

Sao Paulo, 22 January 2009

CDM project activity crediting period renewal review: “Nova Sinceridade Small Hydroelectric Power Plant - Brascan Energética Minas Gerais S.A. (BEMG) Project Activity” (0543)

Requests 1, 2 and 3

“Further clarification is required on how the DOE has validated that the incentives given by the government under the Proinfa plan did not have an impact on the baseline scenario in the context of the guidelines for crediting period renewal (EB 36, Annex 43) and the associated guidelines referred to in assessing the impact of national and/or sectoral policies on the baseline scenario.”

Project participants' comments

Although the request for review is addressed to the DOE, Project Participants believe that the below provided information is helpful to adequately address the raised issue.

1. PROINFA definition

Law # 10,438 dated April 26th, 2002¹, created PROINFA (from the Portuguese “Programa de Incentivo às Fontes Alternativas de Energia Elétrica”, in a free translation, Alternative Electricity Sources Incentive Program).

Among others, one of the initiative's goals is to increase the renewable energy sources share in the Brazilian electricity market, thus contributing to a greater environmental sustainability.

In order to achieve such goals, the Brazilian government has designated the federal state-owned power utility Eletrobrás (Centrais Elétricas Brasileiras S/A) to act as the primary off-taker of electric energy generated by alternative energy facilities in Brazil, by entering into long-term Power Purchase Agreements with alternative energy power producers, at a guaranteed price of at least 80% of the average energy supply tariff charged to ultimate consumers.

According Law # 10,438, art. 2, PROINFA is applicable to projects from PIA (from the Portuguese “Produtores Independentes Autônomos”, in a free translation, Independent Autonomous Producers) only. PIA are companies not controlled or related with public services of electricity generation, transmission or distribution power utilities companies².

It is important to mention that the Brazilian Decree nr. 5,025 dated March 30th, 2004¹, which regulates the Law nr. 10,438, states that PROINFA aims for the reduction of greenhouse gases as established by the United Nations Framework Convention on Climate Change (UNFCCC) under Kyoto Protocol, contributing to the sustainable development. Therefore, the program is clearly a “Type E-” policy.

¹ Available at: <http://www.eletrobras.com/elb/data/Pages/LUMISABB61D26PTBRIE.htm#Legislação>.

² Available at: http://www.planalto.gov.br/ccivil_03/Leis/2003/L10.762.htm

Article 16 of the Decree determines the creation of PROINFA account, which is administrated by Eletrobrás and composed by the revenues and costs related, among others, related to CDM project activities and other voluntary carbon markets projects. Also, it stress that the revenues from CDM or other carbon credits market would be destined to the reduction of PROINFA costs, rated among all classes of consumers. There are also various public evidences that the state-owned power utility is in the process of developing and commercializing CERs from PROINFA's projects³.

In that way, the energy price paid for the renewable energy producers is higher under PROINFA because it considers the revenues from CDM and other voluntary carbon markets. Then, the creation of PROINFA is a strong indication that without a financial support, investments in alternative sources of energy for power generation would hardly be implemented otherwise.

2. PROINFA history

According to the Law # 10,348, the program would be conducted in 2 (two) phases:

- a) First phase: PPAs between renewable energy producers and Eletrobrás would be signed until June 30th, 2004 for the implementation of 3,300 MW of installed capacity from power utilities with operations starting until December 30th, 2008;
- b) Second phase: after achieving 3,300 MW, the goal would be the achieving of 10% of national total consumption by wind, small hydro and biomass projects. This goal would be achieved in 20 years.

In the first phase, the first public call for projects selection was carried out from April 6th, 2004 to May 10th, 2004 and the second one from October 5th, 2004 to November 19th, 2004. However, most of the selected and contracted projects from PROINFA are not under construction yet and some are supposed to not be even constructed. As mentioned above, in the first phase of the Program, it was planned the hiring of 3,300 MW equally divided in wind, biomass and small hydro projects. Then, it was hired 144 projects, but until January 2006, only 200 MW from wind and about 300 MW from small hydro started the construction phase.

The delay was strongly caused by difficulties related to project owners fulfilling all financing demands. Bermann⁴, says that: “(*The National Development Bank - BNDES*) almost disregards that new power plants have a PPA with 20 years”. About Proinfa, the study developed by Bermann states: “*the incentive of renewable energy should not be an additional program, but a priority in energy electric generation*”. According Cerqueira⁵, the goal of 3,300 MW from the first phase of Proinfa corresponds to only 3% of the Brazilian electricity share, a small participation given the Brazilian great potential regarding renewable energy sources. In that way, PROINFA does not have a major

³ See for example: J. A. Gonçalves (2007). *Contagem Regressiva*. Página 22, July 2007 (available at <http://www.pagina22.com.br/index.cfm?fuseaction=reportagem&id=67>, accessed on 21/Jan/2009).

⁴ D. Chiaretti & M. Capela. *Após 5 anos PROINFA atinge 26% da meta*. Valor Econômico. 24 May 2007 (available at http://www.boell-latinoamerica.org/download_pt/material_livro_celio_bermann.pdf, accessed on 16/Jan/2009).

⁵ L. Cerqueira. *Brasil: um país de todas as energias*. RENOVE - Rede Nacional de Organizações da Sociedade Civil para as Energias Renováveis (Available at <http://www.renove.org.br/>, accessed on 16/Jan/2009).

impact in the Brazilian electricity mix. Additionally, being PROINFA a “type E-” policy may not be taken into account in developing a baseline scenario (EB16, annex 3).

Up to December 2008 there was no indication of the PROINFA’s second phase implementation.

3. Baseline scenario

As mentioned in the PDD (page 15), 75 % of Brazil’s generation is composed of large hydro and 21 % of thermal power stations (figure 1). Only 1.77 % of Brazil’s installed capacity comes from small hydro power sources (1.7 GW out of a total of 100.19 GW).

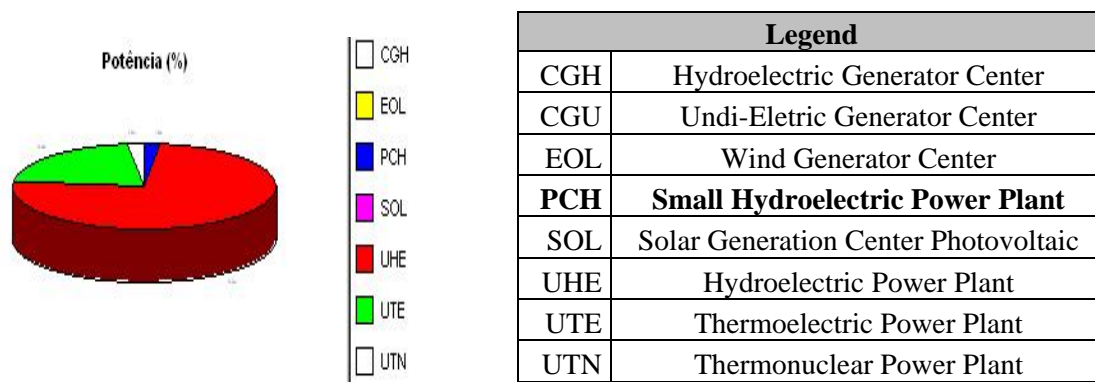


Figure 1 – Operational types of project (Source: ANEEL, 2007⁶)

In the electricity auction, which took place on December 16th, 2005, in Rio de Janeiro, 20 concessions for new power plants were granted, of which only two are for SHPPs (28 MW). From the total of 3,286 MW sold, 2,247 MW (68%) will come from thermal power plants, from which 1,391 come from natural gas fired thermal power plants, i.e., 42% of the total sold⁷.

As stated in the PDD (page 24), “there is a rising demand for energy in Brazil, but it is not being attended by small hydro power plants. In the most recent energy auctions in Brazil, the results were the following: in an auction which took place on July 26, 2007, there was an increase of 1,781,8 MW into National Electric System, all of them from oil thermo plants⁸; in an auction which took place on October 16, 2007, there was an increase of 4,353 MW into National Electric System, from which 69% originated from fossil fuel (oil, coal and natural gas) plants⁹”.

Considering information above, the baseline scenario is identified as the continuation of the current situation with electricity supplied by large hydro and thermal power stations – or by Diesel oil, in the case of isolated systems (page 15 of the PDD).

⁶ ANEEL (2007). *Banco de Informações de Geração - BIG. Capacidade de Geração*. Agência Nacional de Energia Elétrica. <http://www.aneel.gov.br/>.

⁷ L. P. Rosa. Folha de São Paulo, 28 December 2005.

⁸ Source: <http://www.epe.gov.br/Lists/LeilaoA32007/DispForm.aspx?ID=44>.

⁹ Source: Folha de S. Paulo, 17/10/2007, <http://www1.folha.uol.com.br/fsp/dinheiro/fi1710200730.htm>.

4. Conclusion

As mentioned in the PDD (page 4), Nova Sinceridade project was owned by Cat-Leo Energia S.A., a 100%-owned power generation subsidiary of Companhia de Força e Luz Cataguazes-Leopoldina (CFLCL), a traditional Brazilian power utility. Only in December 2004, CFLCL sold Nova Sinceridade to Brascan Energética S.A. Currently, Nova Sinceridade is controlled by Rio Manhuaçu Energética S/A, a company owned by Brascan Energética S/A.

Considering that projects from shareholder power utilities could not participate in PROINFA and the societal configuration of Nova Sinceridade at the time, the project could not apply to the program, and then it does not have access to any advantages from it.

Additionally, Nova Sinceridade Small Hydroelectric Power Plant started operations in April 2002 and PROINFA legislation was not in full effect at that time.

Therefore, incentives given by the government under PROINFA did not have an impact on the baseline scenario in the context of the guidelines for crediting period renewal of the project.

Confident that the above initial comments help to adequately address the raised issue we remain available at any time for additional clarifications.

Best regards,

For the Project Participants

A. Ricardo J. Esparta

E-mail: ricardo.esparta@ecopart.com.br