

Buenos Aires, August 10, 2006

Dear Executive Board members,

Three members of the Executive Board have requested a review of the “Capex S.A. – Agua del Cajón Thermal Power Plant – Open to Combined Cycle Conversion” project. We are pleased of having the opportunity to clarify all the issues raised by the above-mentioned members.

1- Starting date of the project activity

The first issue, common to the three requests for review, is related to the starting date of the project activity. All doubts related to the starting date should be cleared once the specific nature of the electricity activity in Argentina, included in the following paragraphs, is considered:

- a) Distinctive characteristics of electricity generation: In order to keep the reliability of the electricity system when owners of new generation equipment are willing to be dispatched, they are required to comply with very precise regulatory requirements. These requirements consist of a series of tests that new generation units must perform. They are contemplated by the Procedimiento Técnico N° 4 included in the Argentine electricity market regulations (Technical Procedure Number 4), and compliance with this procedure has to be met prior to achieving the “generation unit” status.
- b) Dispatch mechanism: As fully described in the PDD, the Wholesale Electricity Market Manager (CAMMESA), chaired by the Secretariat of Energy, manages the commercial dispatch of all the generation units in the wholesale electricity market. Upon commercial operation approval all units are dispatched considering the marginal cost criteria (the merit-order rule). Prior to such approval, owners of new generation equipment must be authorized by CAMMESA to perform the tests according to the Technical Procedure N° 4 (Test Stage).

These regulatory requirements of tests to be performed and documents to be provided to guarantee that new equipment is reliable for delivering electricity to the grid in terms of its operation and its compatibility for the connection and synchronization to the transportation grid, were begun by Capex by the end of 1999. During the Test Stage, as per the Procedures, the installed capacity was not considered “firm capacity” and the steam turbine was not dispatched according to the merit-order rule. During this Test Stage, Capex S.A. did not receive payment for dispatched and baseload power available to the national interconnected system.

- c) Generation unit status: Several requests for additional information and tests were received from CAMMESA, which were complied as soon as practicable prior to January 11, 2000. In accordance with the regulatory framework, once all Test Stage requirements have been fulfilled, the generator can request commercial operation approval. Such request was made by CAPEX on January 11, 2000. As from January 11, CAMMESA analyzed the fulfillment of the test requirements, and commercial operation approval was granted on January 17, 2000, the starting date of the Project Activity.
- d) The Project Activity: Capex's project is aimed at delivering and selling clean electricity into the wholesale electricity market pursuant to the regulatory framework, displacing –according to the dispatch rules– less environmentally efficient generation through its new generation unit.

Only upon commercial operation approval a new generation unit can be considered a generation unit within the scope of the regulatory framework and, thus, be dispatched according to the merit-order rule.

Only upon fulfillment of regulatory requirements (commercial operation approval) can a project be eligible for CDM, as established in Sub-step 1b of the additionality tool.

The project activity started on 17 January 2000 as stated by Capex S.A. in the PDD. Such starting date is confirmed by official notifications of CAMMESA to the Secretariat of Energy and Capex S.A., as stated in the letter attached to this reply (Note N° B – 005239-1).

- e) CAPEX website: Capex's website pointed out that the project started operation in November 1999. This statement was meant to reflect that equipment was already in condition to perform the required tests to achieve the commercial approval of the steam turbine –condition precedent to start project operation and regulatory commercial activity– and therefore that Test Stage had begun. This does not contradict the starting date of the project activity, since the proposed CDM project activity –as clearly shown in paragraph d) above– begins with commercial operation approval once Test Stage has been completed.

## 2- Approval of the Project under the Pilot Phase of Activities Implemented Jointly (AIJ)

By the time of project design CDM was not regulated and, therefore, commercial decisions related to emission reduction credits were based on companies appraisals on what the future CDM would develop into.

Since CDM was not operational as of such time, Capex S.A., as many other companies, decided to submit the project under the framework of the pilot phase of the activities implemented jointly. This decision was encouraged by the Argentine government, which in Decree 822/98 created the Argentine Office of Joint Implementation. Based on such a Decree the Argentine Office of Joint Implementation suggested project proponents that, until CDM became operational, projects should be submitted under AIJ. AIJ did not generate carbon credits. Therefore, carbon credits were only discussed under the expectation of the upcoming CDM regulation. To reinforce the above mentioned, the letter of approval of the AIJ project granted by the Argentine government explicitly mentioned that the government would further consider the possibility of negotiating a percentage of carbon credits in case they were issued later on. This statement would be non-sense in the framework of AIJ.

Moreover, during a “Question and answer session” with the CDM Executive Board in a side event at COP 10 (2004), an Executive Board member indicated that AIJ projects could be accepted under the CDM. It is reflected in the Earth Negotiation Bulletin report of this side event (<http://www.iisd.ca/climate/cop10/enbots/7dec.html>).

The comment by the Executive Board members also mentions that CDM was only considered at a later stage. The reason for such a delay is quite clear if considered in the context of the institutional situation of Argentina by the time the Marrakesh Accords were celebrated. By the end of December 2001 Argentina underwent a severe economic crisis and political disrupt. This led most private companies in Argentina to focus on short-term issues without time to turn their attention to other matters. Only after some stability was recovered, with a strong impact in private companies of the energy sector (e.g. electricity prices were frozen up while the currency suffered a 3-to-1 devaluation), Capex S.A. returned to CDM issues.

Therefore, it is clear that CDM was considered at the time of project implementation and there is a lot of documentation to support it as validated by AENOR (see Validation Report).

Notwithstanding the above-mentioned issues, the project activity undoubtedly comply with Step 0 of the additionality tool, since version 2 of this tool states in footnote 2 that, as a way to provide evidence that the incentive from the CDM was seriously considered in the decision to proceed with the project activity, the objective to mitigate climate change could be addressed.

### 3- Version 2 of the additionality tool

The third issue raised by the three members of the Executive Board is only an omission by the project participant. We apologize for this inconvenience. Since modifications to the original version of the PDD were required by the validator, the revised version of the PDD

(version 02, 9 May 2006) over-passed the paragraph corresponding to the mention of the latest version of the additionality tool (page 11 of the PDD). The correct text is: "Currently this Tool is given by the version of 28 November 2005." This change will be immediately included in the PDD, the rest of the PDD does not need to be modified.

Additionally, Version 2 of the Tool (28 November 2005) has introduced two small changes that reinforce project participant position (e.g. footnote 2 as explained above). Moreover, there is no doubt about carbon credits being the incentive for going ahead with the project activity as the financial analysis (Step 2 of the tool) shows it in the PDD. None of the two small changes has a relevant implication in the documentation and demonstration of additionality provided in the PDD.

As a consequence of the explanations above, the project activity certainly complies with Step 0 of the additionality tool (version 2).

We hope this reply helps the members of the Executive Board to further analyze the requests for review and therefore avoid continuing with the revision process.

Please do not hesitate to contact us for any additional clarification or consideration that might arise.

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Sincerely,



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