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DAP-IS-3516.01
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Request for review case 1556

Dear Sirs,

Please find below the separate TÜV SÜD response and the negative validation report to the request for review formulated for the CDM project with the registration number 1556.

In case you have any further inquiries please let us know as we kindly assist you.

Yours sincerely,

Werner Betzenbichler
Carbon Management Service

Enclosure

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DOE Response to the CDM Executive Board

Issue 1

The DOE shall describe how the reliability of the input values used in the investment analysis have been validated in accordance with the requirements of EB38 paragraph 54.

As the request of registration was submitted on Jan 17th, 2008, which was before the EB38 guidance (dated Mar 12th, 2008), obviously either at the time of validation or the time of submission to CDM registration, all the parties involved in the proposed project activity were not aware of the regulation released by EB38.

Therefore, we would like to justify our approach to validating the IRR input values before EB38 guidance. Below we have listed all major IRR input values and their respective sources as well as a justification for the applicability of each of the sources.

Parameter	Source (incl. IRL reference)	Justification
Total investment 25,640,000 RMB Stage1 18,250,000RMB Stage2	Feasible Study Section12(IRL No.5)	The amount of the total investment is complying with the description of the FSR.
Fluid capital 64,000RMB Stage1 40,000RMB Stage2	Feasible Study Section12 (IRL No.5)	The amount of the fluid capital is complying with the description of the FSR.
VAT 6%; Income tax 0% for the first 2 years, 16.5% for next 3 years, 33% for other years;	Feasible Study Section12 (IRL No.5) The State Administration of Taxation (2002) No.47 Document(IRL No.24)	The taxation part is in compliance with the relevant Chinese taxation regulation.
Urban maintenance and construction tax 5%; surtax for education	Feasible Study Section12 (IRL No.5)	See above
Staff number 55 Stage1 Staff number 35 Stage2	Economic Evaluation Code for Small Hydropower Projects (SL16-95) (IRL No. 14)	The staff number is reasonable considering of the relative semi-automatic operational system of the hydro plant.
Feed-in electricity 24.22 GWh Stage1 15.78 GWh Stage2	Feasible Study Section12 (IRL No.5)	The feed-in electricity is consistent the actual designed capacity of the project.
Bus-bar tariff (including VAT) 0.2RMB	Feasible Study Section12 (IRL No.5)	This figure is taken from the FSR.

Each of the sources had been assessed in course of the validation, and the applied values were found to be correct.

However there some minor inconsistencies occurred in the investment calculation, e.g. the figure of immaterial assets is slightly different to the original source of the FSR. Therefore the client has provided a revised corrected IRR calculation sheet where all the input values have been clearly indicated, the revised investment analysis demonstrates again that the financial

hurdle for this project is significant, both the IRR of the first level power plant and the second power plant are all below the selected benchmark. The relevant external source are official published statistics, please refer to No. 14, 23, 24 of the revised IRL.

In light of reassessing the IRR sources one major inconsistency was found. When first assessing the IRR the project starting date was assumed to be in the end of 2005. However with submission of the project, it was revealed that the 2nd level plant had already started construction in 2004, which limits the applicability of the FSR only written in August 2005 as a major source for the investment decision. Consequently the starting date of the project activity was shifted to 2004 in the last PDD as submitted with request for registration. However, the FSR as the source claimed by the client since the beginning of the validation was the source for many of the parameters in the investment analysis and it was therefore submitted as PDF copy with request for registration.

In the context of this request for review the client has submitted a study “Nanzhahe Cascade hydro station preliminary financial assessment, issued by Yongzhou hydro power design and research institute, dated April 18, 2004” (previously not available to the DOE) – which appears to be more applicable to the CDM context as it matches the timeline of the project implementation (also refer to issue 3). This document was found to sufficiently demonstrate the need for the CDM money in 2004, presenting an IRR of 8.39% which is sufficiently below the benchmark.

While reassessing the previously submitted FSRs (dated 2005) according to EB38 guidance it was found that these FSRs show an IRR of 13.3% and 11.8% respectively, which is far above the benchmark of 10%. Seeing the project timeline of implementation in the light of this new EB guidance – which requires a justification for every non-consistency – we conclude that this finding is a major inconsistency to the PPs claim for carbon finance, as according to these documents the project had become more feasible in 2005 than in 2004. The additionality criterion can thus not be met and we have concluded to change our validation opinion to non-compliance with the CDM regulations.

Confronted with above findings the client had failed to provide any convincing justification. Consequently we would like to withdraw our request for registration, not considering the project any longer meeting the CDM criteria. It should be mentioned that project participants have been informed on this change of our opinion, while they do not share this point of view.

Issue 2

The DOE shall describe how the investment analysis has been validated, in particular the debt/equity ratio as this differs between the feasibility study report and the PDD.

At the onsite audit it was assured by checking the projects financing that the project had in fact been financed without a bank loan. It was therefore deemed appropriate to that the calculation reflects the true situation of Nanzhahe project.

Upon this request for review the client has confirmed the before mentioned and has requested the bank to provide a letter indicated that the bank loan which was applied in 2005/08/03 was never received. This letter, issued on 2008/05/16 has been submitted to the validation team and is found to sufficiently evidence the difficulty of the project to obtain a loan.

To conclude, based on the above it was found to be reflecting the true situation of the project to not include any bank loan in the calculation of the financial analysis.



Issue 3

Further explanation for the delay in submitting the project for validation is required as this delay impacts the credibility of the claims that CDM revenues were an essential requirements for a positive investment decision. The response should provide a detailed timeline of project implementation and evidence of actions taken to register the project as CDM.

The delay in the development of Nanzhahe project as CDM project activity has been described by the PPs as follows. The first CDM consultancy contract was signed on 15 November 2004, between Hunan Yongzhou zhongxin Hydro Power Development Co., Ltd and Jiangxi Huashijie Environmental Protection Technology Development Co., Ltd. As evidences the PPs have provided the contract and a cancelation of the contract which is dated Oct. 2006, signed by the same parties.

On 5th of February 2007 the consultancy contract with the current CDM consultant, Accord Global Environment Technology (Beijing) Co., Ltd was signed.

Below please see the overview of the main events, with reference to the revised Annex 2:

Date	Event and evidence
15 Nov. 2004	The project owner contracted with a consulting company for CDM development. (IRL No.26)
Oct. 2006	The contracted CDM consulting company could not finish development, project owner made a cancellation with the consulting company. (IRL No.27)
5 Feb. 2007	The project owner contracted with Accord Global Environment Technology (Beijing) Co., Ltd. for CDM development. (IRL No.28)

The assessment of the delay has made us doubt in the seriousness of the projects need for carbon finance. First of all the first CDM consultant, hired for two years, does cancel the contract after two years admitting that no work was done on the development of the project as CDM project activity. The cancellation contract clearly states that during the two years neither payment was installed from PPs to the consultant, nor any service was provided by the consultant. This questions the reliability of the newly submitted evidence regarding the first CDM consultant. Our main concern is however that during all these years no service was provided and that the PPs were waiting until Feb. 2007 to contract a new consultant who was then able to deliver the service needed to further develop Nanzhahe hydropower as CDM activity. We suppose that, in cases in which a project solely relies on carbon finance the PPs would not be willing to wait for such a long time before they can get this additional funding secured. This is especially doubtful in case of Nanzhahe project as 2nd stage was already commissioned in 11/2006 and 1st stage in 12/2007. In this light the PPs were accepting knowingly a considerable loss of eventually urgently needed funding.

Confronted with the above the PPs were not able to provide us a convincing response for the delay. Due to this circumstance combined with the inconsistency found when assessing the first issue we have decided to change our validation opinion. We now suggest excluding Nanzhahe project from being recognized as CDM project activity.