

JSC Macedonian Power Plants  
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Republic of Macedonia

March 10, 2008  
08-1015/1

To the CDM Executive Board

Dear Members of the CDM Executive Board,

On behalf of JSC Macedonian Power Plants (ELEM) we would like to provide our comments regarding the request for review for CDM project No1412 "Rehabilitation of six HPPs in the Republic of Macedonia". With this letter we would like to clarify the specific circumstances that surrounded the implementation of this project and the fact that the CDM was seriously considered in the process of project implementation.

Rehabilitation of the six major HPPs in the Republic of Macedonia is one of the first major infrastructure projects in the history of Macedonia as an independent state. Hydropower occupies a large share of our overall energy generation mix (more than 30% in terms of installed capacity) and keeping the plants in good operating condition is considered vital to the functioning not only of the energy system, but of the Macedonian economy as a whole.

Although the project was considered of prime importance for our country, preliminary estimates showed that overall rehabilitation of the HPPs would involve significant investments, which local banks could not fund. We are a state-owned enterprise and operate under strictly regulated tariffs. In Macedonia, electricity tariffs almost never reflected the real costs of power generation, transmission and distribution. The tariffs have always been set by the Government and, as many other Governments, Macedonian Government would be more concerned about the overall social and financial impacts of new tariffs on the whole country rather than the financial well-being of the power utility company. Under these circumstances, ESM (the predecessor of ELEM) could not get a tariff raise necessary to finance the project and had to look for international financing to support the project implementation.

We would like to emphasize that Macedonia received its first credit rating only in 2004. Until 2004 without a country credit rating we could not access any private international financing. After long negotiations, eventually we managed to secure a credit from an international financial institution, but ESM still had to cover approximately 25% of the investment costs (approximately USD 10 mil.) with its own funds, reduce the scale of some of the originally planned rehabilitation activities (due to the lack of sufficient financing) and repay the loan in the coming decades. Even this arrangement was considered a challenge to ESM, due to our difficult financial situation and the strong exposure of our debt to foreign currency fluctuations. Furthermore, if

ESM failed to repay their debt in the future, this would automatically transfer into a repayment obligation of the Macedonian state, in other words, into a significant additional financial burden that could plunge our young country into a fiscal turmoil.

Integrating the CDM in the project financing was an idea proposed by me (Vlatko Cingoski) in my position of a deputy general manager for investments of ESM at that time. I have received a PhD in Electrical Engineering in Japan and had gained sufficient knowledge about the Kyoto Protocol. I was still pursuing my research there when the Kyoto Protocol was adopted, and closely followed reports in the Japanese press regarding the climate change treaty. The protocol was actively discussed in the press and academic circles in Japan and one of my main goals since assuming a managerial position in ESM was to carry out the HPP rehabilitation project under the CDM. I strongly believed that this would create a new source of income for the project and at the same time would contribute to the global efforts against climate change. No reliable information about carbon prices was available at that time, but estimates based on some reports and academic articles showed that the CDM component of the project could cover a share of the investment expenses over the project lifetime, making the CDM an extremely attractive option.

The benefits of the Kyoto Protocol for ESM were apparent and we wanted to promote this project abroad and attract more attention from carbon investors. CDM investment promotion presentations and meetings were made in 1999 and 2000. Copies of some of these documents were kept in ESM, but during the civil conflict in Macedonia and the reorganization of ESM archives during the privatization and transformation process in 2005, part of the project documentation was lost or relocated to other successors of ESM besides ELEM. Getting access to the archives of completely different legal entities is currently impossible. However, we managed to locate one of the presentations made by the ESM's management as part of our investment promotion campaign in July 1999, which showed the clear intentions of ESM to obtain financing for this project and other planned projects under the Kyoto Protocol (See Figure AN-1 in the PDD). Below are some details of the meeting and the presentation made.

The presentation was made at an official meeting between the management of ESM and the UK National Grid where we discussed the potential for cooperation between our companies as well as the investment opportunities in the energy sector in Macedonia, mainly generation and transmission, as well as potential CDM projects. We emphasized that the CDM is a strongly needed financial injection for the implementation of the HPP rehabilitation project, as well as other renewable projects like new HPP projects and fuel switch to natural gas. On the side of ESM the delegation was headed by Dr. Goran Rafajilovski, the general manager of ESM at that time and myself as a Manager for Investment and Development. We were hosted by the General Manager on UK National Grid at that time and Ms Marina Bate, Business Development Manager.

In that period (1999-2000) we also had official meetings with other potential CDM investors, like Mitsubishi Heavy Industries (Mr. Ishibashi), representatives of the World Bank and other Japanese and European companies.

The HPP rehabilitation project started its implementation in January 2001. The same year the civil conflict broke out and Macedonian government had no time to think about the Kyoto Protocol. However, ESM continued promoting the implementation of this project and other projects under the CDM. As an illustration we


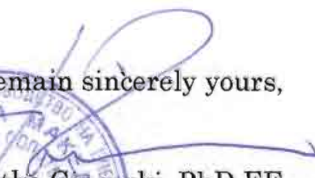
have also provided a copy of a presentation made by me in a UNIDO seminar in Vienna in 2004, which showed that ESM vigilantly followed the CDM market developments and never gave up pursuing the opportunity to register this project, as well as some of ESM's other projects, as a CDM.

In February 2007 our government eventually approved the rules for the operation of the Macedonian DNA and ELEM (as an owner of the generation facilities of the former ESM) continued with the official development of the project as a CDM project going through the PDD preparation, validation and the current request for registration. We hope you understand that the delays in applying for registration were caused by some unfortunate geo-political developments in our country, but it has always been our intention since 1999 to use Kyoto Protocol financing and CDM for the successful completion of the rehabilitation of the six major Macedonian power plants.

Finally, we believe that the successful registration of the project will become a welcome precedent and will have an important capacity building role for developing other CDM projects in Macedonia as well as in other non-Annex I countries in the Western Balkans like Serbia, Bosnia-Herzegovina or Albania.

We remain sincerely yours,

*N.H.*



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Chairman of the Board of Directors  
General Manager  
JSC Macedonian Power Plants

c.c. Macedonian Power Plants Archive