ANNEX VI

REPORT OF THE FIRST MEETING OF THE EXPERT GROUP ON THE PRODUCTION OF SUBSTITUTES FOR OZONE-DEPLETING SUBSTANCES

The Executive Committee welcomed the report of the first meeting of the expert group on the production of substitutes for ozone-depleting substances (UNEP/OzL.Pro/ExCom/18/71). While noting that considerable progress had been made in identifying issues relevant to the shutdown and/or conversion of ODS production capacity in Article 5 countries, the Executive Committee agreed that further study was necessary.

The Executive Committee reviewed the recommendations of the expert group and concluded as follows;

Recommendation 1: **The expert group recommended adopting the sectoral approach in implementing the phase-out in the ODS production sector.**

The Executive Committee noted the following suggestion:

For the Executive Committee to request each Article 5 country producing ODS to submit for approval a plan showing how phase-out would be achieved in each sector. After the plan had been approved, projects to phase out production could then be submitted requesting either a lump-sum for an entire sector, or funding for individual plants or groups of plants. Projects for individual plants or groups of plants would be considered only where they clearly formed part of the approved plan. Prior to plans being approved, production sector projects could be submitted and the Executive Committee would consider them according to guidelines to be agreed at the 19th meeting. Under this proposal, when considering production phaseout plans, the Executive Committee would seek to ensure that sufficient production capacity remains to meet the needs of non-producing Article 5 Parties.

The expert group is asked to consider:

(i) The date by which production sector phaseout plans could be prepared by each Article 5 producing country and what information such plans should contain.

(ii) What criteria the Executive Committee might adopt in the short term to evaluate production sector projects in the absence of approved sectoral plans.

(iii) How sufficient quantity and quality of supplies to Article 5 countries could be maintained during production sector phaseout.

Recommendation 2:**The Expert Group recommended that technical audits of the ODS production sector be carried out on a country basis.**

The Executive Committee noted the suggestion that technical audits would be required to help Article 5 Parties prepare sectoral phaseout plans and to help the Executive Committee calculate the future requirements for Multilateral Fund resources for the production sector. Audits should establish production capacity and production level at a given date and advise on options for cost-effective phaseout. The Expert group is asked to review the terms of reference in the light of this suggestion and to advise on how to proceed if essential information is withheld by companies on the grounds of commercial confidentiality.

Recommendation 3: **The Expert Group also recommended that the ODS phase out capacity to be considered in the calculation of eligible financing by the Fund should be based on the actual production of the country in 1995 and be adjusted against 1996 and 1997 data once they become available.**

The Executive Committee noted that consistency with the Indicative List of Eligible Incremental Costs would usually require funding to be calculated using as a basis the production capacity, not on the production level at any particular time. It also noted possible difficulties associated with measuring production capacity, and the suggestion that there should be an assessment by an objective and independent expert observer for a given date according to modalities to be determined, preferably as part of the technical audit.

The Expert group is asked to advise on how production capacity might be measured in a consistent and objective manner in order to assess eligible financing. It is also asked to prepare estimates to illustrate the potential difference to the Multilateral Fund of compensating for actual production rather than for production capacity.

Recommendation 4: **The ODS substitutes producing technologies were available for transfer to Article 5 countries at commercial terms. The terms of such transfer should be left to enterprises engaged in such business. The liability of the Fund should be limited to one technology transfer fee per substitute substance per country.**

The Executive Committee noted decision 17/4 and the possibility that this decision should apply to technology transfer in the production sector. As it was unclear how the terms of transfer could be left to the enterprises themselves in the context of sectoral plans and the aim of achieving a single deal for a complete sector, presumably with Government coordination. The Expert Group is requested to provide further clarification.

Recommendation 5: **Development of indigenous technologies by Article 5 countries should be supported by the Multilateral Fund provided it was the preferred choice of the Government concerned over imported technology for the relevant substitute. Technologies developed through such support should be made available to the other Article 5 producing countries at no cost.**

The Executive Committee noted the suggestion that a producing country might request funds to develop indigenous technology or funds for technology transfer, but not both and that funds for developing indigenous technology would be no greater than those provided for transferring that same technology. Concern was expressed that companies which accepted the risk of developing indigenous technology should then be expected to provide this free of charge to other Article 5 Parties. The Expert Group is asked to clarify this recommendation.

Recommendation 6: **The Expert Group recommended that the Fund should not finance the feedstock production and the costs of raw material should be considered in the calculation of incremental operating costs.**

The Executive Committee noted that, in the case of plants which were functionally or geographically linked, it might be more cost-effective for the Fund to finance the feedstock conversion rather than pay the incremental operating costs of the downstream user. The Expert Group is asked to consider this possibility and advise accordingly.

Recommendation 7: **Under the shut-down of ODS producing facilities, the Expert Group recommended that eligible incremental costs should include lost profit and the rehabilitation of displaced labour. Cost of demolition should be offset by the scrap value of the old plant.**

The Executive Committee recognised the urgent need to prepare a list of eligible incremental costs for production phaseout. The Expert group is asked to develop guidelines on eligible costs, and in so doing to consider;

(i) Whether any costs are likely to be incurred for environmental clean up following demolition and whether these costs could also be offset against scrap value.

(ii) How lost profit can be calculated without including subjective assumptions about what levels of profit ought to be.

(iii) Considering the Indicative List of Incremental Costs, whether other eligible incremental costs might need to be considered and how they might be calculated.

The Expert Group, in conjunction with the Secretariat, is asked to undertake further study of these issues, together with the issues identified in paragraphs 1, 3, 4 and 5 of the section "Issues to be Studied" of its report. The Executive Committee, requests that this information be made available at its 19th meeting, together with advice on:

(a) How any net incremental benefits from production phaseout might be identified.

(b) How the calculation of incremental costs should address any technology upgrade resulting from a project where lower quality products are replaced by those of higher quality