Department for Business Innovation & Skills

Department of Energy & Climate Change

Electricity Intensive Industries – relief from the indirect costs of renewables

government response to the public consultation

JANUARY 2015

Contents

ELECTRICITY INTENSIVE INDUSTRIES – RELIEF FROM THE INDIRECT COSTS OF RENEWABLES

1. Introduction

1. As part of the Budget 2014 the Chancellor announced that the Government intends to implement measures to reduce the impact of renewables policy on the costs of electricity for the most electricity-intensive industries.

2. A consultation on the proposal for providing relief for electricity intensive industries for the indirect costs of renewables policy was held between 31st July and 24th October 2014. The purpose of the consultation was to seek views on the proposed eligibility and design of the scheme.

3. The scheme specifically covers compensation to Energy Intensive Industries (EIIs) for the indirect costs of the Renewables Obligation (RO) and the micro generation Feed-in-Tariff (or small scale FITs) and also exemption for EIIs for the indirect costs of the Contracts for Difference under Electricity Market Reform.

3. The consultation was available on the Gov.uk website, and was emailed directly to a large number of contacts who have previously expressed an interest in this issue.

5. We received 47 responses to the consultation. Of these, 25 were from companies, 21 were from trade associations or industry representative groups and 1 was from an academic institute. The full list of respondents is attached at Annex A.

6. Government held a stakeholder workshop on the 25th September 2014 to discuss the proposals as well as discussing it at 14 other stakeholder events and meetings.

7. This document sets out the issues raised by stakeholders through the consultation and the Government's response. Further detailed guidance will be issued later in the year, once we receive the necessary approvals including state aid approval from the European Commission.

2. Analysis

8. The consultation included 5 questions.

1.	Do you agree with the approach to eligibility?
2.	Are there any products which have been ruled out by this test which are electricity or trade intensive?
3.	Do you agree with the business-level test approach?
4.	Do you agree with this approach to aid intensity?
5.	How best can we ensure that eligible companies engage with, and take full advantage of the expertise and commercial finance from the Green Investment Bank?

2.1 Question 1: Do you agree with the approach to eligibility?

9. There were 45 responses to this question. 11 respondents specifically agreed with the approach and 4 directly disagreed with the approach. The majority of respondents commented on the proposal, with 16 respondents commenting on the sector level test, and 9 on the business level test. Other comments received were regarding aid intensity. The latter two issues are dealt with in later sections of this report.

Sector Test

10. Many respondents questioned the need for a sector level filter test and considered that the UK Government should compensate all sectors on Annex 3 of the Energy and Environment State Aid Guidelines.

11. There was also a comment received that the UK Government should consider including very trade intensive sectors that would otherwise not pass the sector level test. In addition one respondent was concerned that the eligibility for compensation and exemption was different from the scheme to compensate electricity intensive businesses from the indirect costs of the EU Emissions Trading System and the Carbon Price Floor.

Government's response

12. While the European Commission's Energy and Environment State Aid Guidelines make allowance for a wide range of sectors to be given relief from the costs of the renewables, this list was identified at a European level. The UK Government's objective is to provide relief for those sectors in the UK that are put at a significant competitive disadvantage due to funding support for energy from renewable sources: ie sectors which are both electricity intensive and trade intensive. It does not consider that all the sectors on Annex 3 make electricity intensive products in the UK. Additionally in the case of providing

exemption to electricity intensive businesses from the costs of the Contracts for Difference under Electricity Market Reform there is a redistributive effect, in that other electricity consumers pay more to balance the exemption. The UK government has therefore, in using a sector level test, sought to focus on those electricity and trade intensive sectors in the UK and minimise the additional costs to other consumers.

13. The European Commission's Energy and Environment State Aid Guidelines provide different lists of eligible sectors for relief from the costs of funding renewable energy deployment (annex 3) and carbon taxation (EU ETS State Aid Guidelines). Given this, the Government cannot follow exactly the list of eligible sectors as set out in the current compensation schemes for the indirect cost of the EU Emissions Trading System and the Carbon Price Floor. In addition, the Government considers there are a range of products that are electricity and trade intensive that are not in receipt of the current compensation schemes and as such should receive relief from the costs of funding renewable energy deployment.

14. The Government is still considering information received by sectors that either appear to fail the sector filter test (perhaps because of old data) or do not appear in Annex 3. The Government is also reconsidering the underlying assumption of the retail electricity price for the sector filter test and business level test. This point is considered more fully under question 3 below.

15. Given all the above the Government will retain a sector level filter, but are still considering data received on which sectors would pass the test. While the Electricity Supplier Obligations (Amendment & Excluded Electricity) Regulations 2015 will list an initial list of eligible sectors for CfD exemption these will be revised as necessary and the Government will publish a report later with the final list of eligible sectors.

2.2 Question 2: Are there any products which have been ruled out by this test which are electricity or trade intensive?

16. There were 24 additional products or sectors identified by respondents that were not included in the proposed list of eligible sectors.

17. The Government is considering these cases further and will respond separately at a later date, where possible, prior to the commencement of the scheme.

2.3 Question 3: Do you agree with the business-level test approach?

18. 39 responses were received on this question. 8 respondents specifically agreed with the business level test approach and 20 disagreed. They covered a number of areas.

The need for a business level test

19. A number of respondents considered that the business level test is unnecessary for state aid purposes, introduces an avoidable degree of complexity, and potentially complicates state aid approval.

20. Some respondents were concerned that the test seemed at odds with the stated aims of avoiding the disincentivisation of the take up energy-efficiency measures, avoiding sector distortion and minimising the administrative burden.

Government's response

21. Within some of the eligible sectors, there are sub-sectors or products which are less electricity-intensive to manufacture and, as such, are therefore not put at a significant competitive disadvantage due to funding support for energy from renewable sources. It is the Government's aim to target eligibility at those companies who manufacture the most electricity intensive products. This is important, particularly given that for the Electricity Market Reform Contracts for Difference exemption there is a redistributive cost effect on other consumers, including other businesses. On this basis the Government will continue to apply a business level test.

<u>The appropriateness of using the "business" at the entity level</u>

22. Some respondents considered that the approach at the entity level is flawed as a single entity may contain a number of different businesses with different levels of energy intensity, arguing that the scheme should apply to each operating site rather than at business level

Government response

23. The Government recognises the concerns raised by industry about this. However, there are a number of problems with moving away from a 'business as legal entity' level approach, particularly relating to the calculation and validation of GVA at a plant / installation. To address this, the Government's proposal allows for Government to consider providing compensation to those businesses that only fail the test because of the inclusion of significant costs which do not relate to the manufacture of the eligible product.

<u>The extent of the test</u>

24. Many respondents considered that a threshold of 20% electricity intensity for businesses to be eligible for relief was too high. Alternative suggestions included lowering the threshold to 7%. Additionally comments were received that using a baseline period of 2010-2012 to pass the 20% test was too narrow and that plant shutdowns both on an ad-hoc basis and for vital routine maintenance should be taken into account. There were also views that a mechanism needs to be in place that can deal with business contractions and expansions and the effect that this could have on a company's ability to meet the 20% GVA threshold. Other suggestions included allowing businesses to apply at a later date, using different baseline years to account for increasing electricity costs.

Government response

25. The 20% test is in alignment with the European Commission's Energy and Environment State Aid Guidelines. The Government recognises the impact of using a narrow baseline and has decided to lengthen the period to cover 2010-2014 to address any anomalous years. This will also address concerns about plant shutdowns. A clause in

our proposal on which we consulted allows for consideration of an application where the business fails the test primarily because of the inclusion of significant costs which do not relate to the manufacture of the eligible product. This should also address such issues.

26. The Government does not intend to amend the qualifying metrics over time as this would not provide a fair and transparent application process. The scheme is designed to identify electricity intensive products to provide certainty for the life of the scheme to industry as well as provide budgetary certainty for Government.

The use of UK data only

27. There were some comments that Government should introduce an alternative test which applies at the European level to cover the possibility that only a very limited number of companies (or a single company) in the UK manufacture a particular electricity intensive product. There was a suggestion that Government should allow for a provision whereby if EU manufacturers of a similar product are eligible in their respective country, relevant companies in the UK should be eligible

Government response

28. European Member States take differing approaches to incentivising the uptake of renewable energy and addressing the costs for energy intensive industries. As the schemes on which the Government consulted are UK only we can only reasonably use UK data to calculate business level eligibility. It would also be very difficult to get validated data from other companies in Europe to allow business to make a case for compensation.

The underlying assumption of price of electricity

29. In calculating both the sector level and the business level test the Government proposed to use an underlying price of £67.42 per MWh in 2012 prices exclusive of VAT. This was taken from the DECC publication, "*Annual prices of fuels purchased by manufacturing industry"* (QEP 3.1.3) and was based on the price paid by a large user (with annual usage greater than 8.8 GWh). A number of responses were received on this point making the case that this was not reflective of the price that industry was paying in 2012 and, therefore, underplayed their electricity intensity. This, in turn, would undermine their eligibility for relief.

Government response

30. The Government is currently analysing the responses received on this point and will respond separately at a later date. Prior to the commencement of the scheme we will publish a price for use in the scheme that better reflects the price faced by most industrial consumers.

2.4 Question 4: Do you agree with the approach to aid intensity?

31. We received 38 responses on this point with the majority seeking to provide maximum relief to eligible businesses. the European Commission's Energy and Environment State

Aid Guidelines sets a maximum aid intensity of 85% of policy costs on purchased electricity. However, the guidelines also make provision to go above this for those companies which have an electricity intensity of 20% or more. This allows for a limit to be imposed on a business's renewable costs passed through in the electricity bills of 0.5% of the business's GVA. Most responses proposed that the Government should provide compensation up to this maximum. A few responses proposed that businesses should be able to choose between an aid intensity of 85% of policy cost on their purchased electricity or a limit of 0.5% of their GVA, whichever would be the most advantageous to the business. A few respondents considered that the Government should provide 100% relief.

Government Response

32. The European Commission's Energy and Environment State Aid Guidelines requires that in providing relief from the costs of renewables that business bear some of the costs. As the UK Government's scheme has to meet these guidelines and be approved by the European Commission, it cannot provide 100% relief.

33. In considering the other comments received, the Government remains concerned that limiting costs to 0.5% of a business's GVA could mean that competing companies operating in the same sector would face very different percentage levels of compensation, depending on their levels of GVA. For example a company with a very low GVA could receive much higher levels of relief than a company with high GVA for the same level of electricity use. Under this method, the focus is more on the company's profit or 'value added' and less on their electricity usage. On this basis we consider that this approach could distort competition.

34. In addition, the Government is concerned that for businesses that make both electricity intensive products and non-electricity intensive product, using the GVA approach to aid intensity would require the Government to quantify a business's GVA below their company level to focus on the electricity intensive products. This approach would be administratively burdensome, and very difficult to validate.

35. Given the above the UK Government intends to retain its approach to aid intensity - a maximum aid intensity of 85% of policy costs on purchased electricity.

2.5 Question 5: How best can we ensure that eligible companies engage with, and take full advantage of the expertise and commercial finance from the Green Investment Bank?

36. There were 38 responses to this question. The comments received largely cover awareness and the nature of finance. Considering them in turn:

Awareness and engagement

37. Some respondents considered that the Green Investment Bank could increase engagement and awareness of their products with Energy Intensive Industries perhaps by using the trade or sector association.

The nature of the funding

38. There were also respondents that considered that as the Green Investment Bank operated on strict commercial terms that there was no greater incentive to use their products rather than any other bank. 6 respondents considered that the minimum budget requirement of £10m was too high for many energy efficiency interventions.

39. One respondent considered that the extra process of reporting green outcomes acted as a barrier when considering where to access finance given the standard commercial terms.

40. There were a number of respondents that considered that for large companies, particularly international ones, availability of funding was not the issue when seeking to invest in energy efficiency.

Government Response

41. The Green Investment Bank (GIB) is an independent infrastructure bank, wholly owned by the Government with a mandate to mobilise additional private investment in green infrastructure projects and help the UK make the transition to a more green economy. The company is run by its Board and operates at arm's length from the Government. The non-attributable comments received have been passed to the company for consideration.

42. In accordance with the terms of its state aid approval, GIB invests only on fully commercial terms and may not provide state aid to third parties or crowd out private finance providers by offering finance on more generous terms than would be sought by a commercial investor. Demonstrating that commercial investment in green projects can generate attractive returns is in any event the only way it will achieve its aim of attracting additional private capital to invest in such projects.

43. Non-domestic energy efficiency is one of the priority sectors for GIB and it has sought pro-actively to stimulate investment activity by helping to identify the opportunities for cost savings and offering innovative products by which enterprises can choose to finance energy efficiency investment.

44. There is no specific lower limit threshold for GIB's minimum investment. GIB has told us it would consider small opportunities if a new technology or innovative project had replication value. In addition, GIB can cover a portfolio of projects spanning several years, rather than just investing in individual projects. Many companies with which GIB is in discussions have portfolios of energy efficiency opportunities spanning several years with an investment value of several tens of millions of pounds.

45. It is essential that GIB effectively measures and reports on the green impact of the projects it supports. GIB is seen as market leading in its green assessment, monitoring and reporting processes and a number of commercial partners are choosing to adopt GIB's standards themselves. GIB has received feedback from co-investors and project sponsors about its green reporting requirements and this does not suggest these are unduly onerous.

2.6 Additional Comments

46. There was one additional comment received from a number of respondents. This was to seek early implementation of the relief, and in particular the commencement of the compensation for the indirect cost of the Renewables Obligation and small scale Feed in Tariffs in 2015 rather than 2016 as announced at Budget.

Government Response

47. While it is understood that industry is already bearing the indirect costs of renewables the Government has to get state aid approval from the European Commission for these schemes. While these schemes have been developed in accordance with the European Commission's Energy and Environment State Aid Guidelines the exact timing of approval is unknown. Subject to this however, the Government is seeking to commence the exemption from Contracts for Difference in October 2015 and the compensation for the indirect cost of the Renewables Obligation and small scale Feed in Tariffs in the following April.

Annex A

Respondents to the consultation

1.	Air Products
2.	BASF
3.	BOC
4.	British Ceramic Confederation
5.	British Compressed Gases Association
6.	British Glass Manufacturers' Confederation
7.	British Lime Association
8.	British Polythene
9.	British Tyre Manufacturers' Association
10.	Castings Technology International
11.	Cast Metals Federation
12.	Celsa Manufacturing UK
13.	CEMEX
14.	Chemical Industries Association
15.	Confor (Confederation of Forest Industries)
16.	Confederation of Paper Industries
17.	Confederation of UK Coal Producers
18.	Construction Products Association
19.	Ecotricity
20.	EDF Energy
21.	Energy Intensive Users Group
22.	Food and Drink Federation

23.	GrowHow
24	Gypsum Products Development Association
25.	Hanson
26.	Huntsman Pigments
27.	INEOS ChlorVinyls
28.	INEOS Chemicals Grangemouth
29.	Maltsters' Association of Great Britain
30.	Mineral Products Association - Cement
31.	Outokumpu Stainless
32.	Rail Delivery Group
33.	RWE npower
34.	SABIC Manufacturing Europe
35.	Sahaviriya Steel Industries UK
36.	Scottish Power
37.	Sheffield Forgemastes
38.	SIBELCO
39.	Tata Steel
40.	TechUK
41.	Tees Valley Unlimited
42.	UCL Energy Institute
43.	UK Leather Federation
44.	UK Steel
45..	Unifrax
46.	Vale Europe

47.	Wood Panel Industries Federation

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Any enquiries regarding this publication should be sent to:

Department for Business, Innovation and Skills
1 Victoria Street
London SW1H 0ET
Tel: 020 7215 5000

If you require this publication in an alternative format, email enquiries@bis.gsi.gov.uk, or call 020 7215 5000.

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