

PRI'S RESPONSE TO THE NEW CHINA NATIONAL ENERGY LAW CONSULTATION

May 8, 2020

INTRODUCTION

The United Nations-backed Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI has over 3000 signatories (pension funds, insurers, investment managers and service providers) globally with approximately US \$90 trillion in assets under management.

Responsible investment explicitly acknowledges the relevance to the investor of environmental, social and governance (ESG) factors in investment decision-making for the long-term health and stability of financial markets.

The COVID-19 crisis has demonstrated the importance of resilient societies and economies, supported by a sustainable financial system. In the short-term, policy makers have rightly focused on the health crisis, immediate economic relief and the prevention of future outbreaks. Policy makers will also need to address existing environmental and climate challenges to ensure the recovery is sustainable. ESG issues, and climate change in particular, remain a priority for financial institutions.

The PRI is working to help investors protect portfolios from risks and to expose them to opportunities in the shift to a low-carbon global economy. Energy use contributed to approximately 77% of China's total GHG emissions in 2015. CO₂ emissions from fuel combustion increased from 2.1 billion tonnes CO₂eq in 1990 to 9.3 billion tonnes CO₂eq in 2017.¹ The development of the energy sector in China is therefore of significant importance to global investors. Investors continue to expect policy reform towards a low-carbon global economy: delaying policy action now will likely lead to further, more disruptive, intervention later.

The PRI welcomes the opportunity to contribute comments and suggestions to the China's National Energy Law consultation.

ABOUT THE CONSULTATION

China is going through a critical period of transition to a resilient, sustainable and low-carbon economy aligned with the Paris Agreement and the Sustainable Development Goals. The Fourth Plenary Session of the 19th CPC Central Committee explicitly called for "promoting an energy revolution and building a clean, low-carbon energy system that is safe and efficient". The new energy law aims to provide a comprehensive policy framework that sets the high-level goals and direction for the development of the energy sector in China.

The proposed China National Energy Law (the Energy Law) has been developed under the guidance of the former Legal Affairs Office of the State Council and Ministry of Justice, the National Development and Reform Commission (NDRC) and the National Energy Administration (NEA).

The Energy Law emphasizes the development of clean, low-carbon energy supply, a competitive energy market, increased energy security of supply, as well as the legal liabilities and supervision mechanism.

¹ <https://www.iea.org/data-and-statistics>

THE PRI'S RESPONSE TO THE CONSULTATION

The PRI welcomes the consolidation of existing oil, gas, coal, power and renewable energy regulations into a new national energy law by NDRC and NEA. Setting up a comprehensive policy framework for the energy sector is an important step for China in managing a sustainable energy transition aligned with the Paris agreement. The PRI welcomes the inclusion in the new law of the topics of climate change and low-carbon transition. In particular, the PRI welcomes:

- The focus on low-carbon and renewable energy sources
- The joint emphasis on work safety, environmental protection, and climate change
- The mandatory information disclosure requirement for energy-intensive enterprises
- The transition towards competitive energy markets and market-based resource allocation and price formation

The PRI's key recommendation for the NDRC and NEA is that the new energy law is an opportunity to cement and strengthen Chinese leadership on climate change. In line with developments in over 70 countries worldwide², and consistent with the principle of Common but Differentiated Responsibilities, the PRI recommends:

- **Establishing an absolute cap on emissions and clarifying the longer-term emission trajectory to 2050 consistent with the Paris Agreement.**
- **Enhancing existing energy intensity targets to 70~75% by 2030.**
- **Accelerating the shift away from coal and expanding the use of renewable energies, through a green dispatch and market-based measures to reduce excess coal power capacity.**
- **Public reporting by enterprises on their ESG impacts.**

Globally, investors are increasingly tightening their climate strategies, including commitment to net zero emissions by 2050. Some of the world's largest asset owners have joined this target through the UN-convened Asset Owner Net Zero Alliance. The investor-led Climate Action 100+ has now close to 400 investors engaged with high-emitting companies to reduce GHG emissions.

The PRI has experience of public policy on climate disclosures and responsible investment and real economy policies across multiple markets and stands ready to further support the work of the Chinese regulators on promoting a sustainable energy strategy aligned with sustainable finance and greener economies.

Any question or comments can be sent to policy@unpri.org.

² <http://sdg.iisd.org/news/77-countries-100-cities-commit-to-net-zero-carbon-emissions-by-2050-at-climate-summit/>

DETAILED RECOMMENDATIONS

Article 1 (Legislative Purpose)

The draft law cites a number of objectives including 'energy security, optimising energy supply, improving energy efficiency and promoting the development of high-quality energy'.

The PRI recommends that the Energy Law includes an objective on reducing human contribution to climate change.

Article 5 (Scientific and Technological Innovation – General Principle)

The PRI recommends that Article 5 makes a strong commitment to research, development and commercialisation of clean energy technologies.

Article 14 (Increasing the Role of the Market in the Energy Sector)

The draft law states that private market players should play a key role in the allocation of resources and the evolution of the market structure, including an increasing reliance on market mechanisms of competition and price formation, and establishing an effective energy supervision system.

The PRI recommends to explicitly acknowledge the role of institutional investors in promoting and financing sustainable energy infrastructure. Capital markets and institutional investors can help accelerate the development of clean energy infrastructure through asset allocation and active engagement.

Article 20 (International Cooperation - General Principle)

The draft law indicates that the State adheres to the principle of equality and mutual benefit, win-win cooperation and coordinated security, and strengthens international cooperation in all aspects.

The PRI recommends that the Energy Law includes cooperation with international processes supporting the global response to the threat of climate change as a key principle to which the State adheres.

Article 22 (Status and Content of Energy Strategy)

The draft law cites 'environmental protection needs' as a factor governing the formulation of the national energy strategy.

The PRI recommends that the Energy Law specifically recognises the need to reduce human contribution to climate change as a factor governing the formulation of the national energy strategy.

Article 32 (Optimising the Energy Supply Structure)

The draft law encourages efficient and clean development and utilisation of energy resources, supports the priority development of renewable energy sources, rational development of fossil energy resources, develops distributed energy sources according to local conditions, promotes alternative fossil energy to fossil fuels, low-carbon energy alternatives to high-carbon energy, and supports the development and application of new fuels and industrial raw materials that replace oil and natural gas.

PRI recommends the optimising and reforming of China's energy supply market, including the introduction of power system flexibility, a crucial element for reducing curtailment and balancing an increasing proportion of renewable energy sources on the grid. System flexibility would include comprehensive changes to the design and system planning, such as:

- **Short term power trading.** This plays a vital role in the mobilising of a more flexible power system and can support the integration of the Variable Renewable Energy (VRE).
- **Economic dispatch and rapid trading enable VRE to compete on their short run marginal cost.**
- **Cross regional trade in electricity.** The benefits of which include increased security of supply, improved efficiency and integration of renewables.
- **Pricing of externalities.** A price-based instruments can help achieve environmental goals in economically efficient ways. The establishment of spot markets is crucial to the development of trading between provinces.
- **Development of energy storage and demand response services:** can provide capacity and market structures to increase system flexibility and resources

Article 36 (Tax System)

The draft law indicates that the state will establish and improve the system of energy-related taxes and fees and guide the development of clean and low-carbon energy sources such as non-fossil energy.

The PRI recommends that the Energy Law makes an explicit commitment to ensuring that emitters of CO2 cover the environmental costs of these emissions. The PRI also recommends that China accelerates the construction and operation of a nationwide emission trading scheme, including a carbon pricing mechanism at a behaviour-changing level.

Article 39 (Coal Development and Utilization)

The draft law cites a number of principles governing coal development and utilization, including unified planning, overall survey, orderly development, clean and efficient use; and indicates that the state promotes the clean and efficient use of coal, and appropriately develops coal-based fuels and chemical raw materials.

The PRI recommends that the Energy Law also includes reducing CO2 emissions as a principle governing coal utilisation.

Article 42 (Thermal Power Development)

The draft law states that energy departments shall take measures to develop clean, safe and efficient thermal power generation and related technologies, and to reduce pollutant emissions.

The PRI recommends that the Energy Law also includes objectives to reduce CO2 emissions, as measures to be taken by energy departments.

Article 59 (Mandatory Disclosure of Information on Energy Intensive Enterprises - Requirements)

The draft law states that the department seeking energy conservation shall, in conjunction with the relevant departments, publish the list of key energy-using enterprises in accordance with the law, require them to report on energy use and publish information on energy efficiency and energy consumption per unit of products.

The PRI recommends aligning disclosure requirements with the proposed ESG disclosure framework by the CSRC. These disclosure requirements should include standardised indicators aligned with international/national disclosure frameworks, that allow for comparability across industry sectors, portfolios and time-series. The law should also set a reporting methodology that species the scope, methods of calculation, minimum reporting thresholds, board oversight, monitoring and enforcement mechanisms, as well as guidance on how to assure the quality of reporting by third party auditors. The resulting data should be published in corporate annual

reports, alongside financial indicators, and based on the same reporting scope. The data should be analysed and explained in comparison to sectoral averages and historical performance and made available to all investors (available free of charge, accessible online and available in a timely manner).³

In addition, the PRI recommends that energy intensive companies are required to provide TCFD-based disclosures. Over 2000 PRI investor signatories across 50 markets will have to report against TCFD based indicators in 2020. TCFD-aligned reporting from Chinese companies is therefore a key information required by institutional investors.

Article 61 (Requirements for Energy Efficiency and Emissions Reduction)

The draft law states that energy supply enterprises and energy-using units shall fulfill their obligations on environmental protection and energy efficiency and emissions reduction. Enterprises that have not completed energy efficiency and emission reduction targets shall conduct energy audits or clean production audits in accordance with the law.

The PRI recommends clarifying which government agency or ministry will set the energy efficiency and emissions reduction targets and the frequency for adjusting the targets and the level of ambition on energy savings. We also recommend setting penalties (at a behaviour-changing level) for enterprises that fail to achieve their targets.

Article 67 (Price Cost Supervision)

The draft law states that the price authorities shall take into account the cost of environmental damage in adjusting energy prices; and includes permitted costs, reasonable profits, taxation in accordance with the law and fair burden as principles governing how the price authorities shall formulate and adjust energy prices.

The PRI recommends that the Energy Law includes the social cost of CO2 emissions as a factor for the price authorities to take into account in formulating and adjusting energy prices; and reducing CO2 emissions as principles governing how the price authorities shall formulate and adjust energy prices.

Article 78 (Scientific and Technological Innovation)

The draft law states that The State takes measures to promote the research and development, demonstration, promotion and application of new energy technologies.

The PRI recommends that the Energy Law makes an explicit commitment to promote the research and development, demonstration, promotion and application of new low-carbon energy technologies.

Article 79 (Key Areas of Science and Technology)

The draft law states that the State supports innovative research and development applications of technologies such as energy resource exploration and development, energy processing conversion, energy transmission and distribution, energy clean and comprehensive utilization, energy conservation and emission reduction, and energy production safety.

The PRI recommends that the Energy Law refers to CO2 emissions reduction as well as other pollutant emissions reduction, to recognise the urgent need to reduce CO2 emissions.

³ For more information on our recommendations regarding ESG disclosure in China, see <https://www.unpri.org/fiduciary-duty/esg-data-in-china-recommendations-for-primary-esg-indicators/4345.article>

Article 84 (International Cooperation - Approaches)

Article 84 recommends that The State strengthens international cooperation through international treaties, bilateral or multilateral energy cooperation agreements, participation in or establishment of international energy organizations, international coordination of energy policies and energy standards, the resolution of major issues through consultation and the implementation of joint planning, joint development, personnel exchange and information exchange.

The PRI recommends adding explicitly in this article China's commitment to the Paris Agreement.

Article 113 (Mandatory Disclosure of Information - Fines)

Article 113 specifies that if a key energy-using enterprise fails to report to the department that manages energy conservation or fails to publicly disclose its energy consumption, the department that manages the energy-saving work shall order it to make corrections and impose a fine of between 100,000 yuan and 500,000 yuan.

The PRI recommends adding disclosure of pollutants and GHG emissions in the scope of this article and aligning disclosure requirements with the planned ESG disclosure framework by the CSRC, as detailed in our recommendation for Article 59.