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EXECUTIVE COMMITTEE OF
THE MULTILATERAL FUND FOR THE
IMPLEMENTATION OF THE MONTREAL PROTOCOL
Seventy-ninth Meeting
Bangkok, 3-7 July 2017

REPORT OF THE SUB-GROUP ON THE PRODUCTION SECTOR

Introduction

1. The Sub-group on the Production Sector was reconstituted at the 78th meeting of the Executive Committee and met four times in the margins of the 79th meeting. The Sub-group considered the draft HCFC production sector guidelines, stage II of the HCFC production phase-out management plan (HPPMP) for China and UNIDO's request to carry out the technical audit of the HCFC production sector in the Democratic People's Republic of Korea. The Sub-group consisted of the representatives of Argentina, Australia, Austria, China, Germany, Lebanon, Mexico and the United States of America, with Australia acting as facilitator. Representatives of UNDP, UNIDO and the World Bank were also present as observers.

Agenda item 1: Adoption of the Agenda

2. The Sub-group adopted the provisional agenda contained in document UNEP/OzL.Pro/ExCom/79/SGP/1.

Agenda item 2: Organization of work

3. The Sub-group agreed to follow the organization of work proposed by the facilitator.

Agenda item 3: Draft HCFC production sector guidelines

4. The Sub-group had previously considered the HCFC production sector guidelines (UNEP/OzL.Pro/ExCom/79/SGP/2)on the margins of the, 64th, 65th, 68th, 69th, 70th, 71st, 76th and 77th meetings.

5. The facilitator reminded the Sub-group that only paragraphs (e) and (k) remained in square brackets and said that it might be useful to wait for the outcome of the discussions in the Executive Committee on how to address the issue of HFC-23 by-product before continuing the discussion of paragraph (k).

6. One member noted that paragraph (k) dealt only with swing-plants, and asked whether there remained any issues to be addressed by the provision. If not, then the paragraph could be deleted.

7. Another member said that, pursuant to paragraph 5 of decision XIX/6, and paragraph (e) of the draft guidelines, all lost profits had to be compensated, and that was an issue that was also being raised in the deliberations on the control of HFC-23 by-product. It was agreed to postpone further consideration of the guidelines pending the results of the discussions on HFC-23 by-product by the Executive Committee.

Agenda item 4: HCFC production phase-out management plan (HPPMP) (stage II) for China

8. At the invitation of the facilitator the representative of the World Bank made a presentation that highlighted the achievements in stage I of the HPPMP and reviewed the relationship between China's HCFC production quota system and the "production rights" that had been assigned to each producer for each controlled HCFC. He introduced the proposed production reduction schedule for stage II of the HPPMP, the method used by the World Bank for the calculation of the rates of lost profit and the rationale for the funding being requested.

9. He said that the HPPMP addressed those facilities that produced HCFCs for controlled use; it did not cover those facilities that only produced feedstock as these are outside of the scope of the Montreal Protocol. In addition to the five production lines shut down in 2015 four additional production lines with idle capacity had also been closed. In response to a query about the discrepancy of 15,000 metric tonnes of capacity for HCFC-22, he explained that the 2009 Nexant technical audit had assessed one facility as having only 15,000 metric tonnes of capacity although at that time the facility also had a permit to establish 30,000 metric tonnes of HCFC-22 capacity. Subsequently, the enterprise had built an additional 15,000 metric tonnes of capacity as permitted. It was the understanding of the World Bank that the additional capacity would only be used for feedstock production and so did not breach the agreed terms of the HPPMP.

10. One member said that such a situation could constitute redirection for feedstock use. He also said the deliberations on the treatment of idle capacity in the original agreement had been based on the figures provided in the Nexant technical audit which had not addressed the additional 15,000 metric tonnes of capacity at the enterprise in question. Those deliberations might have been different if the Executive Committee had known that the enterprise might increase its capacity. The member also said that the reason for the assumptions being used to calculate lost profits in the constrained market for HCFC-141b in China were unclear. That market was considered unconstrained when calculating lost profit originally. He expressed surprise that the level of production for feedstock use had not been higher.

11. The representative of the Secretariat introduced document UNEP/OzL.Pro/ExCom/79/SGP/3 which addressed stage II of the HPPMP for China. The phase-out strategy for production phase-out had been developed based on both HCFC consumption in China and HCFC consumption in Article 5 countries that imported HCFCs from China. She said that while consumption in Article 5 countries could be met by production from other countries, the HPPMP had been based, in part, on the consumption in those Article 5 countries that had historically imported HCFCs from China. While that situation could change it was impossible for the Secretariat to predict what might happen.

12. She said that based on the calculations provided by the World Bank, the level of lost profits for stage II of the HPPMP exceeded the remaining agreed eligible funding in the framework agreement. Therefore, the Secretariat had developed a model for four different funding scenarios to ensure that the level of funding remained within that agreed to under the framework agreement. The four scenarios resulted in annual funding, for the period 2017 to 2020, of between US $29.2 million and US $36 million. She also said that the two additional documents submitted by the World Bank, on the 2018 annual

implementation programme and on the responsibility of the project management unit in the implementation of the HPPMP, had been received too late for review by the Secretariat.

13. In response to a request for more information on the different scenarios, the representative of the Secretariat explained the methods used to establish the cost calculations, and said that unlike the first three scenarios, which calculated the funding for stage II of the HPPMP based on the remaining funding of US $290 million, the fourth scenario modelled the funding distribution for the entire HPPMP based on the total approved funding of US $385 million. She said under that scenario the amount calculated for stage I of the HPPMP had been higher than the actual amount approved. Adjusting the remaining funding by applying the approved amount of US $95 million for stage I in the HPPMP ensured that the total approved funding of US $385 million was unchanged, so that the annual tranche for 2017 to 2020 would be US $31.24 million under the fourth scenario.

14. The representative of the World Bank explained while its cost modelling had been similar to that used by the Secretariat, it had used an estimated lost profit as a basis for its calculation. However, the agreed funding did not cover all that lost profit and consequently the amount had been reduced pro rata to fit into the US $290 million envelope. He confirmed that the payments for the lost profits to enterprises were made in tranches, with first payment being made to the enterprise when it signed the agreement to close its ODS production lines and the final payment made once there had been an environmental and social safeguard assessment of the closure of the production lines that demonstrated compliance with the relevant national regulations. With respect to a query regarding the funding from stage I of the HPPMP that had not yet been disbursed, he said that US $19.8 remained, US $1.8 million was allocated for technical assistance activities while the remaining US $18 million had been committed for disbursement to the enterprises once they had demonstrated compliance with the environmental and social safeguards.

15. Concern was expressed at the level of funding being requested for stage II, which would amount to 92 per cent of the remaining funds while only addressing 72 per cent of the remaining phase-out of ODS. It was asked why the World Bank was using the current estimated lost profit to compensate for the whole period of stage II of the HPPMP when both the Secretariat and the World Bank expected that in the future estimated lost profits would be lower than that currently estimated.

16. The representative of the World Bank said that the Bank was first targeting HCFC-141b and HCFC-142b because of their higher ozone destruction-potential. The lost profit would be higher for those chemicals and consequently more funding was required earlier on in stage II of the HPPMP. There had been an increase in the demand for HCFC-141b between 2010 and 2013 but since then the demand had been stable, although no one could be sure of the effects on price of future demand. In addition to the costs of the chemicals being used, the World Bank had also taken an average of the costs of the power used, similar to those costs used under stage I of the HPPMP. He confirmed that the World Bank had not taken into consideration any subsidies for utilities that the enterprises might be receiving from local authorities. The representative of the World Bank explained that the estimated maintenance costs were similar to those of stage I of the HPPMP. The World Bank did not consider the maintenance costs of the whole facility but only those related to the production lines for which it assigned 10 per cent of the total capital investment for maintenance.

17. The representative of the Secretariat said that under its modelling, which had produced a similar result to that of the modelled by the World Bank, the entire lost profit for the period to 2030 had to be accounted for. Therefore the amounts awarded for those who closed their production lines early on, for example in 2018, would be more than for those who waited until later to close their production lines.

18. One member asked whether the method used by the Secretariat took into account the remaining lifetime of the facilities in question. In response, the representative of the Secretariat explained that in the third and fourth scenarios the modelling had increased the compensation by a factor of 3 per cent per year in order to allow for the prediction that the most profitable lines would close last. That adjustment also

had the effect of generally addressing the issue of maintenance costs. Another member suggested that the World Bank or the Secretariat could also develop a model that simply matched the level of funding to the phase-out schedule under the Montreal Protocol. It was also observed that the HPPMP would have an impact on the HPMP as quotas established for the both were closely related.

19. The representative of the Secretariat also explained, in relation to a query about two facilities without an HFC-23 by-product destruction facility, that one of the facilities collected the HFC-23 by-product and then sold it as feedstock in the production of other chemicals. The second facility had no plan for dealing with HFC-23 by-product destruction. Both facilities had produced HCFC-22 in 2010, and had done so in 2015 as well, for both controlled use and feedstock.

20. As the Secretariat had not had time to review the draft agreement, because it had submitted too late, it was presented as submitted. It was suggested that the it should be amended so that the management of HCFC production, and the associated by-product generation, was monitored and verified to ensure that it minimized the associated environmental and climate impacts. While the draft agreement should in principle follow the agreement for stage I of the HPPMP, it could incorporate any lessons that had been learned. However, another member said that the agreement had been the result of a compromise and expressed his concern at making any changes unrelated to the phase-out targets and the tranche distribution. He urged that the rest of the agreement not be reopened and explained that under the Chinese legal system it was not possible to compel Chinese enterprises to undertake additional activities that they had not agreed to and which were not required by law.

21. One member was asked whether some of proposed technical assistance activities would be the responsibility of the World Bank and what additional technical activities were also being planned. Clarification was also sought on responsibility for the annual financial audit.

22. The representative of the Secretariat explained that the technical assistance activities listed in the document were similar to those that had been undertaken regularly under stage I of the HPPMP. The Government of China had, however, also indicated that it would like to undertake additional technical assistance activities that were to be identified during implementation. The amount budgeted for those activities would be included in the tranche implementation plan and would then still need to be approved by the Executive Committee. She also explained that the annual financial audits were the responsibility of the Government of China and funding was provided by the Government for that purpose.

23. The representative of the World Bank further explained that there were in fact two audits: an annual financial audit of the funds disbursed to the Government of China from the World Bank, another audit of the funds that China received and disbursed to the enterprises.

24. Further clarification were also provided by the World Bank on: the methods used to ensure the final environmental and social safeguard assessments and actions, discrepancies in the import and export data, how to ensure that there were no deviations of production for feed stock use and how to address any new integrated plants.

25. Despite the effort by China to develop controls to ensure that there were no deviation of ODS from feedstock to controlled uses, such deviation was possible and it was asked what remedies China had instituted to address the issue. One member explained that as of 2015, Chinese regulations only allowed new production lines to be established in integrated facilities that produced HCFCs for feedstock use only. The central government inspected the activities of the provincial administrations to ensure that the regulations were complied with and the regulations provided for heavy penalties when there had been deviation of those HCFCs to controlled uses.

26. One member said that, in order for the bidding process to start for the planned reductions for 2018 and to establish the allowable production quotas, it would be necessary to approve stage II of the HPPMP at the present meeting of the Executive Committee.

27. The members congratulated the Government of China for meeting the targets that had been set under stage I and for its hard work in preparing stage II of the HPPMP. One member recognized the link between production and consumption phase-out in what was a large and complex industrial sector of its economy. He was sure that the Executive Committee would take that into consideration but it was important to also give the World Bank and China time to ensure that all the documents being submitted were reviewed by the Secretariat before they were considered by the Executive Committee. Another member stressed that those revised documents should also address the concerns raised at the present meeting.

28. The Production Sector Sub-group recommends that the Executive Committee:

(a) Note the submission of stage II of the HCFC production phase-out management plan (HPPMP) for China;

(b) Request the World Bank to resubmit stage II of the HPPMP for China to a later meeting.

Agenda item 5: Preliminary data and request to carry out the technical audit of the HCFC production sector in the Democratic People’s Republic of Korea

29. The representative of the Secretariat introduced document UNEP/OzL.Pro/ExCom/79/SGP/4, which addressed the submission of preliminary data by UNIDO and its request to carry out the technical audit of the HCFC production sector in the Democratic People’s Republic of Korea.

30. She drew the attention of the Sub-group to resolution 2321 of the United Nations Security Council which had modified the procedure for obtaining clearance for scientific and technical cooperation from the Security Council Committee established pursuant to resolution 1718 (UNSC Committee 1718). Paragraph 11(b) of resolution 2321 provided an exception to the rule that all Member States must suspend scientific and technical cooperation involving persons or groups officially sponsored by or representing the Democratic People’s Republic of Korea, except for medical exchanges, in those cases where the State engaging in scientific or technical cooperation had determined that the particular activity would not contribute to the Democratic People’s Republic of Korea’s proliferation sensitive nuclear activities or ballistic missile-related programmes and had notified the UNSC Committee 1718 in advance of such a determination. The Secretariat understood that UNIDO still needed to consult the UNSC Committee 1718 for the project under consideration.

31. One member recalled his intervention regarding concerns about technical cooperation involving the Democratic People’s Republic of Korea under UN Security Council Resolution 2321 and said that his delegation was not in a position to approve the proposal at this time. Moreover, the issue of lost profits in the production sector would make the discussion of project from the Democratic People’s Republic of Korea even more complicated than those taking place for the consumption sector.

32. It was agreed to postpone consideration of the proposal until it could be confirmed that the project did not conflict with United Nations Security Council Resolution 2321 or any other resolutions the Security Council might adopt on this matter.

Agenda item 6: Other matters

33. No other matters were raised.

Agenda item 7: Adoption of the report

34. The present report was reviewed by the facilitator.

Agenda item 8: Closure

35. The meeting of the Sub-group was closed at 9.15 am on 7 July 2017.