Sao Paulo, 04 June 2009

Clarifications on issues associated with registration request for review

Angelina Small Hydro Power Plant Project – A Brascan Energética S/A Project Activity (2393)

Although clarification request 2 is addressed to the DOE, Project Participants (PPs) believe that the below provided information is helpful to adequately address the raised issue.

In the following text, the reasons for request are *italicized* and PPs comments are in blue.

1. Further clarification is requested on the validation of the method/procedure followed to determine the benchmark and the suitability of the benchmark as compared to other similar CDM projects in Brazil.

The method used for the investment analysis of Angelina project was the Benchmark Analysis – Option III of the Tool for the Demonstration and Assessment of Additionality.

Option I – Simple Cost Analysis was not used considering that the CDM project activity and the alternatives identified in Step 1 generate financial and economic benefits other than CDM related income.

Option II – Apply Investment Comparison Analysis was not used considering that investment in small hydropower plants construction is Brascan's business model and, then, a thermoelectric power plant construction, i.e., is not an alternative.

According to the PDD (page 10), the benchmark used by Brascan Energética S/A[1] at the time of Angelina project conception was the Return on Assets – RoA adjusted to the risk profile of the investment – 16 % for Angelina project. RoA measures the company's earnings in relation to all of the resources it had at its disposal. Considering the current practice of Brascan Energética S/A, the company's Weighted Average Cost of Capital – WACC was also calculated based on values at the time of the project conception – 15.63 %. As presented in the PDD (page 11), parameters observed in global financial markets are used for WACC calculation following the Tool for the Demonstration and Assessment of Additionality. Both RoA and WACC were compared to the project IRR (14.1%).

Brascan Energética S/A always used RoA as the most appropriated benchmark to analyze its projects feasibility and, currently, Brascan adopted WACC calculation. All evidences related to the choice of benchmarks and its calculations were presented to and validated by the DOE at the time of validation.

In order to make a benchmark comparison, recent similar CDM projects in Brazil were analyzed. Among eight small hydropower plant projects submitted and with Letter of Approval issued by the Brazilian DNA in 2008 and 2009, six used WACC as benchmark[2]. This demonstrates that besides Brascan Energética S/A other companies believe that WACC is the most suitable benchmark in the decision making context.

2. The DOE is requested to clarify further how it has validated that all the input values to the investment analysis are appropriate for the underlying project activity, in particular the investment cost and the electricity tariff. In doing so, DOE shall validate and cross check, based on reliable and credible

[1] Brascan Energética S/A is the major shareholder of Lumbrás Energética S/A. Lumbrás Energética S/A is a Special Purpose Company created to control Angelina small hydropower plant operations.

[2] Brazilian DNA website. Comissão Interministerial de Mudança Global do Clima (CIMGC). Projetos aprovados. Available at: <http://www.mct.gov.br/index.php/content/view/57967.html>. Accessed on May 25th, 2009.

evidence, the appropriateness of the input values and the application of sensitivity analysis on the plant load factor and the electricity generations from the project.

Variations in the project's internal rate of return (IRR) can be done by increasing project's revenues (sale of electricity) and reducing operation and maintenance costs. Therefore, possible reasonable alterations for the project are related to the increase of the energy price and reduction of costs (management, operations and transmission lines), as presented in the PDD (page 12). Expenses as ANEEL fee and concession were not analyzed considering that they are fixed parameters according to the Brazilian legislation and they will no change in a long term period.

Financial analyses were performed altering each of these parameters by 10%, as requested by DOE, and assessing what the impact on the project IRR would be. It is important to mention that the average Brazilian inflation in 2006 was equal to 3.14%[3]. The use of 10% of variation, around three times the 2006 inflation rate, demonstrates that this was a very conservative analysis.

The energy price considered for this project are based on price established in the projects' PPA (Power Purchase Agreements) for the period of 5 years, and then they will not change in the coming years. Then, an increase of 10% in the energy price was conducted considering the subsequent period after 5 years. Also, it was made a reduction in 10% of the costs as mentioned above. Therefore, values are very realistic and a reduction of 10% is very conservative.

Variations in Angelina project made in the PDD are the most credible and realistic assumptions considering the project specificities. Then, the sensitivity analysis follows the Tool for the Demonstration and Assessment of Additionality (version 5.2), which mentions that the sensitivity analysis shall include a reasonable and realistic variation in the critical range of assumptions, providing a valid argument in favour of additionality.

Variations in the project's revenues through an increasing in the energy generation or load factor are not reasonable alterations considering that electricity generation estimative is based on the assured energy which is calculated based on hydrological data river considering at least 30 years (i.e river flow data, downstream and upstream levels and others). Also, project sponsor signed turnkey EPC contracts for Angelina project, in which costs are fixed in the contract and they will not change.

All financial documents and evidences used in the sensibility analysis were presented to DOE at the time of validation.

Confident that the above initial comments help to adequately address the raised issue we remain available at any time for additional clarifications.

Best regards,

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[3] The IPCA is used as a parameter for the inflation targeting system. In 2006 IPCA's accumulated growth was equal to 3.14%. This index is published by several institutions in the country. One of these institutions is the Central Bank of Brazil in its annual bulletins available at http://www.bcb.gov.br/?BOLETIM2006.