

São Paulo, November 01st 2007

Request for Review UNFCCC, dated October 03th 2007 for the CDM Project 1235
Rio Grande do Sul Cooperatives Small Hydro Power Plants

Review Form 4 dated 03 October 2007

1. Version 3 of the Additionality Tool should be used to demonstrate additionality.

This request is the same for query 1 of the Requests 1, 2 and 3. Please refer to that issue for clarification.

2. Further substantiation is required regarding how the barriers prevent the implementation of this specific project activity and do not impact the baseline. If the main argument to demonstrate the additionality of the project activity is the low IRR, this should be demonstrated in accordance with step 2 of the additionality tool.

This request is the same for query 2 of the Requests 1 and 3. Please refer to that issue for clarification.

3. The PDD states that “It is important to notice that the direct comparison between the SELIC rate and the IRR is not accurate and the idea is not to introduce a benchmark analysis, but to set a parameter as a reference”. However the SELIC reference rate is not appropriate as the projects have been partly financed with a long term loan at a lower rate than the short term market rate used as a reference.

The Cooperativas bundle of projects was developed with corporate guarantees posted by the sponsors and financed by BNDES. At the time of project inception, the long term loan provided by BNDES was indeed below the SELIC rate. In spite of that, the BNDES financing rate available to Cooperativas should not be used as a parameter to assess the project attractiveness. The relevant parameter for an investor seeking financial return is the project yield after interest and principal of long term debt is repaid. In other words, if the project return on investment or the investor's internal rate of return (IRR) for a particular project is above capital market returns of similar risk, then it is expected that the sponsors will decide to invest their capital in the project. At the time of project inception, the sponsors had the alternative to invest in debt instruments of similar maturity to the hydro plants concession. For instance, instead of building

the three power plants, the project sponsors could have used their capital to invest in the 30-year dollar denominated Brazil sovereign bond maturing in 2030. As shown in Figure 1, at the time of project inception, the average yield of the Brazil-30 bond was approximately 17%p.a. in US dollars (source: Bloomberg). Assuming an inflation rate differential of 5% (source: Central Bank of Brazil) between the Brazilian currency, the Real, to the US dollar, the adjusted yield in Real for the 30-year sovereign bond was approximately 22%p.a. Given the expected return on investment for each one of the three projects: Cascata das Andorinhas (IRR of negative 7.5%p.a.), Caraguatá (IRR of 6.2% p.a.) and Linha Três Leste (IRR of 14.6%p.a.), the project sponsors should rather have invested in Brazilian bonds instead of building the power plants. The real magnitude of CDM revenues available to investors was unknown at the time of project inception, however, the fact that the sponsors could count on another source of revenues to increase expected project yield, compensated for the additional risk to invest in the three power plants. In sum, in the absence of CDM, Cooperativas would be a riskier and marginally attractive project.

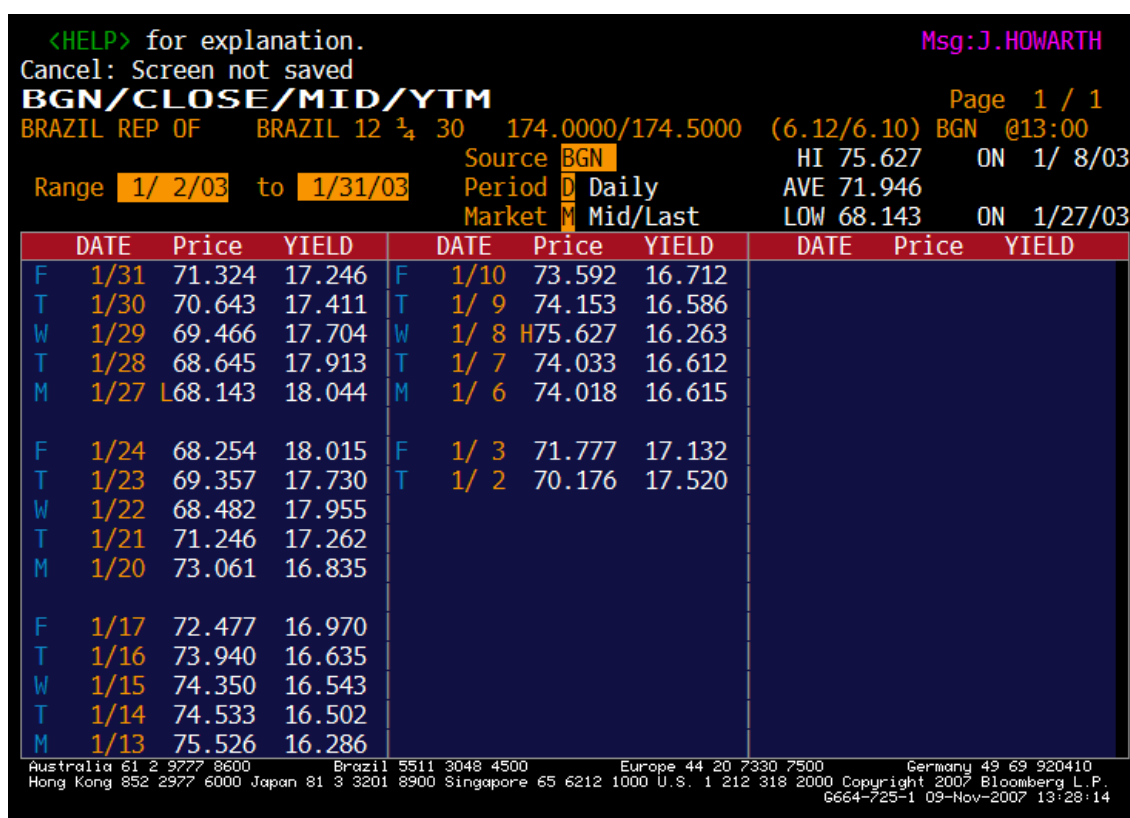


Figure 1 - Bloomberg Screen – Brazil 30 year Bond

4. The PDD states that “The region where the project is located is isolated and undeveloped. The regional electrical company did not construct distribution grid in rural area. And due to that, there

is a lack of infrastructure, such as roads, reliable electricity supply, communication and transports”. However, the cooperatives developing the projects were connected to the grid, as per technical description and the baseline applied. Further clarification is required regarding lack of infrastructure as a barrier.

The project sponsor had to develop these facilities before the implementation of the project. In addition there were no qualified personnel available in the regions due of the lack of schools and universities.

The transmission lines connecting the project activity SHPs to the national grid, were installed by the cooperatives itself and not by the regional electrical concessionaire. Moreover, the waterfall and the are to construct SHP are located in a difficult access point, the roads to transport the construction materials were also constructed by the cooperatives itself.

Furthermore, for Cooperluz, it was necessary to construct a tunnel to conduct the water to the power plant and for Creral, it was necessary to construct pipeline waterfall in native vegetation without deforestation.

The above evidences that the cooperatives need to transpose the lack of infrastructure to implement the project activity. The only business of the cooperatives until some years ago, was the electricity transmission and distribution to the associates and not generation, thus construction of a power plant is a new challenging, full of barriers enterprise.

The following figures show the tunnel and waterfall pipeline.



Figure – Cooperluz water tunnel



Figure – Creral waterfall pipeline

5. The institutional barrier described is of a generic nature. Further explanation and an update of circumstances is required as references are to the situation in the 90s.

This query is answered in the query 2 of Requests 1 and 3. Please refer to that query clarification, at the section “*Further substantiation of the institutional barrier*”.

6. The project financial analysis should be further substantiated and additional information provided. In addition, no sensitivity analysis has been conducted.

Project activity additionality was shown applying “Step 3 – Barrier analysis” and not “Step 2 – Investment analysis”. The Sensitivity Analysis is required only when using Step 2 – investment analysis, Option II or III.

7. The PP states that “All 3 SHPs is being financed part from own resource but the large part by the Brazilian Development Bank – BNDES (from Portuguese “Banco Nacional de Desenvolvimento Econômico e Social”). BNDES is a federal owned company subordinated to the Ministry of Development, Industry and Foreign Trade. Despite of being a state-owned bank, BNDES is one of the unique sources of long-term financing in the country and is the preferable debt sources for the private sector in Brazil”. Subsequently the PDD states that there is “Lack of investment sources to finance the private sector in the country, and the high costs of the available alternatives, as indicated by the project debt structure, which is mostly dependent to the equity capital”. Further explanation is required as which part is equity financed and which is financed by BNDES.

In the PDD is described that:

“ financial support covers 68% of Ceral investment, 57% of Cooperluz investment, 80% of Ceriluz investment of the project costs with a TJLP¹ (BNDES Long Term Interest Rate) rate of 9% plus a 4.0% spread risk for a term of 10, 8.5, 12 years and grace period of 2 years for Ceral, Cooperluz and Ceriluz respectively.”

The process of obtaining funding from BNDES is frequently very cumbersome. Many developers perceive BNDES requiring excessive guarantees in order to provide financing. Although this might be the Bank role as a financing institution to mitigate risk, it is understood as a market barrier.

Financing from BNDES is only available to companies willing to offer corporate or real guarantees in excess of total amount borrowed. In other words, each of the cooperatives had to use its own balance sheet and capital to raise funds from BNDES. In case projects underperform or become unfeasible, BNDES will call Ceral, Cooperluz and Ceriluz’s guarantees and real assets up to their initial credit exposure. In addition to leveraging their balance sheet sizeable borrowings, the cooperatives faced completion risk of the projects and credit risk of the utility.

Moreover, as explained in the following query 8, 14 SHPs that started operation in 2003, are registered as CDM project activity, and among them, at least 7 of them are financed by BNDES, demonstrating that the isolated existence of BNDES financing is not sufficient incentive to this kind of project to be implemented.

¹ TJLP is the BNDES long term and reference interest rate for the Bank financing.

8. Regulatory uncertainty is mentioned as a barrier, since there is a “completely new power sector regulation [is] under development since January 2002”. Nevertheless, the projects were developed despite that purported barrier. In addition, the overview of the Brazilian electricity market is of a generic nature and does not contribute to substantiate barriers.

This request is similar to query 2 of the Requests 1 and 3. Please refer to the clarification to that request.

Summarizing the clarification of query 2 of the Requests 1 and 3, this kind of barrier could be seen as the common practice and not a project specific barrier. In fact, these barrier and risk are not project specific, but that the majority of Small Hydros in Brazil required some source of financial incentives to be constructed in the last years (CDM or Proinfa). Also was demonstrated that the construction of Small Hydros WITHOUT financial incentives are specific cases and that a NEED to financial incentives is the common practice.

For the specific year of 2003, where 2 of the SHPs involved in the present project activity started operation, and the other one was under construction, among the 23 SHPs that started operation in that year, 14 are registered or under request of registration as CDM project activity, representing 61%. In terms of installed capacity incentives represents 85% of the total 268MW.

9. Further details regarding the common practice should be provided in accordance with the requirements of step 4 of the additionality tool, i.e. similar project activities should be described and the differences between each of these activities and the project should be clearly indicated.

This request is the same for query 4 of the Requests 1 and 3, this issue is clarified at that request.

10. The calculation of the emission reductions should clearly demonstrate how the net electricity generated by the project activity was determined.

This request is the same for query 4 of the Requests 1 and 3, this issue is clarified at that request.

11. The monitoring plan should clearly outline how the net electricity generated by the project activity will be monitored, the number and location of meters and how losses will be accounted for.

This request is the same for query 5 of the Requests 1 and 3, this issue is clarified at that request.

12. The DOE shall further clarify the list of the persons interviewed while performing validation (& List of persons interviewed, page 15 of 45 of the Validation Report) as in some cases they have only specified first name of those persons or the position is not sufficiently accounted for.

Project participant do not have comments.

13. The Table of Contents of the Validation Report seems to be only a draft version. The Validation Report should be provided in its final, complete and appropriate format.

Project participant do not have comments.

14. The DOE shall further clarify how they have validated the evidence provided that there was a consideration of the incentive of the CDM in the decision making process related to this project activity. In particular, the DOE shall further clarify how they have been able to “realize that the studies ... started even before operation start”, as the meetings where held afterwards, and their reference to culmination “of the company contract”. The exact same wording is used in the PDD.

Project participant do not have comments.