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EXECUTIVE COMMITTEE OF
THE MULTILATERAL FUND FOR THE
IMPLEMENTATION OF THE MONTREAL PROTOCOL
Twenty-fifth Meeting
Montreal, 29-31 July 1998

TERMINAL UMBRELLA PROJECTS

Introduction

1. In Decision 24/22 the Executive Committee requested the Secretariat and the implementing agencies to meet, as a matter of priority, in the period prior to the 25th meeting of the Committee in order to examine the issues raised by terminal umbrella projects in light of the deliberations at the 24th meeting. In particular, that meeting would need to examine a possible new methodology to be applied to such projects in order to obtain a satisfactory level of information about enterprises on which to base funding decisions and the necessary safeguards that should be put in place to ensure phase-out. It should submit, to the next meeting of the Committee, a paper on the problems faced and possible solutions to expedite the approval of such projects.

Scope of paper

2. Previous considerations and decisions on umbrella projects, sectoral strategies and SMEs, are examined to illustrate the various modalities either available or under development to formulate and deliver projects involving conversion of more than one enterprise.

3. Statistics on umbrella or terminal umbrella projects already approved by the Executive Committee are examined and conclusions drawn about the ability of these projects to be managed within existing rules and policies of the Multilateral Fund.

4. Modalities are examined which may provide a means of moving forward with projects involving much larger numbers of enterprises not suited to treatment as umbrella projects (whether terminal or otherwise).

5. While examples are given of projects in the foam and refrigeration sectors, the principles discussed apply equally to all sectors.

Previous considerations relating to umbrella projects

6. At the 19th meeting the Executive Committee approved guidelines for terminal umbrella projects. The papers considered by the Executive Committee and which gave rise to these guidelines indicated that umbrella projects were being addressed in the following context:

- they combined investment projects for several enterprises in a single sector or sub-sector
- they would target a group of large or medium sized enterprises in a sector or sub-sector using similar technology
- they were not designed to address the needs of SMEs or LVCs, (which were being provided for by other mechanisms)
- they represented the completion of a sectoral phase-out programme
- they enabled more cost-effective and efficient preparation of projects
- that assessment of enterprise proposals within an umbrella project on an individual basis has significant advantages in relation to reviewing and confirming the

eligibility of proposed incremental costs and would maintain the Executive Committee's current level of scrutiny and review of eligibility and other criteria.

7. The guidelines, approved in Decision 19/32, indicate that terminal umbrella projects will be eligible for funding if:

- the umbrella project included all the remaining enterprises in a sector or subsector for which cost-effectiveness thresholds had been established by the Executive Committee;
- the country concerned would submit no further requests for funding from the Multilateral Fund for any enterprise in that sector or subsector;
- the overall cost-effectiveness of the umbrella project fell within the sectoral threshold established by the Executive Committee;
- no individual enterprise proposal had a cost-effectiveness threshold more than 100 per cent above the established threshold.

8. In the same decision, the Executive Committee requested the Secretariat and the implementing agencies to discuss further the question of the percentage of a country's original level of consumption for the sector or subsector accounted for by the enterprises included in the umbrella project and, in the light of the comments made and the experience gained, to report to the Executive Committee at its 20th Meeting.

9. The paper presented to the 20th Meeting proposed that countries whose remaining level of consumption were approaching that of a low consuming country should be encouraged to submit umbrella projects for the remaining enterprises in each sector. The cost-effectiveness threshold of each umbrella project should be at or below that established for the sector/sub-sector. However, individual sub-projects in the umbrella should be allowed to exceed the cost-effectiveness threshold, without an upper limit. Such countries should commit not to request Fund assistance to phase out up to 360 tonnes.

10. Further it was proposed that countries whose remaining level of consumption exceeds 5,000 tonnes should be encouraged to list the remaining sectoral enterprises in groups, each group should include like enterprises, i.e., enterprises with similar consumption and technologies. To enable the Executive Committee to decide the remaining consumption per sector or sub-sector in order for such countries to benefit from Decision 19/32, the following information should be provided:

- establish the remaining consumption per sector;
- provide a list of the remaining enterprises in each sector or sub-sector;
- list enterprises according to their consumption in groups; and
- state the country's priority on which group of enterprises should have first call on the Fund.

11. Subsequently at the 20th Meeting the Committee decided, *inter alia,* that:

- for the purposes of Decision 19/32, a maximum limit of US $4 million would apply to terminal umbrella projects;
- the issue should remain open for further discussion and should be reconsidered prior to the end of the 18-month period (such reconsideration has not yet occurred).

Sectoral phase-out strategies

12. Sectoral phase-out strategies were considered at the 21st, 22nd and 23rd Meetings, together with consideration of a specific strategy for the halon sector in China. In Decision 22/75 the Committee decided, *inter alia* that the concerned Article-5 country may select a sector, project by project, or any other approach agreeable to the Executive Committee for accessing the Multilateral Fund. Relevant basic elements of a sectoral strategy are:

- incremental costs of investment projects and other activities needed to complete phase-out in the sector are assessed and reviewed
- performance criteria for phase-out at the country level are established
- funding subsequently approved by the Executive Committee is disbursed to the country as the performance criteria are achieved, in accordance with the schedule in the strategy.

13. The current limit of US $4 million illustrates a key difference between a terminal umbrella project and a sectoral strategy. The terminal umbrella project is applicable to a relatively small number of individually specified and reviewed projects, while the sectoral strategy may consist of larger, possibly indeterminate numbers of sub-projects or enterprises, the specific phase-out of which may not be monitored individually by the Executive Committee during project implementation.

Small and medium-sized enterprises

14. SMEs were considered by the Executive Committee at the 19th, 20th and 22nd meetings with a view to taking specific actions to facilitate phase-out. As indicated in its decision taken at the 20th Meeting, these specific actions include the possibility of a funding window with appropriate cost-effectiveness thresholds.

15. The paper prepared for the 20th Meeting noted that medium sized manufacturing facilities should be encouraged to compete with projects from other countries under the current cost-effectiveness threshold, while the small operators in low-consuming countries should be grouped and financed under the special allocation for LVCs.

16. For countries close to completing their ODS phase-out, either fully, or for a complete sector, the same paper noted that residual sector consumption could be grouped in one project and approved under the umbrella project concept with the commitment that this is the completion of the sector, or national phase-out programme as appropriate. Alternatively a sector phase-out approach could be adopted which represented a package deal consideration.

Relationship between umbrella projects and other modalities

17. The above background information, drawn from papers to, and decisions of, the Executive Committee defines the relationship between umbrella projects (whether terminal or otherwise) and other modalities for project development, and hence the boundary conditions which define umbrella projects. These are illustrated in Table 1 below:

Table 1

Project modality	Enterprises	Review and approval	Funding
Project by project approach	Only one enterprise	Individually reviewed individually approved.	C/E thresholds apply
Umbrella project	Several similar enterprises in a subsector are covered.	Enterprise proposals individually reviewed. Umbrella approved.	C/E thresholds apply to each enterprise - and thus to the group.
Terminal umbrella project	All remaining enterprises in a sub-sector are covered	Enterprise proposals individually reviewed. Umbrella approved.	C/E thresholds apply to the group, 100% concession to individual enterprises. US $4 million limit applies. Completion of funding for sector.
Small and Medium-sized Enterprises	Not yet decided	Not yet decided.	Possibility of a funding window with appropriate C/E thresholds.
Sector strategy	Includes most of sector and all remaining enterprises	Overall strategy reviewed and approved. No review of individual enterprises. Performance agreement with government.	Funding determined as part of a package deal. Completion of funding for sector. Funding in tranches.
Note: Where the enterprises involved are in LVCs **cost-effectiveness threshold limits are not applied.**			

18. The Secretariat's statistics indicate that a total of 48 projects so far approved by the Executive Committee have included more than one enterprise and can therefore be categorised as umbrella projects. The number of enterprises involved ranges from two to 26, with two exceptional foam projects involving 60 enterprises (in Indonesia) and 80 enterprises (in India). The average number of enterprises involved is 10, or 7 if the two very large projects are excluded from the average. Of the 48 umbrella projects approved, 3 are terminal projects in terms of Decision 19/32. In each case the implementing agency which prepared the project was able to

provide sufficient data of the necessary quality for the Executive Committee to approve the project on the basis of the current rules and policies of the Multilateral Fund. Implementing agencies have indicated that this is likely to continue to be the case in the future. UNDP and UNIDO consider that the logistical problems associated with implementation of umbrella projects become complex and challenging as the number of enterprises increases. The two agencies do not intend to continue preparing very large umbrella projects.

The Issue

19. The issue giving rise to this paper is that proposals have now arisen for much larger numbers of enterprises to be included in umbrella projects. For example, at the 24th Meeting, the World Bank introduced a proposal for an umbrella project in Thailand for 225 enterprises, and a proposal in Turkey possibly involving up to 2000 enterprises has been foreshadowed. Such projects present additional and different challenges.

20. Specifically, enterprises are likely to have very low consumption, which may be difficult to substantiate; production may be seasonal; the enterprises' business may be dominated by servicing rather than equipment manufacture and/or enterprises may be in the informal sector.

21. Where the numbers of enterprises involved is sufficiently large, definition of the project can become unclear. It can become difficult or impractical to confirm the status of the enterprises, their consumption, their baseline conditions, the date of installation of equipment. Additionally, implementation of such projects can become problematical, for example through difficulties in convincing all enterprises to accept similar equipment from the same supplier and difficulties in verifying equipment destruction. For these reasons, such large groups of enterprises may not be suited to the umbrella modality, whether terminal or otherwise.

22. Additionally, where the project may represent a large proportion of a sector, its consideration as a terminal umbrella project is not appropriate as such projects were envisaged as providing cost-effectiveness concessions to a small number of enterprises representing the completion of a sector after the majority of the sector had been converted through the normal project-by-project approach.

23. UNDP and UNIDO have indicated that management of umbrella projects with large numbers of enterprises (for example, over 50) becomes difficult: these agencies would not propose further use of such a modality even if available. The World Bank indicated it had no such difficulty with its mode of implementation.

Profile of remaining consumption in a sector

24. Examination of the progress of phase-out in the most common sectors (for example foam and refrigeration) reveals a frequent pattern. Projects in larger enterprises are developed first. Projects for conversion of most of the large enterprises in most larger-consuming countries have now been approved. Projects in medium-sized enterprises follow and take on a common format permitting straightforward project preparation. Some smaller enterprises may be included if the

opportunity arises. As the numbers of medium-sized enterprises decrease, attention is turned to the smaller scale enterprises. It appears that this stage is now being reached in many countries.

25. Some countries may have relatively few very small or informal enterprises remaining is a sector, such as the foam sector in Egypt, where sectoral phase-out was achieved with a conventional terminal umbrella project. Other countries may have a substantial informal sector. The Executive Committee has not yet been presented with a proposal for a sectoral phase-out in a sector in a country with many informal enterprises. The proposal for 225 enterprises in the commercial refrigeration sector in Thailand, first submitted to the 24th meeting, is the closest example. While not informal, the enterprises in Thailand are very small and their status as manufacturers (as opposed to service shops) appears difficult to corroborate.

26. The nature of the remaining consumption in the sector and the national industrial strategy of the country concerned are the key indicators of the optimum modality for addressing phase-out in the sector.

Phase-out of remaining sectoral consumption

27. Where there are many enterprises remaining to be converted, the sector should be examined to gain an understanding of its composition; the broad numbers of enterprises remaining, their size, level of technological complexity and relevance to meeting the various Montreal Protocol control measures.

One-step approach

28. If a country wishes to address all the remaining consumption in a sector with one project, and:

(a) the remaining enterprises are too numerous to be included in a terminal umbrella project of the type approved in accordance with Decision 19/32;

(b) they cannot be readily identified and scrutinized, or;

(c) there are significant issues in determining the size of the sector and capacity of the enterprises involved;

then in these circumstances the appropriate modality would be a sectoral strategy covering the remaining consumption in the sector.

29. It is important to bear in mind that a sectoral strategy approach is fundamentally different to an umbrella project. In particular, the Government enters into a performance agreement with the Executive Committee and is responsible directly for achievement of the phase-out and disbursement of the funds according to the strategy. Institutional measures including appropriate policy or regulatory measures will inevitably play a major role.

30. By contrast a terminal umbrella project is still prepared, reviewed and implemented on a project by project basis. The phase-out is technology driven, although there may be regulatory measures in place to ensure sustainability (i.e. by prohibiting continued production of CFC products after the conversion of each enterprise has been completed). There is no performance agreement with the government to guarantee phase-out, other than an undertaking not to seek additional funding for the sector.

Multi-step approach

31. In an approach which is not sectoral and does not involve a performance agreement with a government, there is a need for caution regarding potential reduction in the level of oversight available to the Executive Committee. In particular, modalities involving large numbers of projects grouped together, with little corroborated data available at the enterprise level, could potentially change the Executive Committee's scrutiny and review process from one based on examination of individual projects and incremental costs to one restricted to an overview of the project objectives and proposed expenditure.

32. Enterprises which exist in the formal sector, which are permanently in production (not part-time or seasonal, or not mainly concerned with servicing of existing equipment) and which have easily verifiable consumption, could be grouped together in a number of separate, manageable umbrella projects.

33. Each umbrella project would contain enterprises of similar size, engaged in similar production activities using similar technologies, which required a common approach to the conversion task. The umbrella projects could contain a total number of enterprises of the same order as those so far approved by the Executive Committee (that is up to, say, 50 enterprises). Full information and documentation would be provided for each enterprise in an umbrella project and would be subjected to individual review and evaluation as is presently the case. No new modalities will be required as existing rules and policies would be used to move these projects forward expeditiously in the same way as umbrella projects are presently presented.

34. Where very small enterprises or informal enterprises did not exist or were not numerous, the last of the umbrella projects could be brought forward as a terminal umbrella project under the terms of Decision 19/32, thus completing the conversion activity in that sector in the country.

35. However the remaining consumption in a sector could be due to very small enterprises, informal enterprises, enterprises which engage in production only on a part-time or seasonal basis, or enterprises which are engaged mainly in servicing, with equipment production as an adjunct to other activities. These enterprises will not be suited to an enterprise-by-enterprise or terminal umbrella approach, because:

(a) their equipment requirements are likely to be minimal, for example;

(i) for a builder of commercial refrigerators in very low numbers, equipment may be limited to a vacuum pump, and a device to charge the new refrigerant (in some projects already approved, no equipment was requested for producing the foam insulation);

(ii) certain umbrella foam projects already approved have been based on technical assistance with no significant equipment component;

(b) their consumption is very difficult to verify (for instance because they may use CFCs for both manufacture and servicing);

(c) their production level may be variable and difficult to quantify;

(d) technology transfer is impractical and prohibitively costly on the conventional project by project basis (for example when provided by an international expert visiting every enterprise), and;

(e) institutional measures at the government, industry, and supplier level will be essential to make the project implementable and the ODS phase-out sustainable.

36. A possible approach for the remaining small enterprises is outlined below. It could be used either on its own or in conjunction with the proposed SME "funding window" in due course, or any other modality the Executive Committee may decide upon.

Addressing the remaining small enterprises

37. A project proposal involving the remaining small enterprises in a sector would need to be based on one or more of initiatives such as: institutional support through government policy directives or legislation; coordination and management by ozone offices and/or financial intermediaries; technology transfer, monitoring and supervision from industry associations and/or component suppliers and systems houses Implementing agencies would need to work with Article-5 countries to present phase-out proposals which could include the appropriate choice of technology, innovative methodologies for achieving technology transfer; achieving economies of scale through geographical groupings, financial arrangements which could provide flexibility in the allocation of approved resources and other such initiatives.

38. Since the residual ODS consumption will generally be difficult to verify for these enterprises, a mechanism for determining the eligible incremental cost is needed which does not rely only on knowledge of the level of ODS consumption. One option for achieving this would be as follows:

(a) cost the basic capital equipment by establishing the typical equipment requirements for an enterprise representative of those remaining in the sector (equipment requirements will be modest and will generally be similar), and the number of enterprises involved;

(b) cost the technology transfer, trials and support activities on the basis of the activities being provided by local technical resources at local rates (where established as essential, with provision of international support on start-up to train the trainers, and on completion to verify phase-out);

(i) the institutional support proposed to be included in a project would enable the delivery of technology transfer and associated trials and setting-up activities at costs which are paid in local currencies, with substantial savings compared to the estimates currently being approved on a project by project basis (for instance, although larger than the enterprises being addressed in this new modality, commercial refrigeration enterprises producing some 3000 units per year have had technology transfer and trials approved at US $30,000 per enterprise, which would buy weeks or months of expert technical support charged at local rates);

(ii) the level of in-country expertise is steadily growing as the number of larger enterprises and component manufacturers converted with Fund resources increases: component suppliers have a direct interest in small enterprises being converted and thus using their new products;

(c) do not include incremental operating costs or savings in project costs;

(i) The level of IOC or savings, where eligible, are likely to be small, since consumption per enterprise is low. The actual level of costs payable or savings deductible has consistently been difficult to determine and sometimes contentious as the precise level of production of each enterprise is difficult to quantify and costs cannot be fully corroborated. Enterprises will usually receive some form of unavoidable technological upgrade (also difficult to quantify) with the conversion. For these reasons it is proposed that for any new approach to address the remaining consumption in a sector, incremental operating costs (or savings) not be included in determination of the eligible compensation.

39. On the above basis, it could be expected that overall costs for the phase out of residual consumption in a sector would be comparable with the level of compensation currently available under existing cost-effectiveness thresholds. Therefore the provision of compensation for the basic incremental capital equipment eligible for funding, and for the funding for locally provided technology transfer and local institutional support, would represent an effective outcome for the country and a reasonable, equitable estimation of the incremental costs payable under the rules and policies of the Multilateral Fund.

<u>Safeguards to ensure phase-out in the remaining small enterprises</u>

40. As part of the project preparation process, it should be established that the economic, regulatory or other industry structures needed to ensure viability of the phase-out are planned and

that there is a commitment for them to be in place at the appropriate time during project implementation.

41. Measures additional to those taken in individual projects may need to be established and should be explicitly described in the project document. They could include:

(a) role of the government and ozone unit, including regulatory and policy support measures;

(b) enhanced role of the financial intermediary;

(c) role of suppliers such as compressor manufacturers, foam system houses and large enterprises already equipped with new technology with assistance from the Fund;

(d) role of professional/technical/ industry groups or unions;

(e) enhanced final reports;

(f) provision of intermediate reports;

(g) disbursement of funding in tranches.

Conclusions

42. Based on previous decisions of the Executive Committee, various modalities for developing projects involving more than one enterprise are already in use or are planned (umbrella projects, terminal umbrella projects, measures for SMEs, sectoral strategies, measures for LVCs). Umbrella projects have been routinely developed and approved under existing approval modalities.

43. Where the number of enterprises is large (over 50) and their status is uncertain, umbrella projects are not an appropriate methodology.

44. If a country wishes to approach the sectoral phase-out in a single step a sectoral strategy could be implemented, based on a performance agreement with the government concerned.

45. Where a country does not wish to implement a sectoral strategy, enterprises could be grouped in a series of separate umbrella projects. The final project could be submitted as a terminal umbrella project.

46. Where there are significant numbers of small or informal enterprises remaining, the final project should be developed using the following new approach designed to address the remaining small enterprises:

(a) Proposals should include:

(i) institutional support through government policy directives or legislation; coordination and management by ozone offices and/or financial intermediaries; technology transfer, monitoring and supervision from industry associations and/or component suppliers and systems houses;

(ii) the appropriate choice of technology, innovative methodologies for achieving technology transfer; achievement of economies of scale through geographical groupings; financial arrangements which could provide flexibility in the allocation of approved resources.

(b) The requirements for capital equipment should be determined by establishing the typical equipment needed for an enterprise representative of those remaining in the sector (equipment requirements will be modest and will generally be similar), and the number of enterprises involved.

(c) The technology transfer, trials and support activities will be costed on the basis of the activities being provided by local technical resources at local rates (where established as essential, with provision of international support on start-up to train the trainers, and on completion to verify phase-out).

(d) Incremental operating costs or savings will not be included in project costs.

Recommendation

47. The Executive Committee might consider adopting as a decision, the conclusions in the preceding paragraphs 43-46.