

Subsidy Advice Unit Report on a proposed subsidy to Sumitomo Electric Industries Ltd

Referred by Highlands and Islands Enterprise

15 September 2023

Subsidy Advice Unit

Part of the Competition and Markets Authority

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CONTENTS

1. Introduction	3
The referred subsidy	3
SAU referral process	4
2. Summary of the SAU's Findings and general observations.....	5
3. The SAU's Evaluation	7
Step 1: Identifying the policy objective, ensuring it addresses a market failure or equity concern, and determining whether a subsidy is the right tool to use	7
Step 2: Ensuring that the subsidy is designed to create the right incentives for the beneficiary and bring about a change.....	12
Step 3: Considering the distortive impacts that the subsidy may have and keeping them as low as possible.....	15
Step 4: Carrying out the balancing exercise.....	20
Energy and Environment Principles	21
Other Requirements of the Act.....	24

1. Introduction

- 1.1 This report includes an evaluation prepared by the Subsidy Advice Unit (SAU), part of the Competition and Markets Authority, under section 59 of the Subsidy Control Act 2022 (the Act).
- 1.2 The SAU has evaluated Highlands and Islands Enterprise's (HIE) assessment of compliance in relation to its proposed subsidy to Sumitomo Electric Industries Ltd (SEI), with the requirements of Chapters 1 and 2 of Part 2 of the Act (the Assessment).¹
- 1.3 This report is based on the information provided to the SAU by HIE in its Assessment and evidence submitted relevant to that Assessment.
- 1.4 This report is provided as non-binding advice to HIE. The purpose of the SAU's report is not to make a recommendation on whether the subsidy should be given, or directly assess whether it complies with the subsidy control requirements. HIE is ultimately responsible for granting the subsidy, based on its own assessment, having the benefit of the SAU's evaluation.
- 1.5 A summary of our observations is set out at section 2 of this report.

The referred subsidy²

- 1.6 HIE is the economic and community development agency for the Highlands and Islands of Scotland. HIE works with businesses, social enterprises and communities across the Highlands and Islands to help them develop and grow by attracting people to live, work, study, invest and visit. HIE is proposing to award SEI a capital grant of £24.5 million to build a cable manufacturing factory in Pitcalzean, adjacent to Port of Nigg in Easter Ross, 36 miles north of Inverness.
- 1.7 SEI is planning to invest £350 million and HIE is proposing to contribute £24.5 million towards this. The planning, construction and commissioning of the factory is estimated to take 34 months.
- 1.8 SEI is a large and experienced multi-national company based in Japan.
- 1.9 The factory will be capable of producing high voltage direct current (HVDC) and high voltage alternating current (HVAC) cables which are particularly important in the subsea transfer of electrical energy from offshore wind facilities. The

¹ Chapter 1 of Part 2 of the Act requires a public authority to consider the subsidy control principles and, where applicable, the energy and environment principles before deciding to give a subsidy. The public authority must not award the subsidy unless it is of the view that it is consistent with those principles. Chapter 2 of Part 2 of the Act prohibits the giving of certain kinds of subsidies and, in relation to certain other categories of subsidy creates a number of requirements with which public authorities must comply.

² [Referral of the proposed subsidy to Sumitomo Electric Industries Ltd by Highlands and Islands Enterprise \(www.gov.uk\)](https://www.gov.uk/government/news/referral-of-the-proposed-subsidy-to-sumitomo-electric-industries-ltd-by-highlands-and-islands-enterprise)

Assessment sets out that once operational, the facility will create 156 jobs in a disadvantaged region within the UK and, in addition, is forecast to generate a further 280 indirect or induced jobs in the UK, including 198 indirect or induced jobs in Scotland.

SAU referral process

- 1.10 On 31 July 2023, HIE requested a report from the SAU in relation to its proposed subsidy to SEI.
- 1.11 HIE explained that the subsidy is a Subsidy of Particular Interest because the size of the grant (£24.5 million) exceeds £10 million.
- 1.12 The SAU notified HIE on 4 August 2023 that it would prepare and publish a report within 30 working days (ie on or before 18 September 2023).³ The SAU published details of the referral on 4 August 2023.⁴

³ Sections 53(1) and 53(2) of the Act.

⁴ [Referral of the proposed subsidy to Sumitomo Electric Industries Ltd by Highlands and Islands Enterprise \(www.gov.uk\)](https://www.gov.uk/government/news/referral-of-the-proposed-subsidy-to-sumitomo-electric-industries-ltd-by-highlands-and-islands-enterprise)

2. Summary of the SAU's Findings and general observations

- 2.1 The Assessment is drafted in line with the four-step process described in the Statutory Guidance for the United Kingdom Subsidy Control Regime (the [Statutory Guidance](#)) and as reflected in the SAU's Guidance on the operation of the subsidy control functions of the Subsidy Advice Unit (the [SAU Guidance](#)).
- 2.2 Overall, we consider that the Assessment shows that HIE has carefully taken into account the subsidy control principles. HIE provided a significant body of material in support of the Assessment which demonstrated the methodology behind its decision-making process in this case.
- 2.3 Our main findings are as follows:
- (a) In relation to Principle A, we consider that the policy objectives of supporting the supply chain for the UK's renewable energy generation and distribution requirements, as well as supporting the drive for Net Zero, have been described well. We have also found that the equity rationale(s) are well explained and supported by evidence.
 - (b) In relation to Principle B, we found that the Assessment could explain in more detail how the size of the subsidy was assessed to be proportionate relative to the estimated benefits of achieving the identified policy objectives and limited to what is necessary to achieve them.
 - (c) In relation to Principle C, we consider that the Assessment could be strengthened by setting out in more detail the most likely counterfactual over the short, medium and long-term and by incorporating predictions about how the relevant market is likely to develop.
 - (d) In relation to Principle E, we have found that the Assessment could be strengthened by better explaining and supporting with further evidence how the security of supply of HVDC cables policy objective will be achieved by the subsidy.
 - (e) In relation to Principle F, the Assessment could be strengthened by providing further reasoning and evidence in support of the definition of the market, both product and geographic, within which the subsidy will be given. The Assessment could be improved by explaining how the design features described will limit distortions to competition and investment.
- 2.4 The SAU notes that this subsidy is intended to be given in a Green Freeport area and that firms operating within this area potentially benefit from further financial support. The Assessment could be strengthened by further consideration of how

any Green Freeport benefits, if realised, might affect the incentives of the beneficiary compared to the counterfactual.

- 2.5 This report is advisory only and does not directly assess whether the subsidy complies with the subsidy control requirements. The report does not constitute a recommendation on whether the subsidy should be provided by HIE. We have not considered it necessary to provide any advice about how the proposed subsidy may be modified to ensure compliance with the subsidy control requirements.⁵

⁵ Section 59(3)(b) of the Act.

3. The SAU's Evaluation

3.1 This section sets out our evaluation of Assessment, following the four-step framework structure used by HIE.

Step 1: Identifying the policy objective, ensuring it addresses a market failure or equity concern, and determining whether a subsidy is the right tool to use

3.2 The first step involves an evaluation of the Assessment against:

- (a) Principle A: Subsidies should pursue a specific policy objective in order to (a) remedy an identified market failure or (b) address an equity rationale (such as local or regional disadvantage, social difficulties or distributional concerns); and
- (b) Principle E: Subsidies should be an appropriate policy instrument for achieving their specific policy objective and that objective cannot be achieved through other, less distortive, means.⁶

Policy objectives

3.3 The Assessment sets out that the primary policy objective of the subsidy is to support the supply chain for the UK's renewable energy generation and distribution requirements, which then contributes to His Majesty's Government (HMG) and Scottish Government's (SG) Net Zero targets and provides strategic security of supply for a key part of the supply chain, namely HVDC cables which are not presently manufactured at scale in the UK.

3.4 In addition, the Assessment sets out two further objectives:

- (a) to support HIE's regional objectives of securing high quality jobs within the geographic area covered by HIE and securing the 'just transition' for redeployment from the carbon-based economy; and
- (b) to encourage further investment in the proposed Inverness and Cromarty Firth Green Freeport by contributing to the building of a renewable energy supply chain cluster.

3.5 The Assessment goes on to set out in detail how the project aligns strategically with the broader Scottish and UK environment policy.

⁶ Further information about the Principles A and E can be found in the [Statutory Guidance](#) (paragraphs 3.18 to 3.42) and the [SAU Guidance](#) (paragraphs 4.7 to 4.11).

- 3.6 Later, a further number of 'desired outcomes' are articulated which elaborate on these objectives and include the establishment of a state-of-the-art manufacturing facility in the Highlands of Scotland, direct and indirect employment effects, gross value-added impacts and security of HV cable supply.
- 3.7 We consider that the policy objective(s) of supporting the supply chain for the UK's renewable energy generation and distribution requirements, as well as supporting the drive for Net Zero, have been described well.

Market failure and equity objective

- 3.8 The Statutory Guidance sets out that:
- (a) Market failure occurs where market forces alone do not produce an efficient outcome.⁷
 - (b) Equity objectives seek to reduce unequal or unfair outcomes between different groups in society or geographic areas.⁸

Market failure

- 3.9 The Assessment lists positive externalities associated with the project. These include:
- (a) Training of local staff: SEI have identified funds of several hundred thousand for training and training tools and materials during the set-up phase.
 - (b) Research and development (R&D): SEI has allocated funds of several million to research and development, which could lower the costs of producing cables (which may result in cheaper electricity to the consumer), reduce the environmental impact of the cables and/or deliver other technological improvements to the way electricity is transported.
 - (c) Knowledge transfer: The presence of a large inward investor in a nascent industry in the UK will result in significant knowledge transfer into the UK.
 - (d) The Assessment also makes reference to energy security/lower energy costs and the acceleration to Net Zero benefits which will result.
- 3.10 It goes on to set out the supply constraints in this market, given its rapid growth, with up to four-years' lead times on existing orders in the UK. It indicates that these are driving up costs to offshore wind developers (with consequent downstream energy costs passed on to consumers) and slowing down the

⁷ [Statutory Guidance](#), paragraphs 3.21 to 3.34.

⁸ [Statutory Guidance](#), paragraphs 3.35 to 3.39.

transition to Net Zero. Furthermore, the lengthy lead times are also creating difficult planning circumstances for developers who will need to order cable before having a fully confirmed project creating, in some cases, significant financial and project risk.

- 3.11 We consider that the specific positive externality market failures set out in the Assessment are well reasoned and well connected to the policy objectives. However, these benefits are relatively small when compared with the size of the subsidy.
- 3.12 We consider that the lengthy lead times, whilst not specifically identified as a market failure in the Assessment, could potentially be interpreted as a co-ordination failure or a market failure as a result of asymmetric or imperfect information. However, further detail would be required to demonstrate this and explain how the subsidy aims to address it.
- 3.13 The Assessment sets out that there are barriers to entry which contribute to the supply constraints in the market, as discussed in paragraph 3.55. However, this part of the Assessment could be strengthened, in particular to explain whether there are barriers to expansion for existing suppliers which prevent them from responding to latent (and growing) demand and why this is a market failure.

Equity rationale

- 3.14 The Assessment states that the project aims primarily to address the equity objective of reducing regional inequality. It sets out, with supporting evidence, the aim to overcome the regional inequalities of population decline, high unemployment, low economic activity and high levels of deprivation, along with the low levels of productivity and pay in the area.
- 3.15 The Assessment states that the manufacturing facility will reduce unemployment, stimulate further employment and combat deprivation. It will also generate a supply chain cluster in the area as other businesses move to/set up in the area to service the needs of SEI, multiplying further the positive population impacts, since people will be attracted to the region to fill the high-quality employment opportunities that the factory will bring. The subsidy will also deliver improved productivity and pay in the region.
- 3.16 We consider that the equity rationales are well explained and supported by evidence.

Consideration of alternative policy options and why the subsidy is the most appropriate and least distortive instrument

- 3.17 In order to comply with Principle E, public authorities should consider why the decision to give a subsidy is the most appropriate instrument for addressing the identified policy objective, and why other means are not appropriate for achieving the identified policy objective.⁹
- 3.18 The Assessment sets out that HIE instructed an independent professional firm to provide external verification of the financial strength of SEI, the viability of the proposal and the viability gap requiring public subsidy. Informed by these reports, HIE assessed grant support as the most appropriate instrument to secure the inward investment as this would directly reduce the capital cost of the project and therefore positively impact the internal investment metrics used by SEI to assess new investment opportunities.
- 3.19 The Assessment sets out a number of options explored as alternatives to the chosen subsidy approach. We consider that the Assessment could have been strengthened by considering the alternatives in more detail and ensuring that the reasons for rejection were supported by further evidence.
- 3.20 The options addressed included:

Regulation or provision by the public sector

- (a) The Assessment states that both regulatory interventions and provision by the public sector, which we have assumed to mean the construction and operation of the manufacturing facility, were considered but ultimately rejected because HIE believed that the policy objectives could not be addressed through these options.
- (b) In our view, the depth of evidence and analysis of this option, whilst limited, is appropriate considering the outcome the subsidy aims to achieve.

Loan support

- (c) The Assessment concludes that loan support was not considered to be suitable because it does not directly reduce capital costs and thus does not positively impact SEI's investment metrics.
- (d) The Assessment states that because SEI is a global conglomerate with a substantial asset base underpinned by strong profit streams, it is able to access capital markets from a position of strength and thus is able to secure

⁹ [Statutory Guidance](#), paragraphs 3.40 to 3.41.

favourable borrowing terms. The Assessment concludes that the cost of additional borrowing from HIE would not positively impact SEI's investment metrics and therefore loan support from HIE is not considered the optimum means of supporting SEI's investment.

- (e) In our view, the depth of evidence and analysis of this option, whilst limited, is sufficient and appropriate taking into account that the aim of the subsidy is to overcome a viability gap/funding shortfall.

Equity investment

- (f) Similarly, equity investment was considered in the Assessment not to be a suitable option. An equity investment by HIE would not result in any direct reduction in capital costs of the project and would not positively impact SEI's investment metrics.
- (g) The Assessment also states that an equity investment would result in HIE becoming a minority shareholder in a conglomerate with ambitions that may not always be consistent with HIE's objectives, thus posing reputational risk for HIE. However, HEI indicated in the supporting evidence provided to us that a Special Purpose Vehicle would be established to take forward this project. It is therefore not clear how the reasoning set out above would apply were any potential HIE shareholding in the Special Purpose Vehicle only.

3.21 We are of the view that the Assessment has demonstrated that the subsidy is an appropriate instrument for achieving objectives of supporting the supply chain for the UK's renewable energy generation and distribution requirements, as well as supporting the drive for Net Zero. However, it is less clear to us from the Assessment how the subsidy is an appropriate or effective means of attaining security of supply of HVDC cables in the UK.

3.22 We sought clarification from HIE. It explained that no restrictions will be applied to ensure production is reserved for UK customers. Rather that it is attractive to offshore wind developers to secure supply as close to deployment as possible, as HVDC subsea cables are expensive to transport due to weight and bulk. Proximity of manufacture to where the cable is laid minimises the time required for use of special vessels and also significantly reduces the carbon footprint. HIE also stated that the subsidy will create greater competition in the European market for HVDC cable supply with the potential to make cable prices more competitive for offshore wind developers, again reducing costs.

3.23 In our view the Assessment could be strengthened by better explaining and supporting with further evidence, how the security of supply of HVDC cables policy objective will be achieved by the subsidy. In particular, the Assessment could set

out the scope and extent of the proximity to manufacture effects and how they might impact on incentives for both SEI and UK based offshore wind developers.

Step 2: Ensuring that the subsidy is designed to create the right incentives for the beneficiary and bring about a change

3.24 The second step involves an evaluation of the Assessment against:

- (a) Principle C: Subsidies should be designed to bring about a change of economic behaviour of the beneficiary. Second, that change, in relation to a subsidy, should be conducive to achieving its specific policy objective, and something that would not happen without the subsidy; and
- (b) Principle D: Subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy.¹⁰

Counterfactual assessment

3.25 In assessing the counterfactual, the Statutory Guidance explains that public authorities should assess any change against a baseline of what would happen in the absence of the subsidy (the 'do nothing' scenario).¹¹ This baseline would not necessarily be the current 'as is' situation (the 'status quo') but what would likely happen in the future – over both the long and short term – if no subsidy were awarded.

3.26 The Assessment includes various references to what would happen in the absence of the subsidy. Taken together, they constitute a counterfactual whereby the proposed factory at Nigg would not be constructed. The Assessment states that, 'SEI have explained that [in the absence of the subsidy] the company would not make the investment at Nigg in the Highlands due to it not being able to meet its target investment metrics.'

3.27 The Assessment explains that:

- (a) 'If the Company was unable to justify the investment at Nigg, the barriers to entry are the same elsewhere within the UK, and possibly without the necessary deep water, Freeport and market proximity benefits.'
- (b) The supply chain for the UK's renewable energy generation and distribution requirements would not be similarly supported by the development of other facilities. The Assessment explains that, 'the positive externalities associated

¹⁰ Further information about the Principles C and D can be found in the [Statutory Guidance](#) (paragraphs 3.43 to 3.57) and the [SAU Guidance](#) (paragraphs 4.12 to 4.14).

¹¹ [Statutory Guidance](#) paragraphs 3.46 to 3.47.

with the project would not happen if SEI didn't receive the subsidy and set up the factory in Nigg.'

- (c) There would be higher prices for cables and/or scarcity of supply. The Assessment states that, 'as the number of renewable energy and grid interconnector projects grow in other parts of the world (such as Asia, Europe and the US), reliance on the existing supply chain in these markets for HVDC/AC cables will become untenable and continue to rise in price with increasing demand'.

3.28 We note that there appears to be an expectation that there will be increased competition in the coming decade.

3.29 We consider that the Assessment could be strengthened by setting out in more detail, with evidence and analysis, how the most likely counterfactual was established. In particular, the Assessment could be improved by explaining in more detail how the following two elements would evolve over the short-term, medium-term and the long-term:

- (a) The use of the development site at Pitcalzean and other development sites nearby, taking into account the expected Green Freeport benefits.¹²

- (b) Levels of competition in the market for the supply of cables.

3.30 We note that the Assessment sets out that there remains uncertainty with regards to the tax and other benefits which SEI may be eligible to receive as a consequence of the site being within a designated Green Freeport. However, in our view, this should not in itself mean that an expectation, even if uncertain, of the potential Green Freeport benefits should not be incorporated into the counterfactual.¹³

Change in economic behaviour of the beneficiary

3.31 The Assessment explains that the intended change in economic behaviour is the construction and commissioning of a cable manufacturing factory adjacent to Port of Nigg which is capable of producing HVDC and HVAC cables.

3.32 The Assessment states that subsidy payments will be paid 'in arrears on evidence of expenditure defrayed and satisfactory progress reports'. We consider that the expected change in behaviour would be supported by this design feature.

¹² The Assessment states that green freeport benefits are expected to include Enhanced Buildings and Structural Allowance, Enhanced Capital Allowances, Employers' National Insurance Contributions Relief and Non-Domestic Rates Relief.

¹³ Future developments can be difficult to assess not only by public authorities but also by recipients and other market participants. Nevertheless, the Assessment should establish the most likely future scenario in the absence of the subsidy. [Statutory Guidance](#), paragraph 3.44.

3.33 In our view, the Assessment clearly articulates the expected change in behaviour relative to the counterfactual.

Something that would not have occurred without the subsidy

3.34 We note that, as the economic and community development agency for the Highlands and Islands of Scotland, part of HIE's remit is to support inward investment. Further, HIE has identified that SEI has particular characteristics which could support its ability to address the specific policy objectives, namely that it is a 'world leader in the production of, and pioneering technology into the evolution of, subsea cables'. Accordingly, HIE has assessed whether giving a subsidy to SEI would bring about the desired change in behaviour.

3.35 The Assessment states that, for the change in behaviour to occur, the size of the subsidy must be sufficient to satisfy SEI's investment criteria. We consider the assessment of whether the amount is limited to what is necessary to achieve the policy objectives in paragraphs 3.45 to 3.50.

3.36 In our view, the Assessment clearly explains why the expected change in behaviour would not occur without the subsidy.

How the change in behaviour supports the specific policy objective being pursued

3.37 The Assessment explains that, by stimulating SEI to invest in the manufacturing facility:

- (a) Job creation will be supported through direct and indirect employment.
- (b) Expansion outside Europe will primarily service non-European markets 'whereas a UK facility will primarily service UK markets and lead to an increase in both security of supply for Scottish projects with associated schedule upsides, ie fewer risks of delays from global supply chain capacity constraints'.
- (c) An expected result is 'increased confidence from this development to encourage future investments in the low-carbon energy supply chain'

3.38 We consider that the Assessment clearly sets out the assumptions used in forming the conclusion that the change in behaviour will support the policy objectives. In our view, the Assessment could be improved by giving more information on the scale of impact which the change in behaviour is expected to have and the degree of uncertainty over the outcomes.

Additionality

3.39 The Assessment states that:

- (a) 'HIE consider that this project is fully additional in that without grant-in-aid, the project would be too far below SEI's target investment return'.
- (b) 'The proposed £24.5 million subsidy reflects the minimum amount acceptable to the SEI Board.'
- (c) 'The subsidy will not support any revenue expenses and will not compensate for any business-as-usual operating expenditure'.

3.40 In our view, the Assessment clearly explains its conclusion that compensation for a viability gap, by its nature, will not be compensation for costs which the beneficiary would have funded in the absence of any subsidy.

Step 3: Considering the distortive impacts that the subsidy may have and keeping them as low as possible

3.41 The third step involves an evaluation of the assessment against:

- (a) Principle B: Subsidies should be proportionate to their specific policy objective and limited to what is necessary to achieve it; and
- (b) Principle F: Subsidies should be designed to achieve their specific policy objective while minimising any negative effects on competition or investment within the United Kingdom.¹⁴

Proportionality

3.42 The Assessment states that it 'aims to demonstrate that the subsidy is proportionate [and] the minimum amount necessary to incentivise the investment'.

Proportionate to the policy objectives

3.43 The Assessment sets out that:

- (a) the £24.5 million subsidy is less than 10% of SEI's capital cost commitment to the project.

¹⁴ Further information about the Principles B and F can be found in the [Statutory Guidance](#) (paragraphs 3.58 to 3.93) and the [SAU Guidance](#) (paragraphs 4.15 to 4.19).

- (b) Under the EU State Aid regime this level of intervention would be exempt from notification under the General Block Exemption Regulation (GBER)¹⁵ and Regional Aid Guidelines for an assisted area, which Easter Ross was.
- (c) There will be provisions in the agreement to restrict payment in line with work undertaken and actual costs incurred.

3.44 We consider that the Assessment could be improved by explaining in more detail how the subsidy was assessed to be proportionate relative to the estimated benefits of achieving the relevant policy objectives (both efficiency and equity objectives). In our view, the Assessment could be strengthened by further consideration of the estimated benefits in light of the possible time-limited nature of supply security benefits, given an expectation of further European supplier entry in the medium term or long term.

Limited to what is necessary to achieve the policy objectives

- 3.45 The Assessment states that the subsidy amount 'has been arrived at following a series of communications to negotiate a level of subsidy that HIE think is justified and proportionate and SEI consider close enough to their investment return targets to allow them to invest'.
- 3.46 We infer that HIE is of the view that, as a consequence of this negotiated process, the size of the subsidy is the minimum necessary to incentivise SEI's investment.
- 3.47 The Statutory Guidance advises public authorities to consider gathering information from a range of different stakeholders, consider the information they have obtained in the round and decide what weight to place on the different pieces of evidence in their assessment.¹⁶ Subsidy recipients and third parties may have an incentive to provide information on the current situation or future developments that would make a subsidy appear more or less favourable.
- 3.48 HIE has placed weight on information and evidence obtained from SEI in assessing the appropriateness of the size of the subsidy. HIE also commissioned some additional analysis of this information. The Assessment indicates the calculation has been verified by a due diligence process undertaken by HIE and by an independent professional firm.
- 3.49 We consider that it was commensurate for HIE to undertake this due diligence process and to seek verification of the viability gap. In our view, the Assessment could be further strengthened by setting out in more detail what analysis was

¹⁵ GBER and EU regional aid guidelines no longer apply to the UK. There was no mention in the Assessment of any need for HIE to match funding which might be offered by any EU member state as the counterfactual situation was for SEI to alternatively invest in facilities outside Europe.

¹⁶ [Statutory Guidance](#), paragraph 3.45.

undertaken, and what the findings were, including with regard to the work done by the independent professional firm, for example, by setting out in more detail the scope of its review and by explaining how its observations and recommendations have been taken into account in the Assessment.

- 3.50 The Assessment could also set out in more detail how HIE considered other evidence, in addition to the information provided by SEI, to gain wider assurance that the size of the subsidy is limited to what is necessary to achieve the specific policy objectives. For example, the Assessment could explain how HIE used its knowledge and experience of supporting other businesses in connection with the same or similar policy objectives, including any interactions which HIE has had with other potential beneficiaries, in forming a conclusion that the size of the subsidy is appropriate.

Assessment of effects on competition or investment

- 3.51 The Assessment states that the subsidy will have a minimal distortive impact on UK competition or international trade or investment, which is largely based on the expectation of growing demand and insufficient existing supply to meet this.
- 3.52 Anticipated significant market growth can be a key element mitigating trade and competition impacts of subsidies. In a growing market, a subsidy given to one enterprise is less likely to harm a competitor's growth prospects, given the general growth opportunities in the sector.¹⁷
- 3.53 The Assessment sets out different potential geographic and product markets throughout. It alternates between Scottish, UK and European geographic market definitions. The approach to product market definition also varies, at times mentioning HVDC specifically and at others referring to high voltage cables more generally.
- 3.54 The Assessment indicates that, if SEI meets its targets, SEI's output is only expected to provide a moderate proportion of the total supply of HV cables required for installation in the UK between 2026 and 2030. This means that, in light of UK demand growth, there will still be considerable scope for other UK manufacturers to grow their sales and also for foreign manufacturers (if they have supply capacity) to increase their imports into the UK.
- 3.55 The Assessment addresses barriers to entry to cable production under Step 2. It suggests that awarding the subsidy to SEI could reduce barriers to entry, as new entrants often need to partner with established firms and SEI could act as such.

¹⁷ [Statutory Guidance](#), paragraph 16.61.

- 3.56 Step 4 of the Assessment identifies SEI's major competitors and their locations. Of the ten identified, three are identified as being based in Europe. This section also notes that there is currently no UK HVDC production, but that two factories are under construction or planned.¹⁸
- 3.57 The Assessment recognises that supporting entry by SEI will likely have a competitive impact on its competitors, domestically and internationally. It notes that SEI will bring new competition to the UK market. It states that the UK market is also likely to be targeted by European producers, meaning the subsidy is likely to result in import substitution. It suggests distortionary impacts from the subsidy will be minimal, due to the previously mentioned high forecast demand and expected supply capacity gap.
- 3.58 The Assessment highlights design elements of the subsidy which could minimise the distortion of competition, in line with those described in Chapter 3 and Annex 2 of the Statutory Guidance:
- (a) the costs covered by the subsidy are initial investment and set up costs, which are less likely to distort pricing behaviour, and more likely to affect entry and/or investment location decisions;
 - (b) HIE's legal agreement with SEI will make provisions for funds only to be paid towards eligible costs, and for the setting and monitoring of performance criteria;
 - (c) the size of the subsidy is limited to less than 10% of capital investment. The Assessment also concludes that the subsidy is small relative to the market in the UK and Europe, though it is noted that it has not been possible to estimate this robustly; and
 - (d) the award will be time limited and is not expected to compensate for costs which are incurred after 34 months. Time-limited and one-off subsidies are likely to lead to less distortion.¹⁹
- 3.59 Furthermore, the Assessment includes some coverage of the rationale for providing the subsidy as a grant, including in the Step 1 Assessment. It is stated that grant support has been assessed as the most appropriate subsidy instrument based on advice from external advisors.
- 3.60 The Assessment could benefit from considering further several aspects which are relevant to effects on trade and investment:

¹⁸ It is indicated that there is uncertainty regarding timescales for a new facility in Hunterston in Ayrshire.

¹⁹ [Statutory Guidance](#), paragraph 3.80

- (a) More clearly defining the geographic and product markets to inform the competitive assessment, as discussed at paragraph 3.53.²⁰ The Assessment could give further consideration to the likely destination for SEI's output and the incentives it has to supply UK versus European customers, and hence where competitive impacts are most likely. Evidence on market concentration would also help HIE to understand the potential competition impacts.²¹ Relevant decisions in the field of antitrust and merger control which have considered the products or services in question could also contain useful information in this regard,²² such as the European Commission's consideration of a 2017 merger involving NKT Holdings A/S and ABB Limited.²³
- (b) Detailing the potential impacts on domestic and international competitors. Although there is some useful material in Step 4 of the Assessment on competitors, the Assessment could further explore how they might be affected.²⁴ Even in a growing market, SEI's entry would be likely to reduce prospective UK sales (or rate of sales growth) of other (prospective) UK manufacturers and of importers.
- (c) How barriers to entry, along with barriers to expansion or exit, could impact competition and whether the subsidy has the potential to raise these.²⁵ Furthermore, the Assessment could helpfully provide evidence to support the assertion that SEI's entry in Scotland may support new entrants to the market and thus reduce barriers to entry.
- (d) The implications of the subsidy being awarded to a single beneficiary,²⁶ and framing the competitive impacts in this context (including whether impacts are mitigated by SEI bringing new capacity to the market rather than being an incumbent operator).
- (e) While consideration has been given to the appropriate design of the subsidy, the Assessment could be improved by explaining how the features described will limit distortions to competition and investment.

3.61 Overall, the Assessment puts forward arguments to suggest a likely limited distortion of competition at a market-wide level. In our view, clearer geographic and product market definitions would help to demonstrate the extent of any distortionary impacts.

²⁰ [Statutory Guidance](#), paragraphs 16.31 to 16.51.

²¹ [Statutory Guidance](#), paragraphs 16.52 to 16.54.

²² [Statutory Guidance](#), paragraph 16.40.

²³ [Case M.8239 - NKT / ABB High Voltage Cable Business](#)

²⁴ For example, in terms of sales volume and market share impacts, potential to crowd out other investment, and locational impacts on investment. See [Statutory Guidance](#), paragraph 3.59.

²⁵ [Statutory Guidance](#), paragraphs 16.55 to 16.60.

²⁶ [Statutory Guidance](#), paragraph 3.69.

Step 4: Carrying out the balancing exercise

- 3.62 The fourth step involves an evaluation of the assessment against subsidy control Principle G: subsidies' beneficial effects (in terms of achieving their specific policy objective) should outweigh any negative effects, including in particular negative effects on: (a) competition or investment within the United Kingdom; and (b) international trade or investment.²⁷
- 3.63 The Assessment sets out a number of beneficial impacts of the subsidy. These include:
- (a) increasing the supply of HVDC/HVAC cables;
 - (b) creating a UK supplier that will primarily serve the UK markets; and
 - (c) reducing carbon emissions due to lower transportation distances, and therefore costs.
- 3.64 The Assessment also explains how the subsidy will help to create high value jobs in the area, supporting the equity objective of addressing regional inequality.
- 3.65 Overall, the Assessment argues that the investment by SEI is anticipated to yield significant social and economic benefits. It states that these ensure that the costs of the grant incentive will be recouped relatively quickly from economic growth (increased employment, exports and taxes) both from SEI's direct activities but also from the anticipated spillover benefits. These spillover benefits include knowledge transfer, education, training, increased research and development activity and the attraction of suppliers to build a renewable energy supply chain cluster.
- 3.66 We consider that the benefits of contributing to the supply chain infrastructure of HV cables, in particular the local supply chain, are reasonably presented. However, the Assessment may benefit from further evidence to support this conclusion, to demonstrate the extent to which a supply chain infrastructure will be developed as a result of subsidy. As set out in paragraph 3.23 the Assessment would also benefit from further evidence to explain how the subsidy would contribute to security of supply for the UK.
- 3.67 The Assessment provides strong quantitative and qualitative evidence to support its analysis on the benefits arising from securing high quality jobs in the area. The Assessment illustrates how the potential for job creation will address high unemployment rates, population decline and deprivation and contribute to the equity objective of overcoming a regional inequality.

²⁷ [Statutory Guidance](#) (paragraphs 3.96 to 3.98) and [SAU Guidance](#) (paragraphs 4.20 to 4.22) for further detail.

- 3.68 In terms of negative effects, the impact of the subsidy on competition and investment within the UK, and on international trade and investment, is evaluated at paragraphs 3.51 to 3.61. The Assessment refers to a report by an independent professional firm which assumes that labour market displacement will be low for the Inner Moray Firth and zero for Highlands and Islands, Scotland and the UK. As noted in paragraph 3.57 the Assessment provides evidence to conclude that the negative impacts from the subsidy will be minimal, principally due to the large demand forecast and expected supply capacity gap.
- 3.69 The Statutory Guidance states that where relevant, negative impacts on climate change and carbon emissions must be taken into account.²⁸ The Assessment and supporting evidence provides carbon impact valuations which captures operational carbon emissions produced by the factory, alongside carbon impacts caused by the production of construction materials. This includes a valuation of the production of sulphur hexafluoride which is a particularly potent greenhouse gas used in the production of electrical equipment, including cables.
- 3.70 The analysis in Step 4 draws on this evaluation and provides quantitative evidence to explain how these negative carbon impacts are outweighed by the carbon benefits arising from the lower transportation distances between the manufacturer to the deployment location. The evidence does, however, rely on the counterfactual of manufacture outside of Europe.
- 3.71 Overall, notwithstanding the aspects identified in paragraph 3.66 which we believe could be strengthened, we consider that HIE has carefully balanced the negative and positive effects.

Energy and Environment Principles

- 3.72 This step involves an evaluation of the Assessment with regard to compliance with the Energy and Environment principles, where these are applicable to the subsidy.²⁹
- 3.73 The Statutory Guidance summarises the scope of the different Energy and Environment principles that apply to different types of subsidies.³⁰ HIE states in the Assessment that the Energy and Environment principles apply as the primary policy objective for the subsidy relates to energy. The Assessment addresses

²⁸ [Statutory Guidance](#), paragraph 3.100.

²⁹ See Schedule 2 to the Act.

³⁰ Principles A and B apply to all subsidies in relation to energy and environment. Principle C applies for subsidies for electricity generation adequacy, renewable energy or cogeneration. Principle D applies to subsidies for electricity generation only. Principle E applies to subsidies for renewable energy or cogeneration. Principle F applies to subsidies in the form of partial exemptions from energy related taxes and levies. Principle G applies to subsidies that compensate electricity intensive users for increases in electricity costs, Principle H relates to subsidies for decarbonisation of industrial emissions. Principle I relates to subsidies for improving energy efficiency of industrial activities.

Principles A & B only as HIE considers that Principles C to I are not relevant in this case.

- 3.74 The Statutory Guidance states that the Energy and Environment principles apply only where the subsidy's specific policy objective (or one of its objectives) relates to energy or the environment.³¹ Public authorities giving subsidies that have incidental benefits in relation to energy or the environment, that are not related to the policy objective of the subsidy, need not consider these principles.
- 3.75 In our view, the Assessment could articulate more clearly why HIE considers that the policy objective(s) of the subsidy engage the Energy and Environment principles.

Principle A: Aim of subsidies in relation to energy and environment

- 3.76 The assessment against Principle A should show how the subsidy is consistent with delivering a secure, affordable and sustainable energy system and a well-functioning and competitive energy market, or increasing the level of environmental protection compared to the level that would be achieved in the absence of the subsidy. If a subsidy is in relation to both energy and environment, it should meet both of these limbs.³²
- 3.77 The Assessment states that the subsidy is compatible with the requirement of delivering a secure, affordable and sustainable energy system. It also concludes that the subsidy is not considered to be related to environmental protection.
- 3.78 HIE reasoned that the establishment of a HVDC/HVAC cabling factory in the Highlands of Scotland will contribute to energy security, energy affordability and environmental / Net Zero objectives.
- (a) In relation to energy security, the Assessment sets out that UK renewable energy and interconnector projects will help improve energy security. It then argues that a secure and reliable source of these cables is needed to deliver these projects, and that the subsidy helps deliver that.
 - (b) In relation to energy affordability, it argues that a source of these cables in Scotland will reduce the cost of transporting the cables, and so reduce the overall cost of renewable energy projects. This in turn will reduce the cost of electricity. In addition, it sets out that the source of cabling will help deliver offshore wind projects as part of a wider transition to renewable energy sources which HMG and the SG have set out will lower the price of energy.

³¹ [Statutory Guidance](#), paragraph 4.3.

³² [Statutory Guidance](#), paragraphs 4.19 to 4.28.

(c) In relation to Net Zero objectives, HIE sets out that the factory will help ensure the delivery of renewable electricity projects and the grid infrastructure required to distribute electricity efficiently across the UK. The Assessment argues that this will support the delivery of HMG and the SG's Net Zero ambitions.

3.79 Each of these arguments rests on the conclusion that the outputs of the beneficiary's factory will be used in UK infrastructure projects. In relation to affordability and Net Zero, they rely on the view that these projects would not go ahead without supply of HVDC cables from the beneficiary's project. In our view, the Assessment could be strengthened by including further reasoning and evidence as to how and why these conclusions have been arrived at.

3.80 With respect to energy affordability, the Assessment sets out that reduced transportation costs from manufacturing HVDC cables in Scotland will reduce the cost of UK renewable infrastructure projects. However, the Assessment could be improved by setting out how, in support of this argument, the subsidy will result in lower overall costs for the product and its delivery.

Principle B: Subsidies not to relieve beneficiaries from liabilities as a polluter

3.81 The assessment against Principle B should explain clearly how the proposed subsidy or scheme does not relieve a polluter from having to bear the full costs of the pollution caused.³³

3.82 The Assessment sets out that, as part of the standard terms and conditions it uses for grant funding, HIE will place an obligation on the beneficiary to observe all statutory regulations relative to the purpose and/or the business throughout the period of obligation.

3.83 The Assessment further sets out that HIE will include a disclaimer absolving itself of any responsibility for environmental damage caused by the factory. It says this will reinforce that receipt of the subsidy does not relieve the beneficiary from any liabilities arising from its responsibilities as a polluter.

3.84 In our view, the Assessment sets out clearly that it will not have the effect of relieving the recipient from any liabilities arising from its responsibilities as a polluter.

³³ [Statutory Guidance](#), paragraphs 4.29 to 4.35.

Other Requirements of the Act

3.85 This step in the evaluation relates to the requirements and prohibitions set out in Chapter 2 of Part 2 of the Act, where these are applicable.³⁴ HIE informed us that none of these requirements and prohibitions apply.

³⁴ [Statutory Guidance](#), chapter 5.