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Att: CDM Executive Board

Your ref.:
CDM Ref 0993

Our ref.:
ETEL/MRES

Date:
11 May 2007

Response to request for review “Hainan Province Diaoluohu Hydropower Project” (0993)

Dear Members of the CDM Executive Board,

We refer to the requests for review raised by three Board members concerning DNV's request for registration of the “Hainan Province Diaoluohu Hydropower Project” (0993), and we would like to provide the following response to the issues raised by the requests for review.

Comment 1:

“A benchmark rate of 10% is assumed, however this is derived from a 12 year old study. The investment analysis to demonstrate additionality is not satisfactorily, because the source used for benchmark IRR is too old, as of 1995 (“Economic Evaluation Code for Small Hydropower Projects”, issued by Ministry of Water Resources in 1995, Document No. SL16-95)”

DNV Response:

The applied IRR benchmark from the “Economic evaluation code for small hydropower projects” issued by Ministry of Water Resources in 1995 (Document No. SL16-95) is the most specific benchmark for this type of project. This is representing the common Chinese practice for investment decision processes for small scale hydro projects. (Please note that the concept of small hydro project in China differs from the CDM definition. Projects with an installed capacity below 50MW are considered small scale projects for the project's approval process in China). DNV confirms that this benchmark is still in use and applicable and that no other specific benchmark for this type of project has been proposed more recently. It is thus DNV's opinion that this is the most adequate and conservative benchmark that can be applied.

Comment 2:

“An IRR without CDM revenues of 7.9% is presented without sensitivity analysis. This IRR rises to 10.2% with CDM revenues. No sensitivity analyses were carried out.”

DNV Response:

A sensitive analysis is not required for the demonstration of the additionality of small scale projects as per the attachment A to the *appendix B of the simplified modalities and procedures for small-scale CDM project activities*. Furthermore, taking into account the China specifics, it is DNV opinion that a deviation of the key parameters resulting in an increase of the project's IRR is highly unlikely:

- As stated in the PDD and DNV validation report, the financial analysis is based on data from the “Preliminary Engineering Design Report of the Diaoluohu hydropower project” (approved by the Executive Bureau of Hydraulic and Electric Department in April 2005) and an updated investment cost stated in the “Engineering Supervising Report of Hainan Province Diaoluohu Hydropower project” (approved in February 2006). Due to the continuous increase in material costs and manning in China over the past years an

investment cost decrease from the date of approval of the design reports to the real implementation of the project is unlikely.

- For the same reason (increasing of construction and manning costs) the operating and maintenance costs are unlikely to decrease.
- The electricity tariff stated in the PDD and the above mentioned reports is the same that the tariff agreed on the power purchase agreement of September 2006 and thus it is not likely that this variable increases.

The project developer has performed a sensitive analysis which is submitted together with our response to this request for review. DNV has assessed the sensitive analysis and found it to be correct. The three variables mentioned above have been decreased/ increased by 10%. In none of these cases the IRR reach the benchmark.

Comment 3:

“The PP claims that it was not possible to source financing for the project without a CDM investor. The financial barrier analysis claims that the project having the installed capacity smaller than 50MW could not secure loans from the local commercial banks. However no evidence has been presented to support this claim. The validation report claims that the DOE has validated one document. However, that document represents only one bank (China Construction Bank in Lingshui County), not necessarily all commercial banks”

DNV Response:

It is our opinion that the additionality of the project is sufficiently demonstrated by the financial analysis. The PDD points out other barriers that were subsequently verified by DNV. The document *“Decision on the drop out commercial loan from small-scale hydropower project whose installed capacity is less than 50MW”* provided by the China Construction Bank in Lingshui County, is not a project specific document but a guideline for banks to follow for all small scale projects seeking finance. It is DNV’s opinion that this it represents a barrier to the development of hydro projects below 50MW installed capacity in China.

The validation report refers to the evidence provided by the China Construction Bank. We would like to clarify that during the validation process DNV confirmed with other banks the barrier claimed by the project developer. As an annex to this response, a list of the other three banks interviewed, the specific person and the telephone number is submitted. The project developer has requested this information to be provided to the EB and RIT members in confidence but not to make it public.

In conclusion, it is DNV’s opinion that the additionality of the project was sufficiently demonstrated and we sincerely hope the above clarifications and the new documents submitted reinforce our statements in the validation report.

Yours faithfully
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