SRI SAI KRISHNA HYDRO ENERGIES PVT. LTD.

Regd. Office : Plot No. 226, Road No. 78, Phase-III, Jubilee Hills, Hyderabad - 500 033.
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September 22, 2009

The Secretary to the CDM Executive Board
UNFCCC,
Bonn, Germany

Dear Sir,

Sub: Request for review for: "10 MW bundled Luni-III & Luni-II hydroelectric projects for a grid system at Sri Sai Krishna Hydro Energies Private Limited in Kangra District, Himachal Pradesh." (2698)
Ref : Communication from UNFCCC dt.16 September, 2009

With reference to your communication referred above, we are pleased to furnish in the enclosure our response item wise on the issues raised in the "Request for review", for the kind consideration of the board.

Thanking you,

Yours faithfully,
For **Sri Sai Krishna Hydro Energies Private Limited**

(M.Keshav Reddy)
Managing Director

Encl: as above

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1. The DOE should clarify how it has validated the investment analysis in line with VVM paragraph 109 and EB 41, Annex 45, paragraph 6, taking into account that the DPR was conducted in November 2004 and the project start date is March 2006. The DOE should provide a clear validation opinion, based on its sectoral expertise, on the assumptions and input values used in the investment analysis.

The question consists of two parts, viz.,

a) validation of input values in accordance with the guidance given vide paragraph 109 of VVM and paragraph 6 of Annex 45 of EB 41; and
b) validation opinion on the assumptions and input values used in the investment analysis based on DOE's sectoral expertise.

Both the questions are dealt with in seriatim below:

<u>a) Validation of input values in accordance with VVM and EB 41, Annex 45 Paragraph 6:</u> We submit that as far as this part of the question is concerned (validity of input values at the time of the investment decision), the relevant paragraph is 111 than 109 (though the requirements and compliance of the projections to paragraph 109 are dealt with while responding to the second part of the question). Paragraph 111 of VVM states,

"The FSR has been the basis of the decision to proceed with the investment in the project, i.e., that the period of time between the *finalization of the FSR and the investment decision* is sufficiently short for the DOE to confirm that it is unlikely in the context of the underlying project activity that the input values would have materially changed" (emphasis added).

Paragraph 6 of Annex 45 of EB 41 states, "The DOE is therefore expected to validate the *timing of the investment decision* and the consistency and appropriateness of the input values with this timing. The DOE should also validate that the listed input values have been consistently applied in all calculations" (emphasis added). In the rationale, the Guidance adds, "This decision will therefore be based on the relevant information available *at the time of the investment decision and not information available at an earlier or later point*" (emphasis added).

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As you would appreciate, in both the cases, the stress is on the investment decision date and not on the start date. EB in its 41st meeting has stated "the start date shall be considered to be the date on which the project participant has committed to expenditures related to the implementation or related to the construction of the project activity" (paragraph 67). A cursory glance at the above would reveal that the relevant date is the decision making date and not the start date.

In the instant case, the Detailed Project Report (DPR) was prepared in November 2004 and the Board Meeting, where serious consideration of CDM benefits was discussed, took place in January 2005. The gap between the date of DPR and the decision making date is less than 6 months. Hence, we submit that the input values considered based on the DPR was valid at the time of decision making date and this conforms to the guidance given vide paragraph 111 of VVM (which is derived from paragraph 54 of EB 38) and paragraph 6 of Annex 45 of EB 41.

<u>b) Validation opinion on the assumptions and input values used in the financial analysis:</u> Paragraph 109 of VVM requires, that "the DOE shall ...

a) Conduct a thorough assessment of all parameters and assumptions used in calculating the relevant financial indicator, and determine the accuracy and suitability of these parameters using the available evidence and expertise in relevant accounting practices
b) Cross-check the parameters against third-party or publicly available sources, such as invoices or price indices;
c) Review feasibility reports, public announcements and annual financial reports related to the proposed CDM project activity and the project participants;
d) Assess the correctness of computations carried out and documented by the project participants;
e) Assess the sensitivity analysis by the project participants to determine under what conditions variations in the result would occur, and the likelihood of these conditions".

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As you would kindly observe from the worksheet, all the input parameters – project cost, means of financing, gross generation, auxiliary consumption, tariff, O&M cost and escalation thereof, term loan and terms thereof, working capital estimation and interest thereon – are based on the DPR, which was prepared in November 2004 based on which investment decision was taken in January 2005, wherein the decision to register the project as CDM activity was taken to render the project financially attractive. Depreciation and taxation have been considered at the rates stipulated by the Income Tax Act.

DOE has been furnished with a copy of the DPR and evidence for the depreciation and income tax rates. A thorough assessment of all parameters and assumptions used, the suitability and accuracy thereof and the accounting principle used in the calculation of financial indicator was conducted by the DOE based on the DPR as well as other information furnished by the PP and the DOE was convinced of the inbuilt conservatism of the input parameters and the assumptions used in the computation. The information given below would highlight the accuracy and the suitability of the assumptions and input parameters used in the computation:

Parameter	Input Value (Rs. mn. unless stated otherwise)		Explanation and Source
	Luni II	Luni III	
Project cost (Rs. million)	271.20	285.00	While the DPR has estimated the cost at Rs.271.20 mn. and Rs.285.00 mn. for Luni II and III respectively, banks, who have extended financial assistance to the project have estimated the project cost at Rs.291.2 mn. and 291.5 mn., respectively. However, in the financial analysis, DPR values were used in conformity with the guidance given vide paragraph 6 of Annex 45 of EB 41.

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Financing pattern - Equity (Rs. mn.) - Debt (Rs. mn.)	67,80 203.40	71,25 213.75	Banks have also considered a leverage of 3:1 in financing the project and a copy of the loan sanction letters have been furnished to the DOE. Besides, a certificate from the Chartered Accountant on the financing structure is also furnished as further evidence. The conservatism of the input figures considered should therefore be evident.
Central Subsidy	41.25	41.25	This amount is based on the Guidelines issued by the Ministry of Renewable Energy[1] and forms part of DPR.
Plant Load Factor	50%	50%	PLF is based on the DPR. DOE had verified the PLF achieved by other projects in the State, which is around 35% only. Besides, HP Electricity Regulatory Commission itself has recommended only 45% PLF to be used for the purpose of projecting power generation in Detailed Project Reports. The Electricity Regulatory Commissions (ERCs) of neighboring States, namely Uttar Pradesh and Uttarakhand have recommended PLF of 35% and 45% only respectively. Even after accounting for the auxiliary consumption, the net

1 http://www.uttara.in/initiatives/wfw/web%20ua%20water%20for%20welfare/shp/shp_policy_of_MNES_July-2003.pdf

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			PLF works out to 46%, which is higher than the base PLF recommended by the State ERC as well as ERCs of neighbouring States.
Tariff (Rs./kWh)	2.50	2.50	Not only the DPR, even the PPA (a copy of which has been furnished to DOE) provides for a tariff of Rs.2.50/kWh only.
O & M cost	2%	2%	This value is based on DPR. CERC provides for O&M cost at 1.5% for large hydro power project. This is a small hydro power project located in a remote hilly area with no access to physical or social infrastructure. Hence, to attract and retain the talents in such an area is, naturally, costlier. An analysis is presented with respect to O & M Cost incurred by an existing small hydro project in the same region which is a registered CDM project. The analysis prepared based on audited financial statements indicated that O & M Cost incurred is more than 2% and has been increasing steadily. Hence, 2% considered towards O & M cost including administrative expenses is considered reasonable. Moreover, the project remains additional, even if the O&M cost is reduced to 1.5%.
Interest on	11.00%	11.00%	DPR has assumed an interest

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term loan			rate of 11%. During the decision making time the PLR was 10.25% to 10.75%. If the mid rate of 10.5% is taken as the rate of interest instead of 11%, the IRR will come down by about 2 basis points (0.02%) because of slightly higher expenditures for income tax. Hence, the rate of interest considered in the computation is conservative.

It could be seen from the above that PP had furnished, besides DPR, all relevant information to DOE to enable it to conduct a thorough assessment of all parameters and assumptions used in the calculating the relevant financial indicator and determine the correctness, accuracy and suitability of the parameters. DOE was to cross check the parameters, such as project cost, means of financing, subsidy, loan amount, PLF and O&M cost among others through publicly available documents and its sectoral expertise in validating similar projects in the past. Since the projections have been presented in the most transparent manner, not only DOE, but any reader can check the computation and arrive at the same result. PP has presented sensitivity analysis by varying critical parameters by 10% on either side as required by Annex 45 of EB 41. The worksheet also contains the variation required in the selected parameters for the project to lose its additionality. The PDD contains the reasons as to why such variations are unlikely.

In the above background, we submit that DOE has gone strictly by the VVM and Annex 45 of EB 41 in validating the input parameters and assumptions used in the computation of financial indicator and has come to the conclusion that the project is additional.

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2. **The PP/DOE should provide an investment analysis, including the sensitivity analysis, for each individual site considered in the proposed project activity in separate.**

   Investment analysis including sensitivity analysis is prepared separately for each individual site considered in the project activity and furnished as attachments. As per the split computation, the financial indicator of the project work out as follows:

Project	Baseline (IRR w/out CERs)
Luni II	11.70%
Luni III	10.83%
Total Project	11.26%

3. **The monitoring plan in section B.7.1 in the PDD needs to be amended, so that each parameter is monitored for each site in separate. The DOE should validate the revised monitoring plan.**

   The Monitoring plan has been amended in such a way that each parameter is monitored separately for each site.

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