



Department for
Business, Energy
& Industrial Strategy

ENERGY INTENSIVE INDUSTRIES (EIIS): EXEMPTION FROM THE INDIRECT COSTS OF CONTRACTS FOR DIFFERENCE (CFD)

Government response to consultation

March 2017

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Ells – Exemption from the indirect costs of Contracts for Difference (CFD)

1. In his 2011 Autumn Statement, the then Chancellor announced his intention to exempt certain energy-intensive industries (Ells) from a proportion of the costs of Contracts for Difference (CFDs) (the 'CFD exemption'). Since then there have been five consultations on aspects of this policy, and the Electricity Supplier Obligations (Amendment & Excluded Electricity) Regulations 2015 (the '2015 Regulations') were enacted in order to allow the CFD exemption scheme to be implemented.
2. The CFD scheme is a policy designed to encourage investment in low-carbon energy generation plant. The costs of funding the CFD scheme are recovered through a levy on suppliers which is ultimately passed on to domestic and industrial consumers' bills. The scheme became operational in 2014 and the first payments were made in 2016, but as payments increase these costs will place a significant additional burden on Ells, placing them at a competitive disadvantage with their international competitors and increasing the risk that companies may choose to move their production abroad.
3. In December 2015, the European Commission approved the CFD exemption as State aid in accordance with the terms of our notification. The terms of our approved notification require us to make changes to the 2015 Regulations to ensure State aid compliance.
4. Between 22 July and 26 August 2016, we ran a consultation on a number of further changes to the 2015 Regulations to improve the efficiency and accuracy, and to clarify key elements, of the CFD exemption scheme. We also published the proposed Statutory Instrument to amend the 2015 Regulations: the Electricity Supplier Obligations (Amendment & Excluded Electricity) (Amendment) Regulations 2017 (the 'draft regulations').
5. The consultation we ran also covered options on how to implement a mechanism to recover over-exemptions under the CFD exemption, and in respect of the proposed Renewables Obligation (RO) and small-scale Feed-in-Tariffs (FIT) exemption programmes. It is proposed that these two exemption programmes will rely on certain definitions and processes set out in the proposed draft regulations. The consultation was available on the GOV.UK website, and was emailed directly to a large number of stakeholders who have previously expressed an interest in this issue.

6. We also held a roundtable meeting with energy suppliers on 16 August 2016 to discuss the proposals. We had separate discussions with other stakeholders, including trade associations representing energy intensive businesses and individual businesses that contacted the department.
7. We also consulted the Scottish and Welsh Ministers, the Northern Ireland Department for the Economy, Ofgem and the National Grid.
8. We received 46 responses to the consultation. Of these, 19 were from companies, 14 were from sector representative bodies, 11 from electricity suppliers and 2 from government or regulators. The list of respondents is attached at [Annex B](#).
9. This document sets out the issues raised by stakeholders through the consultation and the government's response.
10. A separate consultation on implementing an exemption for EIIs from the indirect costs of the RO and FIT schemes took place from 1 April to 27 May 2016 (the RO and FIT consultation). We cross-refer to this consultation in some places in this government response.

Analysis

11. The consultation included 6 questions:
 1. **Do you agree with our proposed definition of a new business? If not, what alternatives should we be considering?**
 2. **Do you agree with our proposed requirement that ELLs notify us of changes that would affect their eligibility or the proportion of electricity they use that is eligible for the CFD exemption?**
 3. **Do you agree with our proposed amendments to the issuing and expiry of ELL certificates? If not, what alternatives should we be considering?**
 4. **Do you have any comments on our proposed changes to the additional amendments to the regulations outlined above?**
 5. **Which of the two options for recovering and redistributing over exemption do you prefer? Please set out your reasons. We welcome comment on how your preferred option could be improved.**
 6. **In paragraph 82 we propose three options for how we could calculate the over- exempted sum to be repaid. Which option do you prefer and why? What alternative approaches could we take? How do you believe the forecast or actual policy costs should be derived for options 'a' and 'b'?**
12. This government response relates to questions 1- 4 only. Although we consulted on a mechanism for the recovery and redistribution of over-exemption to ELLs in this consultation (questions 5 and 6), this is a complex issue and we are still considering our options. Government will respond on these questions at a later date. In the interim, recovery, but not redistribution, will be possible under generally applicable law.

Question 1: Do you agree with our proposed definition of a new business? If not, what alternatives should we be considering?

Consultation proposal

13. We proposed new detailed provisions in the draft regulations to enable new businesses to benefit from the exemption. We defined a “new business” as one which does not currently have annual accounts but which has been trading for, and has financial data in respect of, two or more consecutive financial quarters in the twelve months preceding the application and has been trading for no more than 21 months. We also specified different requirements for a new business which take account of its limited data, such as setting a different time period that the EII certificate will last.

Consultation responses

14. There were 35 responses to this question. 26 respondents agreed with the approach and 7 disagreed. The majority of respondents commented on the proposal. There were four main concerns raised:
 - That the definition of a new business as originally set out does not adequately cater for mergers, acquisitions and divestments. There were concerns that, following a restructuring, a business would have to reapply after 6 months of trading as a new entity and would lose their exemption in the meantime. There were specific comments that there should be transitional arrangements to allow for continuous exemption, with no gap in eligibility, and it should be possible, in the event of an acquisition, to use data from more than one company to determine eligibility.
 - A number of respondents highlighted the need for flexibility of interpretation within the assessment process for businesses that are not eligible over the full reference period but, because they have bought new electro-intensive plant or undergone changes to their structure during that time, would pass the eligibility test thereafter.
 - One comment was received proposing a lower eligibility threshold for the business level electricity intensity test in order to reduce the level of intra-sector competitive distortions.
 - Three respondents raised concerns about the robustness of data provided by new businesses, and recommended BEIS should either carry out an external audit of this data or carry out monitoring of applicants to ensure ongoing compliance.

Government response

15. We recognise the points raised regarding mergers, acquisitions and divestments and therefore propose to revise the draft regulations to cater for changes to business structure. The proposed revised approach is that businesses in this situation must notify us, and the system will then allow for a transitional period in which any meter that is considered eligible for exemption prior to the restructuring will retain that eligibility until the certificate expires, as long as that meter continues to be used for a specified activity, as listed in Schedule 1 to the draft regulations, irrespective of whether it becomes part of a revised structure or different business. Once the certificate expires, the business which had acquired it would need to re-apply in the normal way.
16. If a business applies with the required data in respect of a three most recent consecutive business years for which there are annual accounts, and meets the eligibility test, it will be able to apply four more times for an EII certificate before its eligibility needs to be reassessed (unless one of the events set out in regulation 12 of the draft regulations occurs). If a business in these circumstances acquires another EII certificate following a restructuring, the same rule will apply to that EII certificate.
17. Under any new structure, any business wishing to include additional meters that do not currently benefit from an exemption will need to apply in the normal way.
18. This approach will enable meters already assessed as eligible to retain that eligibility until the certificate expires. For businesses that have restructured to form a new legal entity, this means that meters that already benefit from exemption do not immediately lose that benefit as a consequence of the creation of that new legal entity.
19. While we recognise that a business's structure will alter over time, it is the objective of the scheme to provide certainty for business and it is not the intention to reassess eligibility every time a business invests in plant or divests itself of less electricity intensive elements of its business.
20. In 2014, we consulted on the electricity intensity threshold for eligibility for the RO and FIT compensation and CFD exemption. We propose to use the threshold agreed as a result of this previous consultation.¹

¹ January 2015 government response (original):
www.gov.uk/government/uploads/system/uploads/attachment_data/file/395809/bis-15-31-electricity-intensive-industries-relief-from-the-indirect-costs-of-renewables-government-response-to-the-public-consultation.pdf

21. We note concerns about the robustness of data provided by new businesses. However, we do not consider that an external audit of the data or extra monitoring of the new businesses is necessary. The draft regulations require such businesses to (i) provide their first set of annual accounts within 30 days of receipt; and (ii) thereafter, re-apply and be reassessed annually until they can provide annual accounts for a period of three years.
22. We also require all businesses which have successfully applied for an EII certificate to provide quarterly reports to confirm that the specified activity in respect of which their EII certificate was issued is still being carried out. There is also a requirement for businesses to provide information to government in specific situations such as discovery of an error in the application or new onward supply, which might affect their eligibility or the proportion of exempted electricity to which they are entitled. This is addressed in further detail in Question 2.

Question 2: Do you agree with our proposed requirement that EIs notify us of changes that would affect their eligibility or the proportion of electricity they use that is eligible for the CFD exemption?

Consultation proposal

23. We proposed that, to ensure accuracy of the CFD exemption, eligible EIs would be required to notify government when there are certain changes that would affect their eligibility or the proportion of electricity they use that is eligible for the CFD exemption. Specifically, notification would be required in circumstances where a business ceases a specified activity for 4 weeks or more, where a business becomes aware that there was an error in its application that meant it either was never eligible, or has been assessed as entitled to a higher proportion of eligible electricity than it should have been, or where a business starts sharing its electricity with, or onward supplying it to, a third party.
24. We also proposed that successful applicants will be required to provide quarterly notifications to confirm that their business is still carrying out the “specified activity” in respect of which they were granted their EI certificate.

Consultation responses

25. There were 42 responses to this question. 30 respondents agreed with the approach and 1 disagreed. Comments received include:
 - There was significant concern from a number of respondents that the requirement to notify a cessation in the specified activity of 4 weeks would include shut-downs for routine maintenance or repairs (which can typically take 6 - 8 weeks or more), that it would be onerous for business to report each time this happened and that it could potentially impact on the level of their exemption going forward.
 - A number of respondents, including the respondent who disagreed with the proposal, also felt that the requirement for businesses to report quarterly that they were still trading and carrying out the specified activity was onerous. A number of alternative suggestions were made including annual reporting or a requirement to notify within three months of any change in circumstances.
 - The issue of third party supply and onward supply from one business to another was raised. One concern was how this would be managed in applying for and awarding certificates; another question focused on how this would work if the onward supply was over a private network.

- One respondent wanted to know what would happen in situations where there were large fluctuations in the mix of grid and auto-generated electricity, due to scheduled or unexpected shutdowns at the auto-generation plant, and whether the exemption programme had systems in place to manage this.

Government response

26. We understand the concerns that maintenance and refit of plant could be affected by the provision in the draft regulations requiring businesses to inform government of cessation of the specified activity for more than 4 weeks. However, it is not our intention that maintenance and repair downtime should be caught by the notification requirement. We consider that such activity is a normal part of the carrying out of specified activities. We propose to provide additional clarity in subsequent guidance to accompany the final regulations. We have also amended the drafting in the draft regulations to remove reference to “4 weeks”.
27. In order to ensure that the exemption remains targeted at eligible businesses and that the level of exemption is accurate, we proposed that businesses should report quarterly that they are trading and that the specified activity for the purposes of their EII certificate is still being carried out. We recognise that there is also a requirement for business to notify government:
- when they stop a specified activity (ie. closing or mothballing a plant)
 - where an error in a business’s application becomes apparent which impacts on eligibility or the proportion of electricity used by the business that is eligible for the exemption,
 - or where a business starts sharing or onward supplying its electricity.
28. However, we consider that quarterly reporting provides an additional but light touch assurance and is therefore appropriate. This is in line with the current administration for compensation for the RO and FIT. It supports the government’s monitoring and review procedures and reduces the risk of a scenario in which a non-eligible business receives aid for a long time resulting in government having to recover significant levels of over exemption. We do not consider that this requirement is disproportionately burdensome for business and therefore propose to retain this provision.
29. We have considered the points raised about third party supply arrangements where there is not a direct relationship between the exempted business and the licensed electricity supplier. To ensure that the exemption caters for such situations we propose to revise the regulations. The applicant business in this scenario will need to provide details of the third party supplier, the overall volumes of electricity consumed at the meter point and any third party consumption at that

point. A certificate will be provided to both the applicant and their third party supplier, the latter being the party who would provide this to the licensed electricity supplier.

30. In response to the point regarding fluctuating mix between grid electricity and auto-generation, the exemption will apply to a set proportion (set out in the certificate) of all electricity that passes through a particular meter point. Therefore, the business should receive the same proportion of exempted electricity, regardless of whether the volume of electricity passing through the meter linked to the certificate is large or small at that specific time.

Question 3: Do you agree with our proposed amendments to the issuing and expiry of EII certificates? If not, what alternatives should we be considering?

Consultation proposal

31. Our proposed amendments to the 2015 Regulations included provision to extend certificates where they would otherwise expire after 6 months or less due to the rule that they expire at the end of the financial year in which they were issued. Under this provision, such certificates will instead last to the end of the subsequent financial year.
32. We also proposed to amend the rules applicable to new businesses that have been trading for less than four financial quarters so that their certificates will expire 16 months after the first day of the period that was the “relevant period” for the purposes of their EII application (defined in regulation 9 of the draft regulations). We also included a provision that all new businesses will be required to provide a copy of their first set of annual accounts to BEIS within 30 days of them being finalised.

Consultation responses

33. There were 32 responses to this question. 28 respondents agreed with the approach and none disagreed. Comments received included:
 - There was significant interest in obtaining greater understanding of the end-to-end application and certification process, including what certificates would look like, how a business would apply for a new certificate after expiry and how the communication process between government, the regulators and suppliers would work with regard to the scheme. One suggestion was to include re-application as part of the annual reporting process to minimise the burden on business.
 - One respondent asked for clarity on whether certificates would last for a calendar or financial year.
 - One respondent questioned the need for annual certificates if eligibility had been granted for five years.

Government response

34. We recognise the need to set out the end to end process for applying for and receiving the exemption, including setting out the communication flows between all parties involved. We will separately provide guidance on this process prior to the commencement of the scheme. The Low Carbon Contracts Company (LCCC) will

publish guidance on “relevant arrangements”, i.e. the LCCC-approved arrangements for ensuring it receives the metering information associated with an EII certificate and which allows LCCC to perform the exemption.

35. We can confirm that the certificates and the recertification process will be run on a financial year basis although businesses can apply for the exemption at any time.
36. While eligibility for the scheme for businesses with three years of annual accounts will only be assessed every 5th certificate, there are a number of factors that affect the certificates. This includes meters used for both specified (eligible) and non-specified (ineligible) activities where the respective levels of those activities can fluctuate. As a result the proportion of electricity that should be exempted may change annually. In addition, for new businesses, the draft regulations require the government to assess eligibility annually until there are three years of data on record. As a result we propose to retain this provision and require all businesses to apply each year for a new certificate.

Question 4: Do you have any comments on our proposed changes to the additional amendments to the regulations outlined above?

Consultation proposal

37. We proposed a number of minor amendments to the 2015 Regulations. These were: inclusion of the finalised list of specified activities following a decision on a common reference electricity price; a provision to take into account a force majeure situation in assessing both eligibility and proportion of exempted electricity; and a number of additional requirements for information to be provided in support of applications to enable the CFD exemption scheme to operate effectively. We also proposed a provision to allow data sharing between LCCC and Ofgem.

Consultation responses

38. There were 18 responses to this question.
- Comments received included those related to over-exemption (Questions 5 and 6). In sum, these welcomed the data sharing proposal (see paragraphs 55-56 of the consultation document), raised questions about data confidentiality, put forward proposals for a minimum threshold below which over-exemption should not be recovered and asked whether there would be any provision for dealing with under-exemption. Comments in respect of our proposals for a mechanism to recover and redistribute over-exemption will be covered in a separate response at a later date.
 - A number of comments were made in both the consultation and the 16 August roundtable (paragraph 6) relating to the role of energy suppliers. These included comments that suppliers needed sufficient foresight from government on when the exemption would come into force; that more detail was needed on the practicalities of how the exemption would work in practice; and a request that energy suppliers should not be responsible for assessing the eligibility of businesses. The proposal to allow for the Secretary of State to consider force majeure when determining eligibility or level of exemption was welcomed.
 - There was a request that, if a business has already provided its independent auditor's report for their RO and FIT compensation application, they should not be required to repeat this exercise for their CFD exemption application.
 - There was a question about why, if exemption was based on a single reference price, businesses need to provide data on their actual electricity costs.

- There was also a question about widening the eligibility list to include new sectors.

Government response

39. Issues regarding a mechanism for the recovery and redistribution of over-exemption raised under this question are pertinent to questions 5 and 6 which specifically cover this point. We are still considering this complex issue and will provide a response at a later date.
40. We intend to continue with our proposal which would allow LCCC to share data with Ofgem to avoid the need for a duplicate data collection process in the proposed RO and FIT exemption programmes.
41. Further detail about the practicalities of the exemption process and how this will work for both applicants and suppliers will be included in the guidance that accompanies the final regulations. Suppliers will not be responsible for assessing the eligibility of businesses.
42. We are seeking to avoid unnecessary duplication in determining eligibility for the CFD exemption. Therefore the draft regulations include a provision that enables data already provided by businesses to government (e.g. in support of their applications for compensation for the RO and FIT) to be used to determine eligibility for, and the proportion of, the CFD exemption. This will include, where appropriate, the report from independent auditors used to validate applications for RO and FIT compensation.
43. Although we do not need to use the electricity cost information received from applicants to determine eligibility, this information is important. In setting a single reference electricity price to determine eligibility, we have made assumptions about what this price should be. This was the subject of a previous consultation and we reported this decision in the previous government response.
44. The draft regulations require the Secretary of State to use a price which, in his opinion, reflects the price paid for electricity by businesses which carry out specified activities. The Secretary of State will therefore keep this under review to ensure that the price used is appropriate. In order to do this we require businesses to tell us what they pay. We therefore propose to retain this provision in the final regulations.
45. We consulted on our proposed approach to widening the eligibility list in 2014. Given this, we are not considering amending the list of eligible sectors at present.

Annex A: Revised impact of an EII exemption from indirect CFD costs on electricity bills

46. The consultation outlined modifications to the Contracts for Difference (CFD) exemption scheme for energy intensive industries (EIIs). These modifications do not change the background, rationale or objectives of the policy. There has also been no update to the overall value for money case of the policy. The original Impact Assessment for the CFD exemption can be found here².
47. This annex updates the best estimate of the impact of the CFD exemption on electricity bills using the latest data available. Under the exemption, eligible businesses will receive up to an 85% exemption from the indirect cost of funding CFDs. Eligible businesses belong to a sector identified as energy intensive and trade intensive, and pass a business level test which demonstrates their electricity costs meet or exceed 20% of Gross Value Added.
48. The bill impact calculations use CFD strike prices (£/MWh) and wholesale prices consistent with the Environmental Levies published in the OBR Economic and Fiscal Outlook November 2016, total electricity demand and illustrative electricity usage (MWh) by different consumer groups. BEIS's (2016) internal estimate of 12TWh per year of eligible electricity was used to calculate the total cost of the exemption which was then spread over all non-exempt electricity users. The counterfactual assumes no exemption so all electricity consumers would pay the same cost per MWh to indirectly fund CFDs.
49. The exemption for EIIs will increase bills for other consumers and is detailed in table 1 below, which provides illustrative examples of the annual impact of the CFD exemption on electricity bills for domestic and non-domestic sectors. These figures are based on the latest available data, and show that the estimated annual impact of the CFD exemption on bills has decreased since July 2016, when the consultation document was published.

² www.gov.uk/government/uploads/system/uploads/attachment_data/file/358163/ANNEX_B_-_Impact_Assessment_-_Eligibility_for_an_exemption_from_the_cost.pdf

50. **Table 1: Annual Impact of CFD Exemption on Electricity Bills (2016 prices)**

Year	Households excl. VAT	Business - medium energy user ³	Illustrative Non-exempt EII ⁴	Illustrative Exempt EII ⁵
2017/18	£0 (+0.1%)	£900 (+0.1%)	£8,000 (+0.1%)	£200,000
2018/19	£1 (+0.1%)	£1,600 (+0.1%)	£15,000 (+0.2%)	£350,000
2019/20	£1 (+0.1%)	£2,300 (+0.2%)	£22,000 (+0.2%)	£500,000
2020/21	£1 (+0.2%)	£3,200 (+0.3%)	£30,000 (+0.3%)	£680,000
2021/22	£1 (+0.2%)	£3,300 (+0.3%)	£31,000 (+0.3%)	£710,000
2022/23	£1 (+0.2%)	£3,300 (+0.3%)	£31,000 (+0.3%)	£700,000
2023/24	£1 (+0.2%)	£3,100 (+0.2%)	£29,000 (+0.3%)	£670,000

Note: Figures in brackets represent the CFD exemption as a proportion of the illustrative users' estimated electricity bill

51. The actual cost in future years, of both CFD payments and the exemption, are dependent on a number of variables including: wholesale prices, the actual investment attracted into new generation capacity, electricity demand and the final scope of eligible businesses.

³ An illustrative business medium energy user has an assumed electricity consumption of 11,000MWh per year.

⁴ An illustrative EII has an assumed electricity consumption of 100,000MWh per year but EII consumption varies significantly from 2,000,000MWh per year to 2000MWh per year.

⁵ An illustrative EII has an assumed electricity consumption of 100,000MWh per year but EII consumption varies significantly from 2,000,000MWh per year to 2000MWh per year.

Annex B: Respondents to the consultation⁶

1. AICL Fertilizers
2. British Ceramic Confederation
3. British Glass Manufacturers' Confederation
4. British Steel
5. Cast Metals Federation
6. Celsa Steel UK Ltd
7. Chase Plastics Ltd
8. Chemical Industries Association
9. Confederation of Paper Industries
10. DONG Energy UK
11. DuPont Teijin Films UK Ltd
12. E.ON UK
13. Ecotricity
14. EDF Energy
15. EEF, the manufacturers' organisation
16. Electricity Storage Network
17. Energy Intensive Users Group
18. Energy UK
19. Engie
20. FabraUK
21. Gazprom Energy
22. Haven Power
23. Hope Cement
24. Imerys Fused Minerals Hull Ltd
25. INEOS Chemicals Grangemouth Ltd

⁶ Does not include the names of respondents who have asked for their response to be treated as in confidence. Scottish government, Welsh government, Northern Ireland Department for the Economy and National Grid were also engaged.

26. Liberty House
27. Mineral Products Association
28. Petroineos Manufacturing Scotland Limited
29. Plastipak
30. RWE npower
31. SABIC Area Manufacturing Europe
32. Scottish Power
33. Sembcorp Utilities
34. SmartestEnergy
35. SSE
36. Tarmac
37. Tata Steel
38. The Maltsters' Association of Great Britain
39. The National Association of British and Irish Millers (Nabim)
40. UK Petroleum Industry Association
41. Uniper UK



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