

For reference, the next paragraphs provide a verbatim transcription of section 1.2 included in the Substantive Revision document (2015), English Translation, p.1-3. The text provide good insight in the rationale of the Project and its context and the considerations that led the Project partners to implement the revision of the ProDoc.

“The Project ‘Market Transformation for Energy Efficiency in Brazil’ (UNDP/BRA/09/G31) goes back to 2005, when the Multilateral Fund for the Implementation of the Montreal Protocol approved a USD1 million funding for implementation of the 'Demonstration project on integrated management for the chillers sector in Brazil'. This demonstration project was approved conditional on the provision of matching funds for implementation of all other activities related to the improvement of energy efficiency in buildings. Negotiations with GEF and IDB were then initiated, which led to the signing of Project BRA/09/G31 document on March 1, 2010.

Focusing on improving energy efficiency in buildings, the goal of Project BRA/09/G31 is to influence and develop the market for energy efficiency (EE) in the commercial and public building sectors, with a view to contributing to savings of up to 4 million MWh of electricity over the next 20 years and reductions of greenhouse gas (GHG) emissions of up to 2 million tons of carbon dioxide (CO₂) .

These targets and outcomes were estimated based on the assumptions made in the design of the Project Document (PRODOC). The initial Project assumption was that the market for Energy Service Companies (ESCOs) in Brazil would grow rapidly from the success of performance contracts, given the technical capacity of ESCOs to calculate and secure the estimated savings to customers and funding entities. Consequently, another assumption was made from the understanding that ESCOs would be the ones borrowing from commercial banks in order to execute energy efficiency projects, based on performance contracts. As a result, the Project components were designed to facilitate access to bank credit for these companies, focusing on the implementation of the Energy Efficiency Guarantee Mechanism (EEGM). And the final assumption was that the performance contract would be made feasible in the public sector through possible changes in the interpretation of Brazilian Public Procurement Law No. 8,666/1993.

The assumptions made and the instruments and components designed for achieving the targets indicated a project of great complexity, with a theme of cross-cutting characteristics which, therefore, required the direct involvement of different players.

Thus, the initial phase of project BRA/09/G31 was characterized by a series of discussions at federal government level. A negotiation channel was established so that the sectors involved in the design of energy efficiency policies and in the National Policy on Climate Change could reach the level of maturity required for them to understand their roles in the Project and, therefore, define its implementation based on a collective construction effort. It should be noted that the applicability of the performance contract as an instrument to leverage the market was always extensively debated.

The need for these initial interactions and negotiations led to delays in implementation startup, and the first contracting occurred only at the end of 2011. Considering the date of signature of UNDP Project BRA/09/G31 document, it should be noted that its design is based on an economic context that preceded the international financial crisis (2007 and 2008) that affected the entire world as well as Brazil. For illustration purposes, the project document (PRODOC) uses as reference for the country's GDP growth from 2000 to 2015 an average of 4.3% in the baseline scenario and 5.3% in the optimistic scenario. However, the trend has been below this expectation, considering the 0.1% GDP growth recorded in 2014, which influenced the pace of execution of EE projects in the country.

Throughout the Project implementation phase, it was observed that other issues were incompatible with the initial recommendations. A study of the State of the Art of Energy Efficiency Contracts in

Brazil, commissioned under UNDP Project BRA/09/G31, confirms that some of the assumptions made were mistaken. The study found that most of the contracts used by the energy efficiency market in Brazil are not based on gains achieved from energy savings in the facility. In other words, the performance contract has not been a common market practice.

In fact, the study commissioned shows that the forms and sources of funding for project development are mainly consumer's equity, funds from concessionaires for the development of projects within the scope of a program regulated by the Brazilian Electricity Regulatory Agency (ANEEL), or service providers' equity.

In addition, although the limited number of ESCOs in Brazil is mostly characterized by small companies, only the few existing large companies have shown the technical and financial capacity to bear the costs of implementing projects based on performance contracts. This is confirmed by the three project guarantees issued by the IDB to date under the EEGM, in the total amount of USD1.6 million to leverage USD9.44 million. These can be characterized as high cost complex projects, all of them requested by a large ESCO. The dissemination of these experiences has led to negotiations with six other companies, but it is noted that none of the guarantees issued are of the "technical risk" type, since it is still very difficult for ESCOs to ensure and technically demonstrate the estimated savings.

Another issue highlighted in the aforementioned study is the fact that the performance contract has not become a public sector option for contracting energy efficiency services. The interpretation of the procurement law by legal and control agencies in Brazil has proven to be a barrier to this option. And to date, all attempts to change this interpretation have failed.

Moreover, public agents would also face operational difficulties in making budget provisions, should the form recommended by a performance contract concluded by an ESCO be adopted. The performance of any service to improve the energy efficiency of a public building, including the acquisition of materials and equipment, is entered in the public budget as an investment. There is currently no mechanism to enable re-allocating the budget from the expense account (such as that intended to cover expenses related to the payment of electricity) to an investment account (such as that which will cover the payment to an ESCO for the provision of services and the acquisition of materials/equipment). Therefore, like in the private sector, these services are procured under a standard service contract, in which economic and financial resources are provided to cover the payments that are the object of the contracts.

Consequently, mistaken assumptions led to the adoption of targets and indicators that have proven somewhat unfeasible in the face of the reality existing throughout the Project."