

Project Proponent responses to issues raised in the Request for Review (#1, #2 and #3)

Project Title: UHE Mascarenhas Power Upgrading Project

Reference N°: 1232

1. The DOE should clarify why this project was submitted for registration as the validation report has determined that the decision to go on with the project activity in 2003 does not consider the carbon credit revenue.

Project Proponent Response: The Validation Report clearly mentions that the proposed project activity considers the carbon credit revenue. The Corrective Action Request #2 (CAR 2) was opened specifically to assess whether the project proponent (PP) considered the CDM related income.

The CAR 2 was accepted and closed out by the DOE due to the fact that the PP has presented concise and credible information/data to determine that the project activity is particularly unattractive to the investors if the CDM related income is not considered.

The citation "The decision to go on with the project activity in 2003 does not consider the carbon credit revenue." (Validation Report, Section 3.2, page 9, paragraph 7) is part of a sentence that was written in order to justify the opening of the CAR 2.

2. In addition, according to Annex 5 of the PDD, the BNDES has financed 70% of the investment in the 4th machine of the Mascarenhas hydro project in 2003. Further clarification and demonstration is required on the decision by the company to invest in this project activity.

Project Proponent Response: The BNDES (*National Bank for the Social and Economical Development*) is a federal public entity related to the Ministry of Development which provides several long-term financial lines to entrepreneurs in Brazil. The PP optioned to obtain a 70% loan via BNDES due to its lowest operational costs and taxes when compared to similar banks in Brazil.

Nevertheless, the BNDES repayment structure is very similar to others banks which shows it is not a one-way money from BNDES, but a loan that comprehends some advantages on the payment conditions, when compared to the other banks, for the PP. This does not correspond to an increase on the financial attractiveness of the project activity, since this loan must be normally refunded (including interest and taxes). Therefore, the financial additionality of the proposed project activity remains credible and concise as long as the BNDES funding do not differentiates from the normal funding structure.

Moreover, the BNDES funding does not represent a public funding from Parties included in Annex I, therefore it does not result in a diversion of official development assistance and is separate from and is not counted towards the financial obligations of those Parties.

3. The DOE should also clarify why, if that is the case, they have not raised a corrective action request regarding the project start date listed in the PDD.

Project Proponent Response: The DOE (SGS) response to this issue might be considered.

4. Further clarification is required as to why the IRR has been calculated on a post tax basis when the taxation rate is also reflected in the calculation of the WACC.

Project Proponent Response: The calculation of the IRR for the proposed project activity considers all taxes, depreciations units and financial expenses. The Weighted Average Capital Cost (WACC) is calculated following the ANEEL (*National Electricity Agency*) recommendations. The WACC calculations are based on the O&M costs for the generation activity, depreciation of the generation assets and the remuneration (fixed assets).

The taxes included in the WACC calculation (wheeling fees, connexion costs, sectoral taxes (12,812%), etc) are different from the taxes included in the IRR calculation (PIS, COFINS, ICMS, Social Contribution, etc). Thus the taxation rate adopted in the calculation of the WACC is not duplicated when compared to the tax basis adopted for the calculation of the IRR.

5. The DOE shall further clarify how the validity and appropriateness of the benchmark applied was assessed and validated.

Project Proponent Response: The DOE (SGS) response to this issue might be considered.

6. The DOE shall further clarify how they have validated the sensitivity analysis.

Project Proponent Response: The DOE (SGS) response to this issue might be considered.

7. When describing the common practice in the region the PDD states that .There are other power generation plants, which were identified in the proposed project activity's region/state operating under similar characteristics (similar age, installed power, power density, and technology) and taking place under similar market conditions (here understood as the regional grid). However, none of these power generation plants were able to carry on activities such as the proposed project activity. Further clarification is required as the footnote indicates that similar projects are not considered as being part of CDM project activities.

Project Proponent Response: The text presented, specially the footnote above mentioned, on the PDD may lead to a minor misunderstand which gives the wrong impression that similar projects are not considered as being part of CDM project activities.

In fact the project named "Repowering Small Hydro Plants in the State of Sao Paulo, Brazil. CPLF Energia" has considered to be part of a CDM project activity (available at: <http://cdm.unfccc.int/Projects/DB/SGS-UKL1151788974.93/viewto>) in order to undertake a similar project activity (repowering hydro power plants).

The common practice analysis reinforce the fact that none power generation plants were able to carry on activities such as the proposed project activity without the CDM, in fact the only project activity under similar conditions is also considering the CDM revenue to conduct the project.

8. Version 3 of the Tool for the demonstration and assessment of additionality should be applied.

Project Proponent Response: The Version 03 of the Tool for the Demonstration and Assessment of Additionality is now applied in the referred PDD. The overall changes summarizes on taking out the Step 0 "Preliminary screening based on the starting date of the project activity" and the Step 5 "Impact of CDM registration".