solar. Of particular note are the elimination of the existing tariff floor (minimum FIT) for both wind and solar as well as the Government of Mongolia's power to determine key parameters such as location of the project site and capacity.

While the MOE would administer the competition and award of renewables, the REL, as a key renewable energy legislation, should set forth key elements of such competitive process – e.g., types and design of competition, principles of transparency and non-discrimination, role and duties of the state, key administrative, technical and financial requirements, compliance rules and other considerations critical to ensuring stable and transparent legal framework, especially in the eyes of investment community.

Without setting the basic parameters in the parliamentary statute, such arrangement may lead to risks of subjectiveness in, and mishandling of, award and contracting procedure, further deterring potential investors. Also, whether the MOE would possess sufficient capacity – human as well as financial – to effectively design *and* carry out competitive procurement remains to be seen.

This risk is further exasperated by a similar lack of details on the proposed requirement of a bank guarantee to complete the renewable generation facilities lacks details. The MOE would exercise, under the Amendments, the authority to determine the missing details.

Also, questions could be asked over propriety as to the dual role of the MOE to both (i) adopt the procedures regulating the competition and (ii) carry out the competition (i.e., award contracts) itself.

The Amendments do not address the above as well as other matters - such as the legal framework for dispatch priority of renewables and for coal power subsidies. In particular, the lack of details on the competitive selection and award of renewables projects is most notable. This is expected to be addressed in the secondary legislation on the competitive procurement of RE that will be passed by the MOE under technical assistance of EBRD. A lot, therefore, will depend on how this secondary legislation on the competitive procurement is designed *and* implemented.[5]

Finally, and importantly, it is our view that the Amendments, including FIT reductions, will not apply retroactively to the PPAs executed prior to the Amendments's effective date (6 June 2019).

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[5] According to the EBRD consultants, the auction in Mongolia with a pilot of 25 MW Solar PV would be conducted in 2020, as a test, to identify and correct different issues from the initial tender design, benefiting from lessons learnt before implementing a definitive scheme.

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10 June 2019

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