



Board of Executive Directors

For consideration

On or after 15 February 2012

PR-3841
31 January 2012
Original: Spanish
Simultaneous Disclosure

To: The Executive Directors
From: The Secretary
Subject: Brazil. Proposal for a loan for the project “Pró-Energía Program for Electricity Distribution in Rio Grande do Sul”

Basic Information: Loan type Specific Investment Operation (ESP)
Borrower *Companhia Estadual de Distribuição de Energia Elétrica (CEEE-D)*
Amount up to US\$130,556,650
Source Single Currency Facility of the Ordinary Capital

Inquiries to: Sylvia Larrea (extension 2088) or Natacha Marzolf (extension 2436)

Remarks: This operation is included in document GN-2617, “2011 Operational Program Report”, approved by the Board of Executive Directors on 4 May 2011. In addition, the loan amount exceeds the ceiling established for Group A countries. Therefore, it does not qualify for approval by simplified procedure.

Reference: GN-1838-1(7/94), DR-398-11(4/11), GN-2617(4/11)

SIMULTANEOUS DISCLOSURE

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BRAZIL

PRÓ-ENERGIA PROGRAM FOR ELECTRICITY DISTRIBUTION IN RIO GRANDE DO SUL

(BR-L1284)

LOAN PROPOSAL

This document was prepared by the project team consisting of Sylvia Larrea (INE/ENE) Project Team Leader; Natacha Marzolf (INE/ENE) Project Team Co-leader; Jorge Mercado (INE/ENE); Laura Rojas (INE/ENE); José Félix Filho (VPS/ESG); Teresa Maurea Faria (LEG/SGO); Mónica Merlo (CSC/CBR); Carlos Lago (CSC/CBR); under the supervision of Leandro Alves, Energy Division Chief (INE/ENE), and Fernando Carrillo-Florez (CSC/CBR).

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ELECTRONIC LINKS	
1.	Environmental and Social Management Report (ESMR) http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35586060
2.	Annual work plan http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35586068
3.	Complete procurement plan http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35586066
4.	Results monitoring and evaluation arrangements http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35586072

OTHER REFERENCES	
1.	Program request to Comissão de Financiamentos Externos [External Financing Committee] (COFIEX) http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35292456
2.	Program engineering report http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35586106
3.	Economic analysis report http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35586082
4.	CEEE-D 2008 financial statements http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35589602
5.	CEEE-D 2009 financial statements http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35589607
6.	CEEE-D 20010 financial statements http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36165151
7.	Financial evaluation report http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36165158
8.	CEEE-D financial recovery plan, April 2011 http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36604495
9.	CEEE-D financial recovery plan 2012-2015, December 2011 http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=36604494
10.	Atendimento Elétrico ao Estado do Rio Grande do Sul e Região Metropolitana de Porto Alegre - Estudo de Viabilidade Técnico-Econômica [Electricity Service in the State of Rio Grande do Sul and the Porto Alegre Metropolitan Area - Technical-Economic Feasibility Study] http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35292394
11.	Tables on customer structure and changes in CEEE-D's market http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35686379
12.	Origins of CEEE-D http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35686432
13.	Breakdown of program components http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=35686474

ABBREVIATIONS

AFD	Agence française de développement [French Development Agency]
ANEEL	Agência Nacional de Energia Elétrica [National Electric Power Agency]
AWP	Annual work plan
BMS	Business management system
CEEE	Companhia Estadual de Energia Elétrica
CEEE-D	Companhia Estadual de Distribuição de Energia Elétrica
CEEE-GT	Companhia Estadual de Geração e Transmissão de Energia Elétrica
CRC	Conta de Resultados a Compensar [Revenue Compensation Account]
EBITDA	Earnings before interest, taxes, depreciation, and amortization
EHSAP	Environmental, Health and Safety Action Plan
EOD	Equivalent outage duration per consumer
EOF	Equivalent outage frequency
EPE	Empresa de Pesquisa Energética [Energy Research Corporation]
ERP	Enterprise resource planning
ESMR	Environmental and Social Management Report
GWh	Gigawatt-hour
ICB	International competitive bidding
IT	Information technology
km	kilometer
kV	kilovolts
MVA	Megavolt-ampere
MWh	Megawatt-hour
NCB	National competitive bidding
PAC	Programa para Aceleração do Crescimento [Growth Acceleration Program]
PCU	Program coordination unit
R\$	Brazilian reais

EXECUTIVE SUMMARY

BRAZIL

PRÓ-ENERGIA PROGRAM FOR ELECTRICITY DISTRIBUTION IN RIO GRANDE DO SUL (BR-L1284)

Financial Terms and Conditions				
Borrower: Companhia Estadual de Distribuição de Energia Elétrica (CEEE-D)		Amortization period:	24 years	
Guarantors: Federative Republic of Brazil and State of Rio Grande do Sul		Grace period:	4 years	
Executing agency: CEEE-D		Disbursement period:	4 years	
Source	Amount	%	Interest rate:	LIBOR
IDB (Ordinary Capital):	US\$130,556,650	60	Inspection and supervision fee:	*
Cofinancing:	US\$87,457,986	40	Credit fee:	*
Total:	US\$218,014,636	100	Currency:	U.S. dollars from the Single Currency Facility
Project at a Glance				
Program objective/description: The program's general objective is the expansion and modernization of the electricity distribution system in the area of the concession held by CEEE-D, which includes the Porto Alegre metropolitan area, and the implementation of new business and sales management systems, to contribute to the company's financial recovery. The program aims to install the power infrastructure necessary to meet the increase in demand, which is expected to be strong during the 2014 World Cup, when Porto Alegre will be one of the host cities. The program's specific objectives are to: (i) meet current and future demand; (ii) improve reliability and quality of service indicators; (iii) reduce technical and business losses; and (iv) modernize CEEE-D's management by means of a new corporate information and integrated management system.				
Special contractual clauses: <u>Special conditions precedent to the first disbursement:</u> CEEE-D will demonstrate the following to the Bank's satisfaction: (i) establishment of the program coordination unit (PCU) (see paragraph 3.1); (ii) documented budgetary allocation for the first year of local counterpart resources for program execution (see paragraph 3.3); (iii) submission of an annual work plan (AWP) for the first year (see paragraph 3.4); and (iv) the signing and entry into effect of the financing agreement between CEEE-D and Agence française de développement [French Development Agency] (AFD). <u>Special execution conditions:</u> (i) Environmental and social: CEEE-D will fulfill all environmental and social obligations listed in the Environmental and Social Management Report (ESMR), and will take the actions envisaged in the Environmental, Health and Safety Action Plan (EHSAP). Annually, until execution of the works is completed, the Bank will verify fulfillment of the environmental and social obligations established in the ESMR. Upon completion of the works, the Bank and CEEE-D will mutually agree on the frequency of this verification (see paragraph 3.6); (ii) Fiduciary management: CEEE-D will prepare a brief manual of operations related to the program within three months after signature of the loan contract (see paragraph 3.6); (iii) CEEE-D will fulfill the indicator set forth in paragraph 2.22, or otherwise, the company will promptly submit an action plan to the IDB identifying the causes of the variations, the financial or management measures to be adopted, and their timetable, to restore the company's conditions (see paragraph 3.6); and (iv) CEEE-D will submit an annual financial report and an update of the 10-year projections.				
Exceptions to Bank policies: None.				
Project consistent with country strategy:				
Yes <input checked="" type="checkbox"/> [X] No <input type="checkbox"/> []				
Project qualifies as:				
SEQ <input type="checkbox"/> [] PTI <input type="checkbox"/> [] Sector <input type="checkbox"/> [] Geographic <input type="checkbox"/> [] Headcount <input type="checkbox"/> []				

* The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable provisions of the Bank's policy on lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75% or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

I. DESCRIPTION AND RESULTS MONITORING

A. Background, problem to be addressed, and rationale

- 1.1 On average, electric power consumption in Brazil has increased at rates of 4.5% per year in recent years. In 2010, power consumption grew 7.8%, and between 2011 and 2018, electricity demand is projected to grow an average of 5.2% per year.¹ Power companies must take the increased demand into account and promote the development of the power infrastructure to support future economic growth.
- 1.2 In the concession area of the electricity distribution company, Companhia Estadual de Distribuição de Energia Elétrica (CEEE-D), which includes the Porto Alegre metropolitan area in the State of Rio Grande do Sul, the demand for electricity has experienced average annual growth of approximately 3.2% in recent years, and demand projections by the National System Operator (ONS) show this trend continuing in the coming years.
- 1.3 **CEEE-D.** CEEE-D holds the power distribution concession in the south and southeast of the State of Rio Grande do Sul. The concession area represents 26% of the state's territory and includes 73 of the 496 municípios in Rio Grande do Sul. CEEE-D currently serves 1.4 million customers (approximately 3.4 million people), delivering 7,682 gigawatt hours (GWh) of power per year. CEEE-D's largest market is made up of the cities of Porto Alegre, Alvorada, and Viamão (considered the Porto Alegre metropolitan area), which represents 64% of CEEE-D's total demand.²
- 1.4 CEEE-D is a public corporation controlled by: (i) CEEE-Participações, holding 65.9%, whose shares are owned by the State of Rio Grande do Sul; (ii) Eletrobras with 32.6%; and (iii) minority shareholders with 1.5%.
- 1.5 CEEE-D's distribution network includes: (i) 52 substations of 230/69 kilovolts (kV), 230/13.8 kV, 69/13.8 kV, and 69/23 kV; (ii) 50,400 kilometers (km) of lines in urban and rural networks; (iii) 1,850 km of transmission lines; and (iv) 46,500 transformers and 830,000 utility poles.
- 1.6 **Problem to be addressed.** The steady increase in demand for electricity (by new and existing consumers) in CEEE-D's concession area has led to its distribution system's transformers and lines operating under high loads, reducing the flexibility of system operation in the event of a failure. This inflexibility makes it unlikely that CEEE-D could provide power to impacted users from another source, resulting in a longer service restoration time. In 2010, in the Porto Alegre metropolitan area, 16 of a total of 24 power transformers and 42 of 142 feeders on the medium-voltage grid became overloaded, with a usage factor of 86%, significantly over the benchmark of 70%.³ This caused voltage drops, impacting the availability and

¹ Data from Empresa de Pesquisa Energética (EPE).

² See electronic link: Origins of CEEE-D.

³ The normal operating percentage is 70% of the equipment's nominal design capacity.

- reliability of the power supply for consumers, increasing technical losses, and reducing the life cycle of the equipment. These problems are compounded by the growing demand for electricity in CEEE-D's concession area and the lack of investment in these areas by CEEE-D for financial reasons.
- 1.7 CEEE-D's financial position is undergoing a transition. From 2008 to 2010, CEEE-D had operating losses and a negative cash flow due to the average increase of 17% in its operating costs over that period, while its net revenues increased an average of 3%⁴ (see paragraph 2.15).
 - 1.8 As a result of the foregoing, CEEE-D has low levels of reliability and a high level of losses, as demonstrated by the following operational indicators: (i) equivalent outage duration per consumer (EOD), indicating the number of hours a consumer is without power during the year; (ii) equivalent outage frequency per consumer (EOF), indicating the number of times the consumer unit experienced an outage; and (iii) percentage of technical and nontechnical losses.
 - 1.9 In 2009, CEEE-D had an average EOD of 27.0 hours of outage per consumer, above the maximum level of 18.0 authorized for the company by the regulatory agency, Agência Nacional de Energia Elétrica [National Electric Power Agency] (ANEEL), and an EOF of 15.2 outages, above the average for similar companies in Brazil of 11.7.⁵ Total distribution losses are 18.75%, also above the 14.08% acknowledged by ANEEL in the rate schedule. This results in penalties under the concession contract, which have an adverse impact on the company's financial position.
 - 1.10 In terms of corporate and business management, CEEE-D uses two information systems, a financial-accounting system and a business system, which despite adaptations and modifications have been discontinued and are not fully integrated. This impacts the company's efficiency levels and fails to provide the information required for the company's effective cost control and operational and financial management.
 - 1.11 Coupled with the region's economic growth projections, and considering that Porto Alegre will be one of the host cities for the 2014 FIFA World Cup, this translates into the need for infrastructure projects and improvements to CEEE-D's distribution system.
 - 1.12 This situation has given rise to the program to modernize and expand the CEEE-D power distribution program known as the Pró-Energia Program for Electricity

⁴ See 2008, 2009, and 2010 financial statements in the electronic links.

⁵ For the application of the EOD and EOF, CEEE-D's concession area is subdivided into 127 districts for which allowable limits have been determined. The southern region of CEEE-D's concession area has the greatest variations in terms of the EOF and EOD, primarily due to its rural nature and its longer average circuit length, making it more vulnerable to system failures.

Distribution in Rio Grande do Sul,⁶ which will involve: (i) the construction and expansion of substations and the extension of secondary transmission lines (see component I); (ii) the upgrading of remote control systems and equipment in substations (see component II); (iii) the upgrading and incorporation of automated equipment in the medium-voltage distribution system (see component III); and (iv) the replacement of the corporate enterprise management and business systems (see component IV).

- 1.13 **Rationale.** The expansion and upgrading of CEEE-D's high- and medium-voltage distribution network will improve existing load factors and add sufficient power transmission capacity to meet the growth in demand. It will also reduce technical losses and correct voltage problems on distribution lines.⁷ These investments will have a positive impact on the company's operation and financial sustainability, reflected in improved operational indicators (EOD, EOF, and technical and business losses), which in turn will have a positive impact on CEEE-D's financial position.
- 1.14 The implementation of the enterprise and business management system will give CEEE-D a comprehensive platform to support the company's administrative, business, and technical management processes for supplying power, while ensuring proper coordination among the various activities, making control of the distribution system more efficient.
- 1.15 **The power distribution subsector in Brazil.** The electricity distribution market includes 64 government-controlled (federal, state, or municipal) or private concession holders. The distribution companies' rights and obligations are set forth in the concession agreement entered into with the federal authority to supply power in a specific territory. Performance of the agreements is governed and enforced by ANEEL, which establishes regulations on rates, safety, and quality of the power supply and customer service in order to ensure continuous, high-quality service, while maintaining the concession holder's economic and financial balance.
- 1.16 **Rates.** Until 1993, consumers in different states paid the same rate for the power they consumed. That rate guaranteed compensation for distribution companies regardless of their efficiency (service cost). In 1993, under Law 8,631, the rate was set for each company based on their individual characteristics. In 1995, Law 8,987 was approved, introducing the concept of economic-financial balance in

⁶ This program is part of the IDB's work with CEEE-Participações (the parent company of CEEE-D and Companhia Estadual de Geração e Transmissão de Energia Elétrica (CEE-GE)). The Bank is also analyzing a loan to CEEE-GE for US\$85.5 million for its program to expand, rehabilitate, and modernize its generation and transmission infrastructure.

⁷ Studies show that the investments considered under the program will be effective: (i) *Power Distribution – Planning Reference Book*, Chapter 4, Power System Reliability, H. Lee Willis; and (ii) Metodologia para o estabelecimento da relação entre a qualidade e os investimentos necessários ao seu atendimento no segmento da distribuição de energia elétrica [Methodology for establishing the relationship between quality and the investments necessary to provide it in the power distribution segment]. Technical Note 0025/2006-SRD/ANEEL.

distribution concessions in order to ensure their financial sustainability with respect to changes in parameters (inflation, taxes, new legislation, etc.) beyond their control.

- 1.17 **Rate adjustment.** The concession agreements allow for three kinds of rate adjustments:⁸ (i) Annual adjustments. To cover operating cost increases due to inflation; (ii) Periodic reviews. Every four to five years; and (iii) Extraordinary adjustments. To cover changes that could impact the concession's economic and financial balance.
- 1.18 In general, the sector's regulatory framework makes sustainability of electricity services viable over the long term with a supply of efficient, quality services, and is consistent with the Bank's Public Utilities Policy (Operational Policy OP-708).
- 1.19 **The country strategy.** Brazil's Ten-year Energy Plan estimates that demand for electricity will grow an average of 5.2% per year between 2011 and 2018.⁹ Increased energy demand is also anticipated due to the construction and use of facilities for the 2014 FIFA World Cup and the 2016 Olympic Games in Rio de Janeiro.
- 1.20 Brazil's Programa para Aceleração do Crescimento [Growth Acceleration Program] (PAC) identifies strategic investments over the coming years in: (i) generation; (ii) power transmission (expansion, interconnections, and enhancements); and (iii) energy efficiency programs.¹⁰ The proposed program helps improve distribution system efficiency, while reducing the level of losses and increasing reliability in service delivery, thus making optimal use of the power generated by the system.
- 1.21 **The Bank's country strategy.** The program is consistent with the priorities established in the Bank's country strategy with Brazil (document GN-2477) and its respective update (document GN-2570), which emphasizes support for investment in infrastructure so the country can achieve sustained growth.
- 1.22 The program's investments will result in a more efficient, sustainable distribution network, while reducing technical losses and improving the quality of the electricity supplied. Therefore, the program is consistent with the Sustainable Energy and Climate Change Initiative (SECCI), since it contributes to energy efficiency and the reduction of greenhouse gases, and is framed within the goals of the Bank's Ninth General Capital Increase (GCI-9) on climate change and sustainable (including

⁸ The most recent periodic review took place in 2010 and resulted in an increase of 6.97%.

⁹ EPE data. See <http://www.epe.gov.br>.

¹⁰ See <http://www.brasil.gov.br/pac>.

renewable) energy. It is estimated that the program will contribute to the reduction of 12,170 tons of CO₂ per year.¹¹

B. Objective, components, and cost

- 1.23 The program's general objective is to support the financial recovery plan of CEEE-D through investments in the expansion and modernization of the electricity distribution system in the area of the concession held by CEEE-D (in the State of Rio Grande do Sul), which includes the Porto Alegre metropolitan area, and the implementation of a new business management system. The program aims to install the power infrastructure necessary to meet the increase in demand, which is expected to be strong during the 2014 World Cup, when Porto Alegre will be one of the host cities.
- 1.24 The program's specific objectives are to: (i) meet current and future demand; (ii) improve reliability and quality of service indicators; (iii) reduce technical and business losses; and (iv) modernize the management of CEEE-D by means of a new corporate information and integrated management system to streamline processes and their respective controls. The Bank's financing will help the CEEE-D meet these objectives and will contribute to improving the company's operational and financial efficiency. The program includes the following components.¹²
- 1.25 **Component I. Investments in the high-voltage distribution system.** To address growth in demand, this component encompasses works for new facilities or the upgrading of existing infrastructure, including: (i) the construction of 14 new substations, seven of which are located in the Porto Alegre metropolitan area; (ii) the construction of 19 new 69 kV lines to address growth in demand, primarily in the Porto Alegre metropolitan area, where 10 of these lines are located; and (iii) the expansion of 10 existing substations in CEEE-D's high-voltage distribution system (between 69 kV and 138 kV).
- 1.26 **Component II. Modernization of equipment in the high-voltage distribution system.** This component supplements component I and includes the replacement and installation of control and protection equipment: (i) replacement of 136 breakers and 37 reclosers; (ii) substitution of 142 current transformers and 170 power transformers; and (iii) installation of 20 remote control and supervision systems in substations. These investments will automate supervision of high-voltage distribution substations and will make it possible to reduce the number of network failures and the time taken to handle and respond to them.
- 1.27 **Component III. Modernization of medium-voltage distribution network controls.** This component aims to improve reliability and quality of service by

¹¹ This was calculated based on the energy saved by the 1.8% reduction in technical losses and an emissions factor for the Brazilian power system of 0.073 kg CO₂/kWh. This factor comes from the Greenhouse Gas Inventory Tool developed by the Environmental Safeguards Unit for the Bank's operational portfolio (<http://vps/esg/toolbox/idbghginventorytool.aspx>).

¹² See electronic link: Breakdown of program components.

installing control elements and automating network operations. This component includes the installation of: (i) 80 automatic reclosers; (ii) 240 automatic three-pole switches; and (iii) 70 automatic capacitor banks.

- 1.28 **Component IV. Institution-strengthening and capacity-building in management.** This component will streamline and accelerate CEEE-D's management processes, by integrating the company's various information flows (purchasing, sales, finance, accounting, human resources, and others). The component involves the procurement and deployment of new information systems for enterprise management (enterprise resource planning (ERP)) and business management (business management system (BMS)).
- 1.29 **Component V. Engineering and administration.** This component will support proper program execution with resources for supervision, including socioenvironmental monitoring, as well as auditing and evaluation.

C. Results Matrix with indicators

- 1.30 The program includes a Results Matrix for its evaluation (see Annex II). The program's main indicators are related to: (i) improving system reliability, measured by the reduction of the EOD and EOF; (ii) reducing technical and business losses; (iii) meeting current and future demand; and (iv) improving CEEE-D's financial position.

D. Cost and financing

- 1.31 The program's total cost is US\$218,014,636 to be financed by: (i) the IDB with an investment loan of US\$130,556,650 (60%); and (ii) CEEE-D with resources from Agence française de développement [French Development Agency] (AFD) for US\$87,457,986 (40%) (see Table 1).¹³

Table 1. Cost and financing (in US\$)

Item		Approved financing		
No.	Description	IDB	Cofinancing	Total
1	Direct costs	128,571,910	75,991,975	204,563,885
1.1	Component I – Investments in high-voltage distribution	75,271,360	44,867,921	120,139,281
1.2	Component II – Modernization of high-voltage equipment	6,591,617	3,849,075	10,440,692
1.3	Component III – Modernization of medium-voltage controls	7,108,933	4,151,155	11,260,088
1.4	Component IV – Modernization of the ERP and BMS systems	39,600,000	23,123,824	62,723,824
2	Contingencies	-	10,766,520	10,766,520

¹³ The program's initial cost of US\$198.8 million was revised to update the costs, mainly of component IV, based on expressions of interest received by CEEE-D. Moreover, given the maximum amount approved by the Brazilian government, the medium-voltage investment component was excluded from the IDB financing, and will be financed through Brazil's National Economic and Social Development Bank (BNDES).

3	Engineering, administration, and audit	1,984,740	699,491	2,684,231
3.1	Engineering and administration	1,984,740	276,491	2,261,231
3.2	External audit	-	223,000	223,000
3.3	Monitoring	-	100,000	100,000
3.4	Midterm and final evaluations	-	100,000	100,000
	Program total	130,556,650	87,457,986	218,014,636
	Percentage share	60%	40%	100%

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing structure

- 2.1 The program will be financed as an investment loan with: (i) a sovereign guarantee from the Government of Brazil for CEEE-D's financial obligations; and (ii) a guarantee from the State of Rio Grande do Sul, the majority shareholder in CEEE-D, for its counterpart contribution and the obligations with respect to program execution by CEEE-D.
- 2.2 Cofinancing. The IDB loan will cover 60% of the estimated costs for program investment, engineering, and administration. CEEE-D is negotiating a loan with AFD to cofinance the remaining 40% of the program (see paragraph 3.3). Disbursements of IDB resources will be made directly to a specific CEEE-D account opened for the program.

B. Main risks and mitigation measures

1. Institutional and fiduciary risk

- 2.3 The program will be executed by CEEE-D, using its organizational structure and fiduciary management systems. During program preparation, an institutional and fiduciary analysis of CEEE-D was conducted using the Institutional Capacity Assessment System,¹⁴ which indicated that CEEE-D's fiduciary and internal and external control systems are sufficiently developed and pose a low level of risk.
- 2.4 The fiduciary management system will improve with the procurement and implementation of the new ERP and BMS information systems financed under one of the program's components. Despite the adequate organizational and fiduciary structure, to facilitate program execution, a program coordination unit (PCU) will be formed, which will operate as a working group (see paragraph 3.1) within the company, comprised of its staff, and representing no additional cost to CEEE-D.
- 2.5 **Concession nonrenewal risk.** CEEE-D, like 36 of the 64 power distribution companies, is exposed to the risk of nonrenewal of its concession, which expires in

¹⁴ Conducted based on the Financial Management Policy for IDB-financed Projects (document OP-273-1) and its operational guidelines (document OP-274-1).

2015.¹⁵ Under current legislation, these concessions cannot be renewed and must be turned over to the Brazilian government for a competitive bidding process. However, bills and a constitutional amendment have been submitted and are moving through Brazil's Congress, which would allow the government to renew CEEE-D's and other distributor's concessions or grant them new concessions without requiring a bidding process (Bill 6595/2009 and Draft Constitutional Amendment 453/2009).

- 2.6 Notwithstanding the foregoing, this risk is mitigated by the fact that program execution will be completed during the term of the current concession, allowing the investments under the program to be made prior to the end of the concession period. At the same time, the current legal framework provides for compensation mechanisms (termination compensation to be paid by the grantor to the concession holder for unamortized assets) in the event that the concession is not renewed. In addition, CEEE-D has a credit with the Revenue Compensation Account (CRC) for US\$1.147 billion,¹⁶ which must be settled in full at the end of the concession pursuant to Law 8,724/1993. Both cases mitigate the risk of repayment in the event of termination of the concession.

2. Environmental and social risks

- 2.7 **Environmental classification.** The works considered in the program will be executed in areas scattered throughout the CEEE-D concession area, and, individually, will not be large-scale. These projects will also take place far from conservation or indigenous areas and the purchase of land or right-of-way is handled amicably.¹⁷ Accordingly, this operation is classified as Category "B" under the Bank's Environment and Safeguards Compliance Policy (document GN-2208-20 and Operational Policy OP-703).
- 2.8 **The program's environmental and social impacts and other CEEE-D activities or projects.** During program design, at the Bank's request, CEEE-D prepared an environmental analysis report.¹⁸ Subsequently, the Bank prepared the Environmental and Social Management Report (ESMR). The main potential adverse impacts will be associated with the construction phase and will be typical of works of this type: (i) interference with vegetation; (ii) noise and dust; (iii) improperly handled solid waste; (iv) potential oil spills; (v) interference with the day-to-day activities of local populations due to works-related vehicle traffic;

¹⁵ Between 2015 and 2017, the concessions of 58 hydroelectric plants and 73,000 km of transmission lines (more than 50% of the lines currently in operation) also expire.

¹⁶ See footnote 17.

¹⁷ The program will not: (i) transform or degrade critical natural habitats or damage critical cultural lands; (ii) transform or degrade natural habitats; (iii) have an adverse impact on any indigenous issue; or (iv) give rise to any issue of resettlement.

¹⁸ This report was published in accordance with the IDB's Disclosure of Information Policy (Operational Policy OP-102).

and (vi) risks of accidents involving workers. These impacts will be localized and temporary, and will be mitigated using the environmental management procedures adopted by CEEE-D. With respect to other CEEE-D activities, no situations that could pose a material risk for the Bank were identified.

- 2.9 **Institutional environmental and social management capacity.** CEEE-D will be responsible for supervising the program's environmental and social management. It was confirmed that CEEE-D has adequate control measures and procedures to mitigate the environmental, social, health, and safety risks associated with a program of this type and its other activities in general.
- 2.10 **Environmental, Health and Safety Action Plan (EHSAP).** The environmental and social analysis did not identify any factor posing a risk to the proposed program's environmental sustainability. However, the project team did identify certain areas that could be improved in the program's and CEEE-D's management capacity for environmental, social, health, and safety issues, set forth in the EHSAP (attached to the ESMR), which takes into account the recommendations included in the ESMR and agreed upon with CEEE-D.

3. Execution risks

- 2.11 **Construction risks and costs.** CEEE-D has significant experience in the sector and in the construction of works similar to those planned for the program, strong management methods, and solid operating capacity for execution of the program works. The design of the new facilities followed the pattern of the existing infrastructure, but due to space limitations, underground networks and encapsulated substations will be used in the design of the distribution network for the Porto Alegre metropolitan area. The program generally includes standard engineering works, on land already used for the same purposes; therefore, the technical risk is considered minimal.
- 2.12 The construction of program works, including the detailed engineering of the high-voltage distribution lines, will be done with a specialized workforce hired using a fixed-price competitive bidding system, which transfers any additional costs caused by delays or other factors not considered in the bidding process to the contractor, except in cases of force majeure. The program investment costs have been determined based on similar projects done recently by the company. The ERP and BMS costs were estimated based on indicative proposals by leading companies devoted to implementing these systems.
- 2.13 Given the foregoing, the construction risk is considered minimal in view of the fact that: (i) the works have been developed considering the technical-economic analysis and conclusions submitted by EPE for the expansion of the basic transmission network in the Porto Alegre metropolitan area; (ii) the proposed works use procedures that follow good practices in planning and engineering, supported by Brazilian and international technical standards; (iii) the equipment to be supplied is standard; (iv) the planned works are not complex and do not require special

equipment or skills; (v) the budgeted costs are consistent with market prices; and (vi) the proposed timeline is compatible with the volume of works.

- 2.14 **Operation and maintenance risk.** The investments to be made aim to increase the reliability of the system by reducing corrective maintenance costs. This will free up the resources necessary for proper preventive maintenance of CEEE-D's system, which is less costly.

4. Financial risk

- 2.15 CEEE-D's financial position is undergoing a transition. As of December 2010, CEEE-D posted gross revenues of 2.601 billion Brazilian reais (R\$) and net revenues of R\$1.721 billion, representing an increase of 5% and 4%, respectively, over 2009. CEEE-D posted losses before interest and taxes of R\$170 million, with a net loss for the year of R\$191 million. CEEE-D has total assets of R\$4.043 billion, including R\$2.065 billion with the CRC),¹⁹ and a total debt of R\$596 million, of which 75% in long-term debt. Total equity is R\$1.759 billion.
- 2.16 As a result of the company's unsustainable financial position, the CEEE-D's Board of Directors has made a commitment to restoring and improving this position. To this end, CEEE-D has prepared a financial recovery plan focused primarily on (i) reducing operating costs related to staff, legal costs, power losses, and fines (9% reduction in 2011 and a maximum annual increase of 3% in subsequent years); (ii) increasing revenues (10% annually from 2011 to 2020); (iii) prioritizing investments that generate income; and (iv) using the CRC credit.²⁰
- 2.17 **Financial projections.**²¹ During the operation's preparation, a model was developed with financial projections for CEEE-D based on the revenue, demand, costs, and investments considered in the financial recovery plan. These projections show that CEEE-D would generate earnings and a positive operating cash flow in 2014 (including CRC). The financial indicators and ratios also improve over the length of the projection.
- 2.18 The sensitivity analysis conducted indicates that rate reductions due to a reduction of 10% in recognized operation and maintenance costs or a reduction of 2 percentage points in the rate of return do not pose a significant risk, given the company's billing level. A 10% increase in operating costs was also analyzed, and had a negative impact on all of the company's financial indicators and results, but

¹⁹ Given the rate uniformity between 1970 and 1993, in 1971, Law 5,655 created the CRC compensation fund to protect distribution companies with costs exceeding their rate-based compensation. Likewise, distribution companies with surplus revenue had to reimburse the Brazilian government. In 1993, Law 8,631 eliminated the rate equalization. After a lawsuit, in 2009, CEEE-D was granted the amount of R\$2.065 billion, equivalent to US\$1.147 billion.

²⁰ The annual unaudited financial statements for CEEE-D as of December 2011 show operational improvement in terms of the EBITDA (earnings before interest, taxes, depreciation, and amortization) margin as a result of the implementation of the financial recovery plan started in April 2011.

²¹ See electronic link: Financial evaluation report.

this possibility is considered very unlikely given the financial recovery plan that CEEE-D is implementing.

- 2.19 The company is currently analyzing the way to settle the CRC credit, which in principle, would be used to pay off the company's lenders. To do so, a ratio was calculated between the balance of the debt and the balance of the CRC to see the degree of coverage of the company's borrowings at the end of each year. This indicates that the company's total debt is 100% covered until 2013, and stabilizes at 90% in the following years.
- 2.20 CEEE-D' actions along with the characteristics of the electricity market show that conditions exist for CEEE-D to be able to financially manage the obligations it would assume.
- 2.21 To ensure its sustainability, CEEE-D will implement the financial recovery plan introduced in paragraph 2.16 in order to: (i) improve its operating margin by reducing its operating costs and recovering its revenues; and (ii) prioritize its income-generating investments, provided these investments and their respective financing do not have an adverse impact on the company's financial position.
- 2.22 Thus, during execution of the loan contract, CEEE-D will show an improvement of the EBITDA margin as indicated in Table 2.²² Fulfillment of this indicator will be a special execution condition and will be verified annually. Should the indicator deteriorate, the company will have to submit an action plan to the IDB identifying the causes of the variations, the financial or management measures to be adopted, and their timetable, to restore the conditions for the company's improvement. CEEE-D will submit an annual financial report and an update of the 10-year projections.

Table 2. Financial indicator to be monitored

Indicator	2011	2011E	2012	2013	2014	2015
EBITDA margin	-5%	0%	> 2%	> 3%	> 6%	> 6%

C. Economic, financial, and technical viability

- 2.23 **Economic viability.** The economic evaluation was done using the cost-benefit methodology with and without the program. It considered: (i) investment costs; (ii) operating and maintenance costs; (iii) benefits of the increased power supply due to the new transmission capacity on lines, substations, and networks; (iv) benefits of the increased service reliability given the reduction of outages due to the new lines, substations, and protection and control systems; and (v) benefits of savings in generation costs due to reduced technical losses.
- 2.24 The net benefits due to increased power consumption are estimated by consumers' willingness to pay for the energy attributable to the program less the supply costs.

²² The projects are consistent with the financial recovery plan forecasts, updated as of December 2011.

- The net benefits corresponding to enhanced reliability are estimated by valuing the energy associated with reduced failures at the non-supply cost estimated for Brazil at R\$2,900 per megawatt-hour (MWh), according to the 2019 Energy Expansion Plan.²³ Reduced energy lost to failures due to enhanced reliability was estimated based on CEEE-D's projection of reducing its EOD indicator by 15% to 20%, or a minimum of four hours. The value of the benefits associated with reduced technical losses was calculated considering that the program will reduce them by 1.8%, valuing them at the marginal cost of generation plus transmission (R\$137.3/MWh). The benefits of the reduction of business losses associated with the increased billing and taxes received by the company and the government related to the ERP and BMS systems modernization component does not entail additional economic benefits, since in the absence of the program, the benefits are received by the consumers.
- 2.25 On the basis of the identified costs and benefits, the program's economic evaluation yields an economic internal rate of return of 12.9% and a net present value of benefits of US\$12.9 million (discounted at 12%).²⁴ The economic evaluation includes the ERP and BMS systems modernization component, which entails additional benefits that have not been quantified, such as cost savings and quality of service improvements.
- 2.26 The sensitivity of the outcomes to variations in the primary parameters used (willingness to pay, reliability, reduction of technical and business losses) shows that the associated risk of an adverse impact on the EIRR and NPV is very low. The EIRR would be 11.9% only in the event of reductions of over 10% in willingness to pay.
- 2.27 **Financial viability.** The investments under the proposed program would help CEEE-D become a sustainable enterprise in the medium and long term through: (i) increased revenues through the reduction of business losses, increased coverage of demand, improved collections, and an increase in rates given new investments;²⁵ (ii) cost reduction by reducing operating and maintenance expenses and reducing penalties for improved quality of service. CEEE-D's financial recovery plan and planned future investments in loss reduction and debt refinancing under terms consistent with the life of its assets will make the company able to meet the financial obligations it assumes.
- 2.28 To ensure program execution and fulfillment of the development objectives, the operation has a guarantee from the State of Rio Grande do Sul.²⁶ In addition, to ensure that the counterpart resources for program execution are allocated, every year CEEE-D will submit budgetary evidence of the resources needed to make the

²³ According to technical note EPE-MME EPE-DEE-RE-030-2009.

²⁴ See "Economic analysis report" under Other References.

²⁵ Given that the investments are recognized in the rates.

²⁶ The guarantee was approved by the Law of 14 January 2011.

counterpart contributions. The financial projections also show that CEEE-D's financial recovery will allow the company to meet its debt repayment obligations.

- 2.29 **Technical viability.** The independent engineer contracted by the IDB reviewed the program and confirmed that it is adequate in terms of cost, quality, and execution timeline to ensure that the works are done in the allotted time and with the required technical specifications. He also concluded that CEEE-D has significant experience in the sector and has control mechanisms and processes in place to implement, supervise, and monitor the program.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Implementation arrangements

- 3.1 **Structure.** CEEE-D will be responsible for program execution, administration, monitoring, and evaluation. To ensure fulfillment of the loan contract with the Bank in administrative, fiduciary, procurement, financial, accounting, and socioenvironmental matters, a PCU will be established within CEEE-D, which will include a coordinator, an engineer, a financial/accounting specialist, an environmental specialist, and a bidding and procurement specialist. **Establishment of the PCU, including the technical staff cited above, will be a condition precedent to the program's first disbursement.**
- 3.2 The executing agency will be responsible for implementing and supervising the program, and defining and approving the annual work plans (AWPs), providing information allowing the Bank to monitor and evaluate program impacts, coordinating and managing disbursements, and maintaining accounting and financial records, including the annual financial statements required by the Bank.
- 3.3 CEEE-D is negotiating a loan with AFD to cofinance the program (see paragraph 2.2). AFD has completed the due diligence process for the program in the technical, financial, and environmental areas. AFD expects its Board to approve the operation in March or April of 2012. **The following will be conditions precedent to the first disbursement: (i) the signing and entry into effect of the financing agreement between CEEE-D and AFD; and (ii) CEEE-D's documented budgetary allocation of the resources necessary for the counterpart contribution for the first year.**
- 3.4 **Monitoring and evaluation.** The program will include the following instruments to be produced by the executing agency: (i) AWP; (ii) six-monthly progress reports on the AWP and the results obtained in executing the activities; (iii) an action plan for the next six-month period in those areas requiring corrective actions to improve program performance; and (iv) an annual financial report and an update of the 10-year projections. **CEEE-D's submission of the AWP for the first year will be a condition precedent to the first disbursement.**
- 3.5 The purpose of the evaluation system will be to verify compliance with the targets agreed upon in the Results Matrix (Annex II). It will include semiannual monitoring

reports, a midterm evaluation to verify compliance in overall program execution and progress toward the Results Matrix targets, and a final evaluation, six months after completion of execution.²⁷

- 3.6 **Special conditions for execution.** The following special execution conditions have been established: (i) Environmental and social. CEEE-D will fulfill the environmental and social obligations listed in the ESMR and will take the actions envisaged in the EHSAP. Annually, until execution of the works is completed, the Bank will verify fulfillment of the environmental and social obligations established in detail in the ESMR. Upon completion of the works, the Bank and CEEE-D will mutually agree on the frequency of this verification; (ii) Fiduciary management. CEEE-D will prepare a brief manual of operations related to the program within three months after signature of the loan contract; (iii) CEEE-D will fulfill the indicator presented in paragraph 2.22. Should the indicator deteriorate, the company will have to submit an action plan to the IDB identifying the causes of the variations, the financial or management measures to be adopted, and their timetable, to restore the conditions for the company's improvement (see paragraph 2.28); and (iv) CEEE-D will submit an annual financial report and an update of the 10-year projections.

B. Management

- 3.7 **Procurement.** IDB-financed works, goods, and services will be procured, and consultants will be contracted, in accordance with the Bank policies contained in documents GN-2349-7 and GN-2350-7, respectively. Program procurement will be reviewed on an ex post basis, except for the procurement of the ERP and BMS, which will be subject to ex ante review by the Bank.²⁸
- 3.8 **Fiduciary considerations.** The main fiduciary considerations to be reflected in the loan contract include: (i) semiannual ex post review of disbursements; (ii) contracting of external financial-accounting auditing services for the program and the company satisfactory to the Bank; and (iii) preparation of a brief manual of operations for the program.
- 3.9 **Retroactive financing and recognition of expenditures.** Expenditures of US\$21.4 million will be recognized against the counterpart, and expenditures of US\$18.3 million (8% of program costs) will be recognized against the Bank loan proceeds. Items recognized are expenditures for works considered under the program, incurred during the period indicated in Operational Policy OP-504, after 24 August 2010, the date the program entered into the Bank's pipeline, and no more than 18 months prior to the loan's approval. This retroactive financing is important in order not to penalize program execution. The company moved forward with its own resources while the operation was being processed with the IDB, for which it

²⁷ See electronic link: Results monitoring and evaluation arrangements.

²⁸ AFD will use the IDB's procurement policies.

had to reallocate available cash among its various investments and obligations with the expectation that IDB resources would cover the expenses incurred.

- 3.10 **Financial planning and disbursements.** The financial plan to accompany each request will be updated every six months, based on the program's actual cash requirements. Program resources are planned for disbursement according to the following consolidated financial plan.

Table 3. Tentative disbursement schedule (US\$ millions)

	2012	2013	2014	Total
IDB	54.8	64.2	11.6	130.6
Cofinancing	42.7	37.3	7.4	87.4
Total	97.5	101.5	19.0	218.0
Percentage	44%	47%	9%	100%

- 3.11 **External audit.** During the execution period, the program's and the company's financial statements will be audited by CEEE-D's audit firm, provided that it is deemed eligible by the IDB, and sent to the IDB within four months following the close of the fiscal year. Beginning in year five, if no significant problems are identified, the program audit will be incorporated into CEEE-D's audit report, providing any applicable clarifications in the notes to the financial statements. Every six months, the external auditors will issue an opinion based on a review of the disbursements approved by the Bank in the preceding six-month period, which will include verification of financial considerations and procurement processes.

Development Effectiveness Matrix				
Summary				
I. Strategic Alignment				
1. IDB Strategic Development Objectives		Aligned		
Lending Program		The program will contribute to support climate chance initiatives, renewable energy and environmental sustainability in the area of Sustainable practices.		
Regional Development Goals		The program will contribute to the Infrastructure for competitiveness and social welfare goal and protecting the environment, responding to climate change, promoting renewable energy, and enhancing food security.		
Bank Output Contribution (as defined in Results Framework of IDB-9)		The program will contribute to the infrastructure for competitiveness and social welfare indicador related to Km of electricity transmission and distribution lines installed or upgraded.		
2. Country Strategy Development Objectives		Aligned		
Country Strategy Results Matrix			In preparation.	
Country Program Results Matrix		GN-2617	The program is included in the 2011 Country Program Document.	
Relevance of this project to country development challenges (If not aligned to country strategy or country program)				
II. Development Outcomes - Evaluability		Highly Evaluable	Weight	Maximum Score
		8.4		10
3. Evidence-based Assessment & Solution		9.6	25%	10
4. Ex ante Economic Analysis		10.0	25%	10
5. Monitoring and Evaluation		6.6	25%	10
6. Risks & Mitigation Monitoring Matrix		7.5	25%	10
Overall risks rate = magnitude of risks*likelihood		Medium		
Environmental & social risk classification		B		
III. IDB's Role - Additionality				
The project relies on the use of country systems (VPC/PDP criteria)		Yes	The program relies on the use of all Financial Management Sub-systems (budget, treasury, accounting and reporting, external control and internal audit).	
The project uses another country system different from the ones above for implementing the program		Yes	Monitoring and evaluation.	
The IDB's involvement promotes improvements of the intended beneficiaries and/or public sector entity in the following dimensions:				
Gender Equality				
Labor				
Environment		Yes	The program will improve the oversight capacity of environmental, social health and safety management.	
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project				
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan.				

The program will contribute to indicators in the area of infrastructure for competitiveness and social welfare related to "kilometers of electricity transmission and distribution lines installed or upgraded." It will also support the climate change initiative through the use of sustainable practices. The program is aligned with the Country Program Document. The new country strategy for Brazil is in preparation.

The problems being addressed through the program are clearly defined and the diagnosis is empirically based. The main factors that contribute to these problems are clearly specified, as are the interrelationships among factors and the magnitudes of factor deficiencies. The program's impact, outcomes and outputs are clearly stated and show vertical logic. All outcomes and output indicators have baselines, targets and sources of information and are SMART. No impact indicators are included. The program was analyzed using a cost-benefit analysis that generated rates of return above 12%. The program has a monitoring and evaluation plan and an allotted budget for each activity. The program will be evaluated using a reflexive methodology and an ex-post economic analysis. The risks of the operation are identified and classified and present mitigation measures, however, no indicators, baselines or targets are included to monitor these measures.

The program uses country systems in the financial management and monitoring and evaluation area. It is also foreseen that the project will generate externalities for the public sector in environmental management.

RESULTS MATRIX

Program objective	The program's general objective is to improve the population's quality of life and ensure the sustainable development of the State of Rio Grande do Sul through investments in the expansion and modernization of the electricity distribution system in the area of the concession held by CEEE-D, which includes the Porto Alegre metropolitan area, and the implementation of a new business management system. The program aims to ensure the power infrastructure necessary to meet the increase in demand, which is expected to be strong during the 2014 World Cup, when Porto Alegre will be one of the host cities.									
Outcome indicators	Baseline (2010)			Target (2014)			Source of information	Frequency of verification		
Reduction of the EOD rate – Equivalent Outage Duration per Consumer (hours/year)	METRO	18.80		METRO	15.04		CEEE-D – operation information ANEEL – published indicators	Annual		
	NORTH	28.05		NORTH	22.44					
	SOUTH	39.22		SOUTH	31.38					
	CEEE-D	26.99		CEEE-D	26.99					
Reduction of the EOF rate – Equivalent Outage Frequency per Consumer (number of times/year)	METRO	12.26		METRO	11.04		CEEE-D – operation information ANEEL – published indicators	Annual		
	NORTH	18.60		NORTH	16.74					
	SOUTH	18.27		SOUTH	16.44					
	CEEE-D	15.18		CEEE-D	13.66					
Reduction of load percentage on high-voltage and medium-voltage transformers (%)	METRO	86%		METRO	71%		CEEE-D – operation information	Annual		
Increase in power sold per year (GWh)	7,683 GWh			8,783 GWh			CEEE-D – demand growth information	Annual		
Reduction of the percentage of total losses (with respect to energy entering the system) (%)	Total	18.74%		Total	15.18%		CEEE-D – operation information ANEEL – published indicators	Annual		
	Technical	7.48%		Technical	5.68%					
	Commercial	11.26%		Commercial	9.50%					
Economic internal rate of return (EIRR)	12.9%			> 12%			Final evaluation	By the end of program execution		
EBITDA margin (EBITDA/Liquid operating income)	-5.3%			6%			Financial statements	Annual		

Output indicators	Baseline 2010	2011	2012	2013	2014	Total	Source of information
Component I. Investments in high-voltage distribution							
New, completed substations (MVA)	0	0	0	437.5	0	437.5	CEEE-D semiannual reports
Substations – completed expansions (MVA)	0	100	200	75	0	375	
New, completed distribution lines (km)	0	0	5.5	54.5	0	60	
Distribution lines – completed enhancements (km)	0	0	0	125	64.8	189.8	
Component II. Modernization of high-voltage distribution equipment							
High-voltage distribution automation and control elements installed (units)	0	9	120	513	0	642	CEEE-D semiannual reports
Component III. Modernization of medium-voltage distribution controls							
Medium-voltage distribution automation and control elements installed (units)	0	0	50	508	0	558	CEEE-D semiannual reports
Component IV. Institution-strengthening - Replacement of enterprise management and business information systems							
ERP and BMS systems (% of implementation)	0%	0%	35%	75%	100%	100%	CEEE-D semiannual reports

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Country:	Brazil
Project number:	BR-L1284
Name:	Pró-Energia Program for Electricity Distribution in Rio Grande do Sul
Executing agency:	Companhia Estadual de Distribuição de Energia Elétrica - Estado Rio Grande do Sul (CEEE-D/RS)
Prepared by:	Mónica Merlo – financial specialist and Mario De A. Ferreira – consultant

I. Executive summary

1. CEEE-D's institutional capacity, as a borrowing institution and the program's executing agency, was evaluated using the Institutional Capacity Assessment System, which indicated that the company's set of fiduciary, internal and external control systems shows a satisfactory level of development, posing a low level of risk.
2. Based on this assessment it was concluded that, in general, the company has an adequate organizational structure with sufficient administrative, technical, and financial management capacity to execute the program satisfactorily, in accordance with the conditions and requirements established by the Bank. It was also noted that the fiduciary management capacity will improve substantially, since procurement and implementation of a new information system (Enterprise Resource Planning (ERP)) will be financed using proceeds from the Bank's loan.
3. CEEE-D will be fully responsible for program execution, making full use of its organizational structure and fiduciary management systems. There are no plans for participation by public or private third parties in this process. For the local counterpart requirements, the company has reported that it will make this contribution with own resources. Another factor considered by the team is the change of the state authorities in 2011.
4. We have confirmed that due to the program's strategic importance for ensuring the state's power supply in the coming years, especially in the city of Porto Alegre, program execution will remain a priority for the state authorities.

II. Fiduciary context of the executing agency

1. The main support tool for the company's fiduciary and business activities is an Enterprise Resource Planning (ERP) application called Synergos, which is slated for

- replacement with project resources. It comprises two subsystems: one for financial accounting (SIFCO) and the other for business (clients). It is a platform owned by SYNAPSIS, and its usage rights were purchased by CEEE, including the technology transfer. The system has been discontinued, has design problems, and in order to address the company's current management needs, has undergone a series of adaptations and modifications to incorporate new features and new subsystems to supplement the information, some of which are not fully integrated.
2. Despite meeting the company's needs, the current system has technical and structural limitations that impact the levels of efficiency, economy, and timeliness of the company's fiduciary management and control activities.

III. Fiduciary risk evaluation and mitigation measures

1. In general, the operation's fiduciary risk is low, as confirmed by the institutional assessment conducted through interviews and meetings with the company's executives, managers of the main fiduciary management units, consultants, and the external audit firm's representative. All identified risks are detailed in the fiduciary agreements and requirements established with the company.

IV. Considerations for the Special Conditions of the contract:

1. Special conditions precedent to the first disbursement request:
 - a. The following will be demonstrated to the Bank's satisfaction:
 - (i) The executing agency will have all local counterpart resources necessary for project execution in due time and form.
 - (ii) A program coordination unit will be established, according to agreed upon institutional arrangements, with adequate professional staff and the respective organizational, administrative, and financial procedure manuals.
 - (iii) An annual work plan will be submitted.
2. Other Special Conditions to be set forth in the contract:
 - a. Conversion criteria and application of the exchange rate agreed upon with the executing agency for expenditures in local currency: exchange rate in effect on the date of conversion of the operation's currency into local currency.
 - b. The program's financial control and recording systems, by investment category, source of resources, and currency, to operate through the SYNERGIA-STO information system, are in operation and meet the information and management control requirements established by the Bank.
 - c. Required audited financial reports: (1) Annually: Auditor's opinion on the program's and entity's financial statements, reports on fulfillment of the contractual clauses and on the program's internal controls; and (2) Semiannually: Report on the integrated examination of procurement

processes and disbursement requests approved by the Bank in the preceding six months.

- d. The company's internal audit unit includes in its annual work program a periodic review of financial management procedures, fulfillment of targets and results indicators, throughout the program's execution period.

V. Agreements and requirements for procurement execution

The fiduciary agreements and requirements for procurement establish the provisions applicable to the execution of all procurement planned for the project.

1. Procurement execution

The project will be executed through an execution unit inside CEEE, which will be responsible for administration, monitoring and evaluation, legal matters, communications, and information technology support. It will also perform operational activities and will act as liaison with the various units involved in the program.

For procurement execution, the administrative activities required for procurement processes, such as preparation of the procurement plan, drafting of bid documents or requests for proposals, publication of notices, communications with bidders, etc., will be performed by the executing unit in collaboration with the Bid Committee. The drafting of technical specifications/terms of reference, technical evaluations of the processes, and technical supervision of contract execution will remain the responsibility of CEEE's technical units.

- a. Procurement of works, goods, and nonconsulting services: Contracts for works, goods, and nonconsulting services¹ arising under the project and subject to international competitive bidding (ICB) will be executed using standard bidding documents issued by the Bank. Bidding processes for works subject to national competitive bidding (NCB) will be executed using national bidding documents agreed to with the Bank. For goods and nonconsulting services, Banco do Brasil's electronic procurement system will be used. The procurement of works, goods, and nonconsulting services will be undertaken using the Policies for the procurement of works and goods financed by the Inter-American Development bank (document GN-2349-7).
- Procurement of information technology (IT) systems: An integrated enterprise resource planning (ERP) system and business management system (BMS) will be selected. The procurement of the hardware necessary for their operation is also planned. Both solutions will meet the minimum requirements established and appropriate for the needs of the Brazilian power sector.

Since the Bank does not yet have a specific standard document for the development and implementation of information technology solutions, the standard document for the selection of consulting services will be used, including the following: (i) quality-based selection; and (ii) fixed-term contract.

¹ According to the IDB's procurement policies, nonconsulting services are treated as goods.

The terms of reference will include the required technical considerations for the solutions, e.g. compatibility with the databases, etc.

- b. Selection and contracting of consultants: Consulting service contracting arising under the **project** will be executed using the Bank's standard request for proposals. The selection and contracting of consultants will be carried out using the Policies for the selection and contracting of consultants financed by the Inter-American Development Bank (document GN-2350-7).

The project's largest consulting project is identified in the paragraph on IT. The rest are projects involving small amounts for the design of certain works.

- Selection of individual consultants: The selection will consider the qualifications of at least three candidates for the job. When necessary, advertisements may be placed in local or international media to attract qualified consultants.
- c. Recurring expenses: These include operating and maintenance expenses required to make the project operational during its useful life, covering the following: utilities and communications, translations, office supplies, photocopies, mail, and other expenses necessary for proper project administration; those that would be financed with loan proceeds under the annual budget approved by the Bank, and incurred under the execution unit's administrative procedures, which will be reviewed and accepted by the Bank provided they do not violate the basic principles of competition, efficiency, and economy.

Recurring expenses also include the costs of consultants contracted to assist the execution unit during the useful life of the loan. However, operating expenses do not include salaries of civil servants in the exercise of their public duties.

2. Threshold table (US\$ thousands)

Contracts for goods and nonconsulting services for which the estimated amounts are less than US\$5,000,000 will be procured using Banco do Brasil's electronic reverse auctioning system. The onsite reverse auction and the price list methods may also be used under the conditions established in the agreements with the government. The thresholds for these methods are: (i) onsite reverse auction up to the threshold for shopping; and (ii) price list up to the threshold for NCB.

Works			Goods ²			Consulting	
International competitive bidding	National competitive bidding	Shopping	International competitive bidding	National competitive bidding	Shopping	International advertising for consulting projects	100% national shortlist
> 25,000	≤ 25,000 and ≥ 500	< 500	> 5,000	≤ 5,000 and ≥ 100	< 100	> 200	< 1,000

When the procurement plan is designed and updated, the following thresholds will be taken into account for the selection of the methods and examination by the Bank,

² Including nonconsulting services.

which will be included in the Operational Manual to define the procurement agreements to be used by the participating entities. The thresholds are determined according to the level of procurement risk posed by the project, which is considered low.

Threshold for ex post review		
Works	Goods	Consulting services
(1) All NCB processes	(1) All reverse auction processes	(1) After the first standard request for consulting services, all those below US\$500,000 (2) All individual consultants < 100

During project execution, the Bank may modify the ex ante review thresholds at will, if it believes the fiduciary context of the executing agency or country has changed. In this case, the Bank will inform the execution unit of this decision, and the execution unit will include the new execution conditions in the procurement plan.

3. Initial procurement plan

Category and description of procurement contract	Estimated procurement cost (US\$ thousands)	Procurement method
CONSULTING		
Transmission line projects	750.0	8666/QCBS
Implementation of ERP and BMS solutions, including procurement of software licenses and IT infrastructure (basic hardware and software)	66,000.0	QCBS
Individual consultant – Projects to coordinate and select power systems	600.0	CQS
Technical monitoring during implementation of the corporate ERP/BMS systems	1,100.0	QCBS
Support for program administration	1,607.9	QCBS
WORKS		
Construction of substations and lines	117,301.8	8666/NCB/ICB
GOODS		
Procurement of automation and control equipment (current, power transformers and switches)	28,746.8	8666 - Reverse auction - NCB
SERVICES		
Installation of automation and control equipment	2,532.0	8666

4. Procurement supervision

The ex ante or ex post review method will be determined for each selection process.³ Ex post reviews will be conducted every 12 months according to the project's supervision plan. The ex post review reports will include at least one physical inspection visit,⁴ selected for the procurement processes subject to ex post review.

5. Special provisions

- a. After the public opening of the consultants' bids, the information related to the examination, clarification, and evaluation of the bids and recommendations for the awards will not be communicated to the consultants or others not officially involved in the process until publication of the contract award (except as established in sections 2.20 and 2.27 of the Policies for the selection and contracting of consultants financed by the Inter-American Development Bank (document GN-2350-7)). Moreover, consultants or others not officially involved in the process will not be permitted to examine or copy the bids of other consultants;
- b. As a condition for bid submissions and/or contract awards, it will not be necessary for the bidders or consultants : (i) to be located in Brazil; (ii) to have a representative in the country; or (iii) to be affiliated or enter into subcontracts with Brazilian suppliers, contractors, or consultants;
- c. The provisions set forth in sections 2.49, 2.50, 2.52, 2.53, 2.54, and 2.59 of the Policies for the procurement of goods and works financed by the Inter-American Development Bank (document GN-2349-7) will also apply to contracts for goods, works, and nonconsulting services to be procured under national competitive bidding procedures;
- d. A considerable difference between the amount of the bid qualified as the lowest-cost bid and the reference amount will not be considered grounds to void the bid, unless after investigating the reasons for the higher cost, it is determined to the Bank's satisfaction that the reference value is correct and realistic.
- e. The execution unit will update the procurement plan at least every six months, or as required by the Bank to reflect the project's actual execution needs and progress.
- f. Consultants will not be required to submit performance or bid bonds.
- g. The types of contracts described in section IV of the Policies on consultants will be the only types of contracts the borrower may use to contract consulting services provided by firms financed with the loan proceeds.

³ The responsibility, support for the review, and methodology are described in the [Guidelines for ex post review of procurement processes](#).

⁴ The inspection verifies the existence of the procurement, while leaving verification of the quality and fulfillment of the specifications to the sector specialist.

6. Records and files

The program's records and files will meet the following minimum conditions:

- a. The files will contain original documentation filed in chronological order, and will be sealed and numbered sequentially.
- b. The files will be stored in a secure room used exclusively for that purpose, with restricted access. A person will be designated as responsible for the files, and will control access to the area (under lock and key) and activity therein. Measures will be taken so that the file area runs a low fire risk (no smoking, etc.).
- c. If files are removed from the area, the person removing them will be responsible for ensuring that they are complete. The party responsible for the file will also ensure that they are returned complete. Movement of files and the abovementioned control of their integrity, as well as the addition of documentation, will be duly documented.
- d. A procedure will be implemented so that the person responsible for the file may transfer this responsibility to another (for vacations, etc.). The transfer of this responsibility will be documented along with the status of the files and records at that time.
- e. There will be a registry of files.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/12

Brazil. Loan ___/OC-BR to the Companhia Estadual de Distribuição Elétrica (CEEE-D)
Pró-Energia Program for Electricity Distribution in
Rio Grande do Sul

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Companhia Estadual de Distribuição Elétrica (CEEE-D), as Borrower, and with the Federative Republic of Brazil and the State of Rio Grande do Sul, as Guarantors, for the purpose of granting the former a financing to cooperate in the execution of the Pró-Energia Program for Electricity Distribution in Rio Grande do Sul. Such financing will be for an amount of up to US\$130,556,650 from the Single Currency Facility of the Ordinary Capital resources of the Bank, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on _____)

LEG/SGO/CSC/IDBDOCS: 36644791
Pipeline No. BR-L1284