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Executive Committee of
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Implementation of the Montreal Protocol

Fourteenth Meeting
Nairobi, 29-30 September 1994

LETTER OF IMPLEMENTATION STRATEGY FOR SMALL MONTREAL PROTOCOL INVESTMENT OPERATIONS THROUGH AN UMBRELLA AGREEMENT

(Submitted by The World Bank and The Government of India)

August 29, 1994

Dr. Omar El-Arini
Chief Officer
Multilateral Fund for the Montreal Protocol
Montreal, Canada

Dear Dr. El-Arini:

Letter of Implementation Strategy for
Small Montreal Protocol Investment Operations
Through an Umbrella Agreement

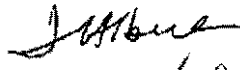
At its July 1994 meeting, the Executive Committee (EC) of the Multilateral Fund decided to support, on a pilot basis, the implementation of a streamlined project approval procedure for projects under US\$500,000. At that time it was also decided to consider at the 14th Meeting of the EC a proposal to initiate the implementation of this pilot mechanism.

The World Bank and the Government of India's Ministry of Environment and Forests (MOEF) are pleased to present for the consideration of the EC a Letter of Implementation Strategy (LIS) for Montreal Protocol Investment Operations.

The attached Letter and Technical Annex will provide the Executive Committee with a comprehensive overview of the approach proposed for processing small projects and the basis for establishing the cost-effectiveness criteria (the mechanism is referred to as the Small Project Approval Procedure). The Letter of Implementation Strategy also proposes to process about 10-15 projects on the basis of an advance of US\$4 million, to underwrite the mechanism, from the Multilateral Fund to be approved at the upcoming meeting of the EC.

Also attached is a brief Introductory Note which provides the rationale for the streamlined project approval procedure and the details of the general processing and administrative arrangements. With the assistance of the Fund Secretariat and Executive Committee, we look forward to the successful implementation of this mechanism.

Regards,


(for)

Ken Newcombe
Chief

Global Environment Coordination Division
Environment Department

Attachments

cc: Mr. Tan Meng Leng, Chairman, Multilateral Fund
Mr. John Whitelaw, Vice-Chairman, Multilateral Fund

INTRODUCTORY NOTE

IMPLEMENTATION STRATEGY FOR THE PROCESSING AND APPROVAL OF SMALL MONTREAL PROTOCOL INVESTMENT OPERATIONS

**General Guidelines and
Details of Implementation
(Including Pilot Phase)**

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IMPLEMENTATION STRATEGY FOR THE PROCESSING AND APPROVAL OF SMALL MONTREAL PROTOCOL INVESTMENT OPERATIONS

General Guidelines and
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Introduction

1. This note provides the background, context and details of the mechanism for the establishment of the Implementation Strategy for Small Montreal Protocol Project Approval and Processing (hereafter referred to as "SPAP"). The details of the step-by-step procedure, which would be applicable to both the pilot and operational phases of the SPAP, are outlined in the two attached flowcharts.

2. This note also serves as an introduction to the Letter of Implementation Strategy which has been prepared by India's Ministry of Environment and Forests (MOEF), which is piloting this new project procedure with the World Bank. Its purpose is also to provide the background leading to the implementation of this mechanism and the criteria for program implementation.

Background

3. The Parties to the Montreal Protocol have granted the implementing agencies of the Multilateral Fund the authority to approve project whose total incremental cost is less than US\$500,000. However, the Multilateral Fund Executive Committee (EC) has not yet developed the policies (in the form of clear cost effectiveness guidelines) for extension of this authority to the implementing agencies. Consequently, implementing agencies have had to use the same resources as those employed on large projects to secure funding and approval of the numerous small projects with total incremental costs less than US\$500,000.

4. At the EC's 12th Meeting, the World Bank proposed to develop a project processing concept which would further streamline the project approval procedure and accelerate the flow of funds to the Bank's client countries. A more detailed concept of this approach was presented to the EC at its 13th Meeting at which time the Executive Committee agreed to support the approach.

5. As the phaseout of ODS becomes more complete with implementation of large readily identified projects, phaseout activities will shift towards residual smaller projects, many of which will be in the small scale industries and unorganized sectors. A mechanism is needed to permit processing of such projects without draining available technical resources and extending ODS phaseout schedules.

6. Also, as the in-country mechanisms of developing countries for Montreal Protocol project identification, preparation and implementation become operational, the capacity to assume a larger role in the project cycle will increase and additional efficiency gains will be possible through the adoption and implementation of streamlining mechanisms such as the SPAP.

Criteria

7. The SPAP is a project approval process which will accelerate the approval of small projects under US\$500,000 and, implemented within the context of an umbrella agreement, will accelerate project implementation, disbursements and ODS phaseout.

8. The SPAP is intended to service project authorizations in the under US\$500,000 total investment cost category. Other criteria must also be considered, as the intention is only to expedite funding of projects which have a reasonable degree of justification and cost effectiveness, not to service all project under the US\$500,000 limit.

9. Accordingly, the following additional criteria will be considered in the implementation of this program:

- (a) the SPAP should be managed as a facilitative mechanism for small scale industries which choose to adopt non-ODS technologies and procedures. It is not intended to exclude projects from further consideration utilizing the existing project approval and funding mechanism, nor is it to be a requirement for processing small projects;
- (b) the SPAP should consider consuming sector projects only (i.e., refrigeration, foam, aerosols, solvents, halon) but not producer or supporting projects without direct ODS savings (i.e., polyol, alternatives, compressors). This should not impose a problem as such projects usually exceed US\$500,000 and require extensive preparation and analysis;
- (c) only focus on projects where the majority (i.e., 50+ percent) of incremental costs are incremental capital costs, as such projects generate the most immediate need for funding, a feature the SPAP should be designed to satisfy;
- (d) all projects considered under the SPAP should be for one-time funding of a full phaseout of ODS by the affected enterprise. This requirement is intended to avoid creation of "back-door" for funding via subdividing larger projects into less than US\$500,000 components; and
- (e) projects which have unit abatement costs exceeding agreed to guidelines should not be considered for funding under the SPAP but should be prepared for authorization by the MPEC if considered to be justified for other reasons.

10. The selection criteria for the sectors and sub-sectors and for the projects which would be channeled through the SPAP are provided in the Technical Annex to the Letter of Implementation Strategy.

Mechanism

11. The proposed mechanism which has been developed to implement the SPAP is depicted in Charts 1 and 2. The steps involved are simple, and only differ slightly from the establish business procedures for processing of Montreal Protocol investment operations.

12. The backdrop of the SPAP is an umbrella agreement within which the funds will be channeled to the participating enterprises. Once the Bank and country-client have agreed on an implementation mechanism and have negotiated an umbrella grant agreement, funds can be advanced from the Multilateral Fund to underwrite the Letter of Implementation Strategy which would have been reviewed by the Fund EC. Additional advances would be made to replenish the window in the umbrella grant agreement which is dedicated to this mechanism on the basis of periodic reports by the Bank to the EC on the status of commitments.

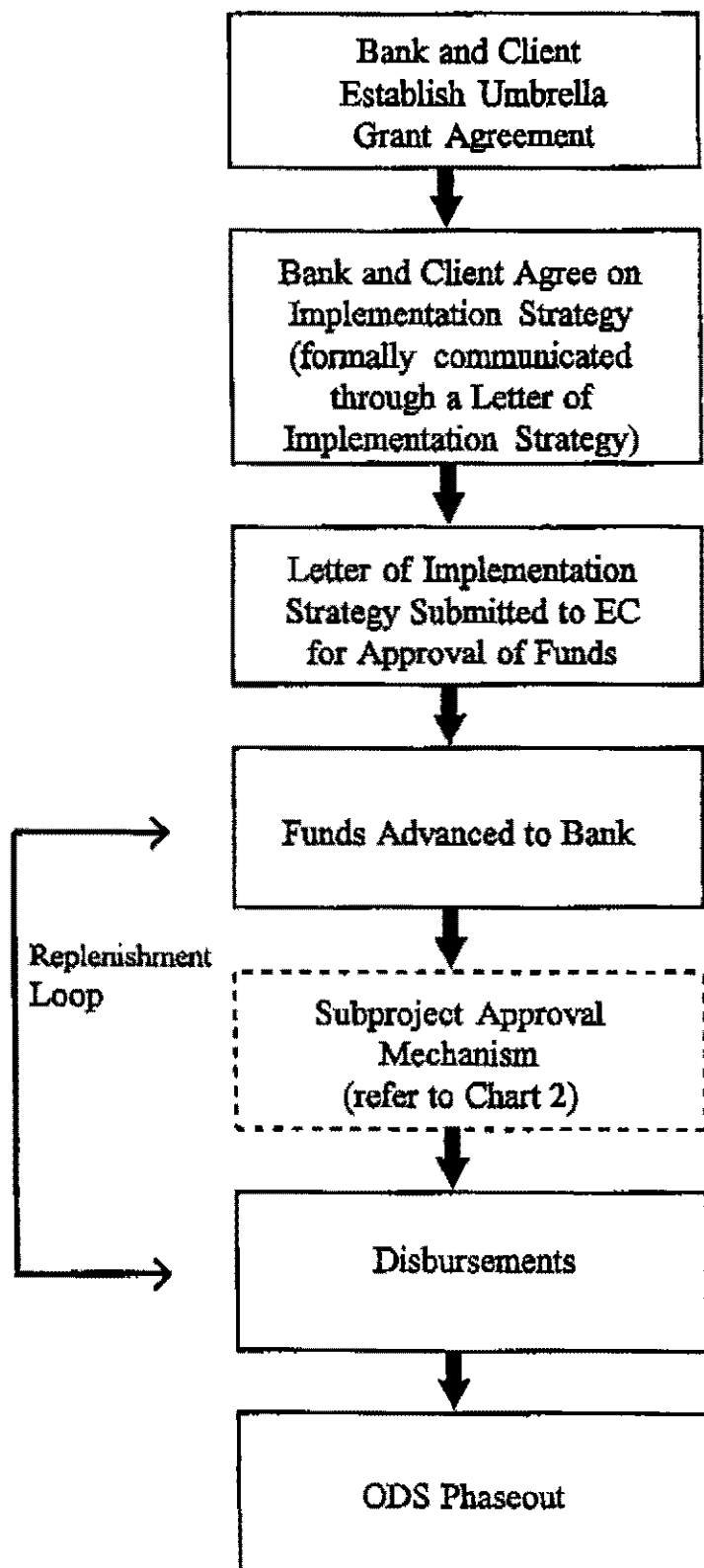
13. Chart 2 provides the step-by-step details of project (or subproject) processing for the under and above US\$500,000 categories. The under US\$500,000 column represents the processing of projects covered by a Letter of Implementation Strategy. As represented, the mechanism is further streamlined in that the project preparation activities are coordinated locally (as is the case in India for all project preparation activities). The proposed mechanism also eliminates the need for the Bank to prepare documentation for formal EC approval and consists in the review of project documents prepared in accordance with established guidelines and eligibility criteria.

14. During the trial period, projects which are cleared by the Bank for processing through the SPAP will be forwarded to the Fund Secretariat which will review the projects to determine whether new policy issues arise and whether the proposed activities meet the general eligibility criteria.

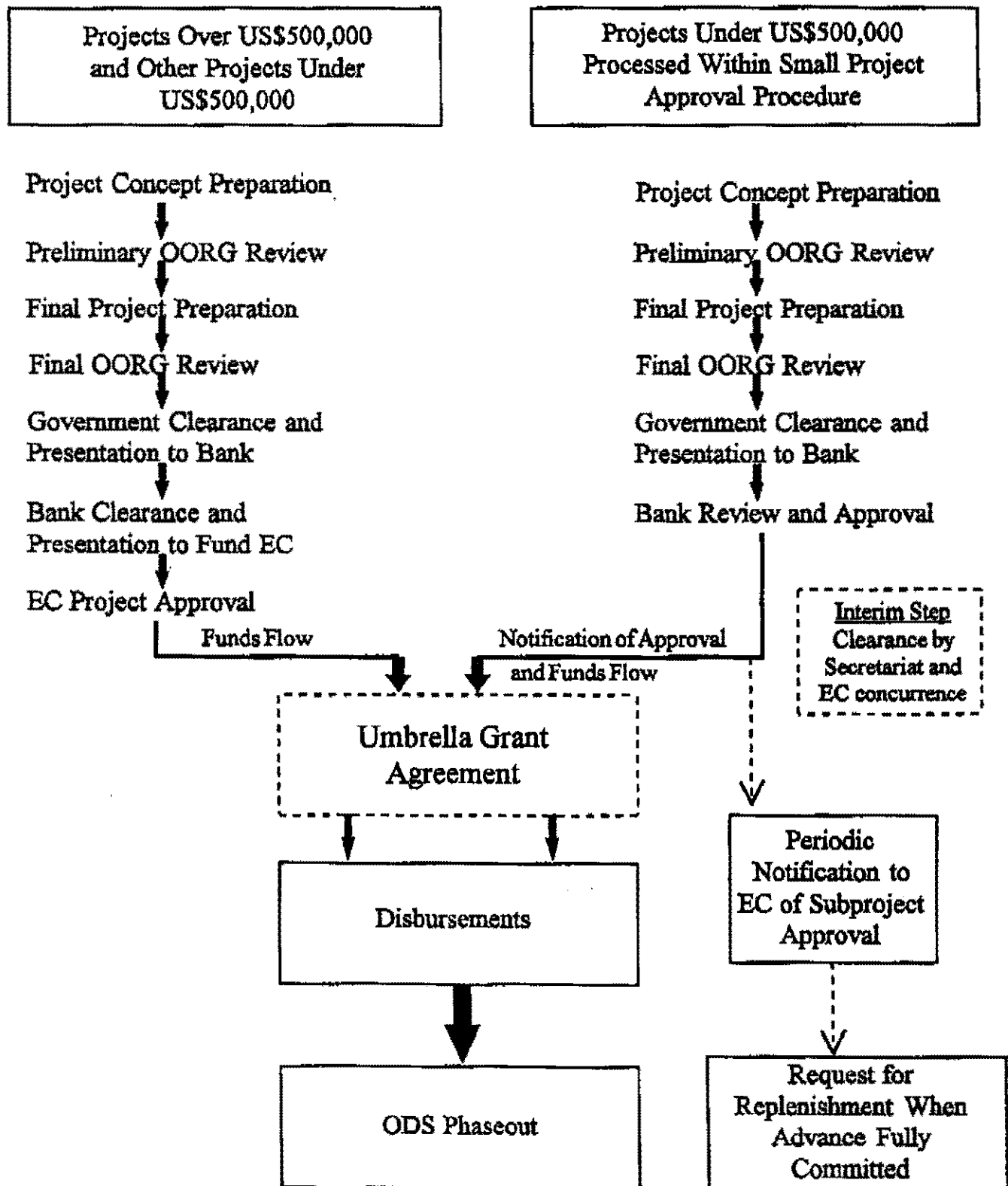
15. Upon final clearance of the project, the Bank will inform the recipient country through a formal communication that the project has been approved and that funds may be disbursed for the implementation of the project.

Small Project Approval Procedure

Diagram of Key Processing Steps



Subproject Processing Within Umbrella Agreement





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Vinay Shankar
Additional Secretary

F.No.5(2)/180/94-IC-O

Date August 26, 1994

Sub: Letter of Implementation Strategy for Montreal
Protocol Investment Operations

Dear Mr. Vergin,

The Government of India is a party to the Vienna Convention on Ozone Layer Protection and the Montreal Protocol on Substances that Deplete the Ozone Layer and is therefore committed to the global effort to eliminate the emission of ozone depleting substances (ODS). Also, as a member of the Executive Committee of the Multilateral Fund for the Implementation of the Montreal Protocol, India has been active in the funding mechanism established to provide resources to developing countries to cover the incremental costs of implementing the actions needed to eliminate the substances regulated by the Montreal Protocol.

Country Program

India's Country Program for the Phaseout of Ozone Depleting Substances and related documentation were approved by the Executive Committee (EC) of the Multilateral Fund in November 1993 as a first step in the development of a comprehensive phaseout strategy. The Country Program envisages ODS phaseout without affecting industrial and economic growth while minimizing economic dislocation.

Small Scale and Informal Sectors

An important aspect of the country program is related to the national strategy which deals with the small and medium sized enterprises. In its presentation of the Country Program to the Fund Executive Committee, the Indian delegation emphasized the importance of the small scale and unorganized sectors in India

subsector by subsector) basis, where cost effective activities are undertaken, particularly for the small scale industries which choose to adopt non ODS technologies. This encouragement for cost-effectiveness has allowed us to establish the guiding principles with appropriate covenants, to enable the implementation of such a process in the Indian context. The selection of sectors and/or subsectors for the initiation of this strategy will take full advantage of global experience and data not only from India but also from projects approved by the Multilateral Fund.

The determination of boundaries for project approval under the SPAP is a strategically important process. While the boundaries must be high enough to ensure an equitable allocation of resources between small and large enterprises, they must be low enough to encourage active development of the most cost effective projects first. A key objective is to establish the boundaries in such a way that they are easily understood and maintain equity between prospective enterprises and their access to available resources, hence only one cost effectiveness boundary per sector/subsector is proposed.

The cost-effectiveness criteria were established on the basis of a review of the Fund's portfolio of ODS phaseout projects and the pipeline of projects in India. The methodology for calculating the unit abatement cost (UAC) is established in the Technical Annex.

Cost-effectiveness boundaries are therefore proposed as follows:

Aerosol Sector	-	the UAC will not exceed \$2 per kg.
Foam Sector	-	the UAC will not exceed \$3 per kg.
Refrigeration and Solvent sectors	-	the UAC will not exceed \$5 per kg.

All ODS reduction projects which are eligible for funding through the Multilateral Fund will be considered and those which fulfill selection criteria will be processed through the SPAP and the balance through regular procedures. As outlined in the Technical Annex, several projects will not meet the SPAP cost-effectiveness criteria. This mechanism is, therefore, established without prejudice to those projects.

As this mechanism has been approved by the Multilateral Fund Executive Committee on a pilot basis, the Government of India proposes that the advance to the World Bank to underwrite this agreement be set at US\$4 million. It is expected that about 10-15 projects would be channeled through this mechanism over the next 6 months, subject to clearance by the review committees established by the Government of India. It is our understanding

and the need to develop a project processing mechanism to deal with the situation. At that same meeting, the EC approved funding for UNDP to undertake a survey of small scale industry and informal sectors. About two-thirds of ODS usage is in the small and medium scale sectors and an efficient mechanism will be required to deal with the large number of small projects which are expected to be funded by the Multilateral Fund. Any strategy, whether project or procedure related, must therefore also address these sectors.

Umbrella Agreement

Over the past two years India has actively been preparing investment projects for funding by the Multilateral Fund for the Implementation of the Montreal Protocol. During this time, we have sought, in cooperation with the World Bank, ways and means of streamlining the project approval procedure in order to accelerate the flow of funds to the eligible enterprises. The Bank in the meantime has established the Umbrella Agreement which provides the framework for a streamlined mechanism for the flow of funds from the Multilateral Fund to the eligible enterprises. To this end we are currently discussing with the Bank processing the second Ozone Depleting Substances Project on the basis of umbrella grant agreement which would allow the Bank to make provisions for funding the future projects over the next two year period. The umbrella grant agreement is an important step in establishing a sustained effort for the undertaking of a large number of investment activities which will phaseout ozone depleting substances (ODS).

The establishment of this umbrella grant agreement also provides us with additional opportunities to streamline the project approval procedure for those projects under US\$500,000 for which special approval authority has been extended to the implementing agencies as per the decision of Second Meeting of the Parties taken while establishing the financial mechanism. The Government of India is therefore requesting, through the World Bank, the support of the Multilateral Fund Executive Committee for establishment of this mechanism (referred to as the Small Project Approval Procedure (SPAP)) as outlined in the attached Technical Annex. The Government of India, in association with the Bank, has determined that this mechanism should, for the immediate future and subject to review, be utilized to fund projects which meet cost effectiveness criteria outlined below, and which are consistent with the Country Program and achievable ODS phaseout priorities.

Cost-Effectiveness Criteria

The overall strategy for implementation of the SPAP is to establish a merit order of attack, on a sector by sector (or

that this advance will be channeled through the umbrella grant agreement being prepared and that no additional legal instrument is required to make it effective.

With the successful establishment of this mechanism we anticipate that an increased interest will be expressed by the eligible enterprises and an acceleration of ODS phaseout efforts should ensue.

With regards,

Yours sincerely,

Vinay Shankar

(Vinay Shankar)

Mr. H. Vergin,
Director
India Country Division
The World Bank
1818 H Street N.W.
Washington D.C.
USA

**IMPLEMENTATION STRATEGY FOR THE PREPARATION AND
PROCESSING OF SMALL MONTREAL PROTOCOL INVESTMENT
OPERATIONS THROUGH AN UMBRELLA GRANT AGREEMENT IN
INDIA**

**Technical Annex to
Letter of Implementation Strategy**

1. INTRODUCTION

This annex to the Letter of Implementation Strategy for projects under US\$500,000 provides the basis upon which cost-effectiveness boundaries were established for piloting the Small Project Approval Procedure (SPAP) in India.

2. BACKGROUND

The Parties to the Montreal Protocol have granted the implementing agencies of the Multilateral Fund the authority to approve projects whose total incremental cost is less than US\$500,000. However, this mechanism has not yet been put in place. Consequently, implementing agencies have had to use the same resources as those employed on large projects to secure funding and approval of the numerous small projects with total incremental cost of less than US\$500,000.

As the phaseout of ODS becomes more complete with implementation of large readily identified projects, and the information dissemination efforts reach the smaller end-users, phaseout activities will increasingly focus on smaller projects, many of which will be in the small scale industries and unorganized sectors. A mechanism is needed to permit processing such projects without draining available technical resources and extending the ODS phaseout. This annex supports the efforts to prepare a framework (hereafter referred to as the Small Project Approval Procedure (SPAP) within which small World Bank Montreal Protocol investment projects in developing countries would be implemented and supervised through "umbrella type" grant agreements designed to expedite the approval process without compromising built-in safeguards designed to assure that only cost-effective projects are funded.

3. SECTORAL PRIORITIES

A primary goal of all projects will be to facilitate a prompt and timely conversion to non-ODS technologies prior to the development of shortages in ODS supplies and/or obsolescence resulting from adoption of the new technologies by major manufacturers. In this regard, the SPAP is to be managed as a facilitative mechanism, primarily for small scale industries which choose to adopt non-ODS technologies and procedures. However, it is not intended to exclude projects from consideration, nor be a requirement for smaller projects. All ODS reduction projects which are eligible for funding through the Multilateral Fund will be considered and those which fulfill SPAP criteria will be processed through the SPAP and the balance will be processed through the Multilateral Fund Executive Committee.

Within the SPAP, selection criteria will favor those projects which are most cost effective, are replicates of MPEC approved projects, and have no outstanding policy issues. The aerosol and foam sectors contain most such projects. Projects in the small scale and unorganized sector which require technical and financial support to survive the transition to non-ODS technologies will receive priority, provided they meet cost-effectiveness guidelines

and have no outstanding policy issues. These projects are likely to be found in all sectors. Projects with strategic implications that have long term potential for ODS savings but require lead-time for implementation will be evaluated on a case by case basis, as per normal procedure and may be included in the SPAP test program if they meet other criteria.

4. COST-EFFECTIVENESS COMPARISONS

An approval criteria for all projects will be the agreed cost-effectiveness guidelines presented in this annex. In this regard, only projects which exhibit Unit Abatement Costs (UAC) below the guideline for the sector will be approved under the SPAP. Projects with characteristics which cause the UAC to exceed the guideline will be processed through the Bank and the Multilateral Fund as per the current procedure.

The approval criteria were based on a sample of 121 foam, aerosol, and refrigeration projects recently approved by MPEC and/or under development in India. These projects were analyzed to identify trends and comparisons of Unit Abatement Cost (UAC) as a function of sector and ODP savings. Figures 1, 2, and 3 graphically illustrate these comparisons and show a strong correlation between UAC (an indicator of cost effectiveness) and ODP savings (a function of installed capacity). Of the 55 foam sector projects included in the analysis, 11 are from India, 8 are approved and 3 are included the work program. While 2 of the India-foam projects are more than one standard deviation above the calculated mean, the probability that the remaining projects are from a different population is quite low. A preliminary conclusion is that foam projects for India can be judged by the same cost effectiveness standards used in other developing countries. Data was judged to be insufficient to obtain significant relationships for solvent sector projects at this time.

The most striking observation from Figures 1-3 was the strong correlation of UAC and ODP impact. In the case of foam projects, the UAC varied inversely with the ratio of ODPs to the 0.7 power, while for aerosols, the factor was 0.65, and for refrigeration, the factor was 0.52. A simplified correlation commonly used for project cost estimates is that total investment varies with the ratio of capacities to the 0.6 power. If UAC were to be converted to total capital investment, a similar observation would develop.

Another observation is that the cost of the first ton of ODP to be phased out is about \$33,000 for aerosol projects, \$140,000 for foam projects, and \$260,000 for refrigeration projects. The burden imposed on small projects by this "entry level" cost penalty distorts the use of UAC as a tool to evaluate cost effectiveness of such projects. This phenomena should be analyzed during the test period for the SPAP as it may exclude many otherwise eligible small projects.

Although a strong UAC:Capacity relationship together with an "entry level" cost exists for all projects, there is also a need for simplicity in comparing projects. On balance, a decision was taken to set common UAC criteria for each sector. This decision gave precedence to a desire to attract a significant number of projects for consideration under the

SPAP while sustaining the integrity of the procedure. These criteria, also termed cost-effectiveness boundaries, were selected to consider 50-75 % of the projects as eligible for inclusion in the test of the SPAP. The following table illustrates the percentage of the total number of projects included in the data base for this study which could be processed through the SPAP provided they meet other selection criteria.

Aerosols		Foam		Refrigeration	
UAC	% included	UAC	% included	UAC	% included
3.5	95	6.0	95	10.0	85
3.0	87	4.0	91	7.0	72
2.5	78	3.5	87	6.0	65
2.0	72	3.0	60	5.0	57
1.5	46	2.0	30	3.0	26

The cost-effectiveness boundaries proposed for testing the SPAP should provide a reasonable overview of projects under preparation and expedite approval of a significant percentage of the total projects under preparation at this time. The proposed boundaries are as follows:

- Aerosol Sector - the UAC will not exceed \$2 per kg.
- Foam Sector - the UAC will not exceed \$3 per kg.
- Refrigeration and Solvent Sectors - the UAC will not exceed \$5 per kg.

The above criteria are subject to review and/or modification following completion of the test period for the SPAP. From the above table, it is clear that several projects will not fit these criteria. Such projects, however, would be processed using normal project procedures. The SPAP mechanism is therefore established without prejudice to such projects.

5. THE INDIA CONTEXT

Other than India's interest in protection for the small ODS user, ODS use patterns do not appear to be unique to India. Phaseout plans, however, are influenced by the fact that large producers of ODS in India will alter their operations to adjust to the declining demand for ODS such as CFC11 and CFC12 while preparing to phase in the use of nonODS alternatives such as HFC134a. In India, this changeover is to be partially offset by emphasis on the use of HCFC22 as a substitute for CFC12. As a consequence, India will likely

experience significant fluctuations in the supply and demand for ODS materials at a time when many projects are in an implementation stage. This uncertainty could distort the phaseout period by creating confusion on the part of ODS consumers, particularly the small user with limited financial resources. For instance, it is conceivable that if a temporary CFC shortage could develop during which prices would escalate rapidly. As a consequence, a small ODS user might be forced to shutdown before receiving the needed guidance, materials, and financial support to make a transition to nonODS. A facilitative procedure, such as the SPAP, will mitigate this problem by timely provision of technical assistance and capital resources for accomplishing the ODS phaseout in small industries.

a. ODS CONSUMPTION IN INDIA

India prepared a Country Program for phaseout of ODS in September 1993. On the basis of producers data included in the Country Program, India produces 85% of its domestic ODS requirements and imports the remainder. In terms of ODP, 70% is produced domestically and 30% is imported, mostly as H1211 and H1301. Total consumption was estimated to be 13,122 tons ODP in 1991. Growth rates are expected to reach 20% in the next few years as trade is liberalized and financial reforms are instituted. Such growth will directly affect future consumption of ODS.

b. TECHNOLOGY REQUIREMENTS

India has a large indigenous resource of technology and technical experts which could be applied to meet the technical needs of small industries. The technology gap which does exist is in large scale industries where world-class new technologies are emerging for domestic refrigerator foams and refrigerants and for production of nonODS alternative chemicals. The problem for smaller industries, however, is acquiring the guidance needed to apply proven cost effective nonODS techniques to their local needs. In such cases, small industries must rely heavily prompt and effective use of direct technical assistance by experts.

Table 1

INDIA ODS CONSUMPTION - 1991

(metric tons)	Domestic Production	Imports	Exports	ODS Consumed	% of Total ODS	ODP Consumed	% of Total ODP
CFC-11	1450	510	60	1900	18.3	1900	14.5
CFC-12	3280	0	430	2850	27.5	2850	21.7
CFC-113	40	280	0	320	3.1	256	2.0
H-1211	50	500	0	550	5.3	1650	12.6
H-1301	0	200	0	200	1.9	2000	15.2
Carbon Tet (Solvent)	3920	80	0	4000	38.6	4400	33.5
Methyl Chloroform	540	10	0	550	5.3	66	0.5
Total	9289	1580	490	10370	100.0	13122	100.0

Table 2

INDIA ODS CONSUMPTION BY INDUSTRY SECTOR - 1991

SECTOR	ODS	% of Total ODS	ODP	% of Total ODP
Refrigeration & Air Conditioning	1990	19.2	1990	15.2
Foams (inc Dom. Refrig.)	1580	15.2	1576	12.0
Solvents	4950	47.8	4806	36.6
Aerosols	1100	10.6	1100	8.4
Fire Extinguishing	750	7.2	3650	27.8
Total	10370	100.0	13122	100.0

Annex A

PARAMETERS WITH IMPACT ON COST EFFECTIVENESS

Cost-effectiveness is defined as the degree to which a given project can accomplish a full ODS phaseout at a cost comparable to similar projects elsewhere. The measure of cost effectiveness used in this report is Unit Abatement Cost as defined in the formula:¹

$$UAC = [CC \times CRF + (OC-OS)] / [M \times ODP]$$

where:

- UAC = Unit Abatement Cost
- CC = Incremental Capital Cost
- CRF = Capital Recovery Factor (over economic life of project)
- OC = Incremental Annual Operating Cost
- OS = Incremental Annual Operating Savings
- M = Annual Quantity of ODS (not used as a result of project)
- ODP = Ozone Depletion Potential of ODS

Key parameters affecting the determination of UAC are the project cost estimates for incremental capital and operating costs. Capital cost estimates typically have a range of plus or minus 10 percent for conventional activities, and up to 25 percent for projects employing newer technologies. Incremental operating cost estimates should reflect current established prices and consumptions of materials, however, there is often a wide variance in the perception of "current" and "established".

A parameter with direct impact on UAC is the estimate of ODS reduction. Under current guidelines, only current usage of ODS is considered to be the impact of a project for UAC determination, even though the project may not be implemented for 2-3 years. ODS use on the other hand is a direct function of plant capacity and capacity utilization which in turn is primarily market driven within the limits of mechanical and operational capabilities. Since UAC's are to be indicative of cost effectiveness, the ODS impact should be representative of a project's actual impact on ODS usage. Current usage is not necessarily indicative of ODSs impact, particularly in cases where there are distortions such as labor strife, major equipment failure, and other incidents beyond the direct control of project and its management. ODS impact determinations may be difficult for small scale industries where supply and demand are seldom in balance, consequently special allowances may be needed to equitably consider cost effectiveness on small projects.

