Santiago, April 20, 2006

Dear Members of the Executive Board:

We have received the notification from the Secretariat that our CDM project the "Trupan Biomass Power Plant in Chile" has received 5 requests for review by EB members. These requests have raised 2 issues:

1. The additionality of the project is questionable, given that the proposed project activity shows an IRR is 4.2% higher than Arauco's normal discount rate, which is an indicator that the project is a likely baseline scenario. Though the investment analysis was not chosen by Arauco to demonstrate the additionality of the project activity, the barrier analysis presented is not deemed enough to convince that a big company such as Arauco would have difficulties to overcome these barriers.

2. The Trupan biomass power plant sources its biomass fuel through many small sawmills in the area, therefore the way in which Arauco plans to assess the potential leakage effects due to the project activity should be done in a very careful way. It is not clear if the established monitoring plan outlined in the PDD will be enough to ensure the origin of the biomass and to assess the possible leakage effects the project might cause in the area.

In the paragraphs below, we would like to provide a preliminary response to these issues:

After a long debate in the CDM community, and especially at the Conference of the Parties and Executive Board, it was accepted that the additionality analysis could be based "not only" on financial barriers. According to this, we find it surprising that, though the financial analysis was explicitly not chosen in the Trupan PDD to demonstrate additionality, the project is now being questioned based on financial grounds. In fact, we decided to include a financial analysis in the PDD in order to be fully transparent and to clearly demonstrate and justify the presence of barriers that currently prevent projects such as the Trupan Power Plant from happening in Chile.

We also mentioned in the PDD that the normal discount rate for projects in Arauco was 12 %, but for special cases such as this one, a higher discount rate of 15% to 20% was more appropriate. This was stated in footnote 11 of the PDD, but was apparently disregarded by the reviewers. The higher discount rate is justified mainly because the Trupan project combines two proven technologies in a way in which no other company had ever done it before, not only in Chile but also in a worldwide context. As we repeatedly mentioned it in the PDD, there are no other projects of this kind in Chile or in the world that we are aware of. With such level of discount rate, the net present value of the project would have certainly been negative, and we would have probably not received any observations questioning the additionality of the project based on financial grounds.

The reference made by the reviewer about the size of Arauco being enough to overcome any difficulty and / or barrier related to the Trupan project activity, is not accurate and not fair. Usually, big companies such as Arauco, have much stricter policies than smaller ones. Especially when they are publicly listed and have corporate debt issued abroad, as is the case of Arauco. In these cases, companies are constantly scrutinized by risk evaluators and graded accordingly. In addition to this, Arauco belongs to a highly conservative conglomerate in Chile, focused almost entirely in the forestry business. For these reasons, the decision to combine two technologies in a way in which no one had done it before, only to be a very small player in the Power Generation Business is not a minor issue for a company like Arauco, and should not be taken so lightly.

But even if we considered the possibility that the size of Arauco allowed it to overcome all the barriers faced by the Trupan project, it would still not be explained then why there are other big players in the forestry industry in Chile such as CMPC and Masisa, who are still not doing what Arauco has done in power generation using biomass residues. Particularly, if we assume that these projects are financially attractive. Masisa S.A. for example is a world-class player in the wood panel board industry who is currently building an US$ 80 million plant in the VIII region of Chile (the same region in which the Trupan project is located). Such plant does not contemplate the integration of a power cogeneration unit to its MDF production process. As this, there are plenty of other examples we showed to the validators, which due to space reasons, we cannot mention here. This clearly shows that the size of the company is by no means enough reason to justify the capacity to overcome the barriers presented in the barrier analysis of the Trupan PDD. It does also confirm the existence of barriers that really prevent the wide implementation of these type of projects in Chile, particularly under the assumption that these projects are financially attractive.

The "Tool for the Demonstration and Assessment of Additionality" clearly allows project proponents to justify additionality based not only on financial grounds but also on a barrier grounds. We definitely believe the financial analysis in this case is not an indicator of the Trupan project activity being the likely baseline scenario, but more an indicator that helps to explain and reinforce the presence of real and relevant barriers that prevent initiatives such as the Trupan power plant from happening in Chile. Apart from Arauco, no other company in the forest industry has done anything like this so far. The presence of these barriers has not only been addressed by Arauco in the Trupan PDD, but also by well known international organizations such as the OECD[1].

The second issue raised by the reviewers is also surprising to us, since Arauco simply followed the baseline methodology in this regard. The Executive Board took one entire meeting to decide how a grid-connected biomass project such as the Trupan project activity should address and identify possible leakage effects. Once the Executive Board made its decision about this matter, we simply chose the best approach (L2) by which we could most easily and accurately monitor the biomass availability in the influence area of the Trupan power plant. This was explicitly and clearly stated in the monitoring plan described in the PDD. Arauco simply included the necessary variables and procedures in the monitoring plan to correctly monitor and account for the leakage effect of the project activity, just as instructed in the monitoring section of the baseline methodology. Most of this information comes from

[1] "2005 OECD Environmental Performance Review for Chile" pages 19, 59, 63 and 65.

Trupan's biomass fuel suppliers database, which is constantly updated to ensure a smooth supply of fuels to the plant.

In addition to the above, we also provided additional information in the PDD that makes leakage highly unlikely. The fact that local sawmills serve their own needs in the very first place before selling their biomass to other buyers, the extremely higher cost of fossil fuel compared to biomass fuels and the potential that Arauco has with the biomass that comes from its forest operations (which is currently piled or burned in an uncontrolled manner), clearly aims towards a very low probability of leakage associated to the Trupan project activity. It is also relevant to point out that the Trupan plant only receives fuels from sawmills that process wood from sustainable managed forest plantations. This has been rigorously controlled by the Trupan procurement department since the power plant began its operation in 2003, and it is done via dispatch bills control. Since the dispatch bills must be kept for taxing purposes, this can be audited by a DOE anytime.

Arauco fully acknowledges and understands the relevance of this issue, and will take especial care in the implementation of its monitoring plan. In fact, the Trupan mill is currently in the process of ISO 14,001 and OHSAS 18,001 certification. This will further contribute to ensure the generation of high quality and thorough information in this regard, for an accurate calculation of the corresponding emission reductions of the project activity.

For all the reasons mentioned above, Arauco truly believes that the "Trupan Biomass Power Plant in Chile" reunites all the requirements to fully qualify as a CDM project activity. It clearly aims at sustainable development in Chile by means of generating renewable and clean energy. There have been many projects with positive net present value that have been successfully registered as CDM project activities in the last years. Especially in the case of renewables. The Trupan project activity does present a clear and solid case of additionality based on a barrier analysis. According to this, Arauco would respectfully like to request the Executive Board to please authorize the registration of the "Trupan Biomass Power Plant in Chile" as a CDM project activity by its 24th meeting.

Sincerely,

Christian A. Patrickson
Celulosa Arauco y Constitución S.A.