

Incentives for Non-Conventional Renewable Energy (NCRE) Projects in Chile

During recent decades the energy scenario has raised various challenges worldwide. Energy policies of many countries have had to incorporate into their strategies, the diversification of the matrix with new generation sources, especially those electrical generation technologies known as Non-Conventional Renewable Energy (NCRE).

Chile is no exception. It is a developing country whose electricity demand is increasing at the rate of approximately 6%, similar to its GDP growth projection.

Limited sources of fossil fuels, dependence on imports and increasing international prices since 2005, has forced Chile to concentrate its efforts on developing innovation to favour the diversification of the electricity grid, taking particular advantage of Chile's potential in the area of natural resources. In this respect, NCRE offers an important opportunity for investment.

1. Stable and transparent legal framework for foreign investment

The clear policy of the government to attract foreign investment is reflected in the legal and tax systems, as well as the specific foreign investment regulations. It is often stated that Chile has a stable and transparent legal framework for foreign investment, characterized by clear, non-discriminatory and non-discretionary rules. The flexibility of Chilean foreign investment and tax laws contribute to foreign investment confidence.

2. Open access to energy sector and transmission lines

Chile has a rather liberal legal framework for the energy sector that is based on the principles of competition in the generation segment and separation of the functions of electricity generation, transmission and distribution. Nationals and foreigners alike can participate in the energy sector without any regulatory barrier. The state currently only controls the functions of regulation and monitoring, the National Electric Commission (CNE) being the state entity responsible for preparing and coordinating plans and standards. Moreover, there is a guaranteed access to transmission lines for all energy projects (no discretionary exclusions) and partial or total exemption of transmission charges for small scale NCRE.

3. Chile's Energy Matrix and NCRE

Today, the Chilean electricity system is divided into four sub-systems: the Interconnected System of the Norte Grande (SING), the Central Interconnected System (SIC) - the largest in terms of power and scope - and two additional local systems in the regions of Aysén and Magallanes.

As compared to other countries with natural resources, such as Sweden (8.8%), Ireland (8.7%), Denmark (29.8%), New Zealand (13.3%) and Portugal (17.7%), at 1.6%, Chile has a very low percentage of its energy sourced from NCRE¹. The electricity sector in Chile relies predominantly on hydro-electric power generation (41.9% of generated energy in 2008), whilst classical petroleum based power plants (24.1%) and coal (27.1%) account for most of the remainder.

Chile is currently facing a tough challenge as officials have approved a contentious US\$3.2 billion hydroelectric dam project that would staunch the flow of two major rivers in Aysén, a region in Chilean Patagonia. The HidroAysén project - a collaboration between the country's two largest energy firms - plans to generate 2,750 megawatts of power, but it must first seek approval for a 2,300 kilometre transmission line, costing another US\$3.8 billion, that would carry power to Santiago.

The public outcry that has occurred due to this project makes it all the more poignant to concentrate on the introduction of NCREs into the electricity generation matrix, hence the focus of this article - to outline the attractive investment incentives available to foreign investors in this sector.

To promote the introduction of NCREs into the electricity generation matrix, amendments have been made to the General Law on Electrical Services, through Short Law I (Law N° 19,940) and Short Law II (Law N° 20,018). In brief, these amendments improved the entry conditions for NCRE into electricity systems by:

- Assuring any renewable energy generation company the right to sell its energy in the electricity market at spot price.
- Fully or partially releasing NCRE power stations with power outputs of less than 20MW from transmission tolls.
- Assuring that a minimum percentage of the demand for NCRE arises from regulated clients.

¹ Chilean Electrical-Electronic Industry Association (Asociación de la Industria Eléctrica- Electrónica, AIE) 2010, data 2008.

- Allowing for the connection of small power stations (less than 9 MW) to distribution networks.

4. Fixed % of NCRE required under law

In 2008, Chile enacted the Non-Conventional Renewable Energy (NCRE) Law N°20,257, which made it mandatory for electricity companies selling energy to final customers to assure that a minimum of 5% of the energy they sell comes from NCRE sources, directly or indirectly. This percentage will increase by 0.5% per year as from 2015 to reach 10% in 2024.

5. Grants for feasibility studies and investments in NCRE projects

In the context of modifying the national legal framework, the Chilean Economic Development Agency (CORFO) has been offering various incentives for investments in NCRE projects, including:

- (i) Grants to fund preliminary pre-investment feasibility studies or specialized consultancy required before the materialization of NCRE projects that involve investments of more than US\$400,000.- that are eligible in accordance with the provisions of the Kyoto Protocol to the United Nations Framework Convention on Climate Change (“Kyoto Protocol”). The amount of the subsidy is up to 50% of the total cost of the study or consultancy with a cap of US\$60,000 per project submission, and provided that it does not exceed 2% of the total estimated investment. The wind prospecting studies have a maximum subsidy of US\$20,000 for monitoring in a point, or US\$30,000 for two points.
- (ii) Grants to fund advanced pre-investment feasibility studies. This program uses funds of the Banco KfW of Germany and the National Energy Commission (CNE) to co-finance part of the costs of basic and detailed engineering, electricity connection studies and environmental impact evaluations and/or declarations. The grant covers up to 50% of the total cost of the study or consultancy with a maximum of 5% of the estimated investment, provided that it does not exceed US\$160,000 per project submission. This grant applies for projects that have been submitted to the preliminary processes and does not apply to studies measuring the availability of resources or for pre-feasibility studies.

During the second half of 2011, the Ministry of Energy will implement a fund to promote NCRE projects, specifically it will finance instruments that will directly support initiatives of this type, including:

- i) Insurance for the development of exploration in geothermal resources;
- ii) Insurance to incentivize the construction of NCRE projects and their transmission lines;
- iii) Tenders of projects to increase the percentage of NCRE projects;
- iv) Solar plant in Northern Chile.

In addition, the Ministry of Energy, together with the Ministry of National Assets, will carry out a new tender in 2011 to develop wind projects on state land with high energy potential.

6. Trading carbon credits.

Chile has ratified the Kyoto Protocol and NCRE projects qualified under the Clean Development Mechanism (CDM) may obtain additional income by selling “carbon credits” to developed countries or operators in developed countries that have ratified the Kyoto Protocol.

7. Additional Guidance

In our firm’s opinion, the best way for Chinese investors to enter the Chilean energy sector is to become partners with Chilean companies and develop joint activities, which will allow Chinese investors to enter easily in a market that is relatively unknown to them. In particular, you need advisors who have excellent relationships with both public and private sectors to help lobby and successfully execute any deal in the energy sector.

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