Subsidy Advice Unit Report on the proposed Energy Intensive Industry Exemption from the Nuclear Regulated Asset Base policy costs scheme

Referred by the Department for Energy Security and Net Zero and the Department for Business and Trade

17 June 2024

Subsidy Advice Unit

Part of the Competition and Markets Authority

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1. Introduction

1.1 This report is 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 the Department for Energy Security and Net Zero's (DESNZ) and the Department for Business and Trade's (DBT) joint assessment of compliance of the Energy Intensive Industry (EII) Businesses Exemption from Nuclear Regulated Asset Base (RAB) Policy Costs scheme (the Scheme) 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 DESNZ and DBT in their Assessment and evidence submitted relevant to that Assessment. We received one third party submission which was shared with DESNZ and DBT.

1.4 This report is provided as non-binding advice to DESNZ and DBT. The purpose of the SAU's report is not to make a recommendation on whether the Scheme should be implemented, or directly assess whether it complies with the subsidy control requirements. DESNZ and DBT are ultimately responsible for making the Scheme, based on their 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 scheme[2]

1.6 The Scheme is designed to benefit Energy Intensive Industry businesses[3] in Great Britain (GB) by reducing electricity costs, encouraging EII decarbonisation and electrification[4] and minimising the risk of carbon leakage.[5] Although the Assessment does not set out a cap for the Scheme in terms of amount of subsidy that could be paid, the Assessment states that DESNZ and DBT estimate that the annual value of the subsidy granted under the Scheme may be between £[✂][6] [£

[1] Chapter 1 of Part 2 of the Act requires a public authority to consider the subsidy control principles and 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 Energy Intensive Industry (EII) Businesses Exemption from Nuclear Regulated Asset Base (RAB) Policy Costs subsidy scheme by the Department for Energy Security and Net Zero (DESNZ) and the Department for Business and Trade (DBT) - GOV.UK (www.gov.uk).
[3] EII businesses include those in sectors such as steel, metals, chemicals and paper.
[4] The Assessment explains that the reduction of electricity costs is directly linked to enabling the deployment of electrification technologies, for example switching to electrical powered from gas-powered technologies.
[5] Carbon leakage is explained in paragraph 3.7.
[6] Here and throughout, the SAU has excluded from the published version of the report information which it considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). The omissions are indicated by [✂].

tens of millions][7] in 2025,[8] increasing to £[✂] [£ tens of millions][9] per year over the next 10 years, with an upper estimate scheme budget of £[✂] [£ mid billions].[10]

1.7 The Scheme will exempt GB-based eligible EII businesses from 100% of the forthcoming nuclear RAB policy costs,[11] which the Assessment states would otherwise add up to £[✂]/MWh on the bills of EII businesses over the next 10 years. The Assessment states that this approach will align with that taken for other renewables costs such as Contracts for Difference, Renewables Obligation and small-scale Feed-in-Tariffs schemes awarded under the British Industry Supercharger scheme introduced in April 2024.[12]

1.8 To be eligible, EII businesses will need to pass both a sector-level and business-level test. The sector-level test checks whether some or all of the products the business manufactures fall within energy and trade intensive sectors. The business-level test relates to the proportion of electricity costs relative to Gross Value Added which the business faces. The Government intends to carry out a review of the analysis which underpins eligibility for the measures in 2026.

SAU referral process

1.9 On 29 April 2024, DESNZ and DBT jointly requested a report from the SAU in relation to the Scheme.

1.10 DESNZ and DBT explained[13] that the Scheme is a Subsidy Scheme of Particular Interest (SSoPI) because the uncapped design of the Scheme means that it is capable of allowing subsidies to be granted over the value of £10 million.[14]

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[7] The SAU has expressed the annual value of the Scheme in a broad range. The value lies within this range, but the range does not constitute a maximum or minimum value.
[8] The Assessment, which was referred to the SAU on 29 April 2024, prior to the dissolution of Parliament on 30 May 2024 in advance of the general election on 4 July 2024, states that 'the timing for RAB costs depends on when a Final Investment Decision (FID) is reached on a nuclear project, with government committing to take FID for at least one such project before the end of this parliament period. Therefore, there is the realistic chance that RAB costs could start to be collected from energy suppliers this year'. DESNZ and DBT stated that these figures were their current best estimate of the annual value of the subsidies on the basis of taking Sizewell C forward, but without including additional nuclear power plants given the uncertainty around costs and funding of additional nuclear power plants.
[9] The SAU has expressed the annual value of the Scheme in a broad range. The value lies within this range, but the range does not constitute a maximum or minimum value.
[10] The Assessment states that this figure is based on the upper end of annual costs of nuclear RAB policy costs for Sizewell C, multiplied by a factor of three to account for the government targets of taking two nuclear power plants to FID by the end of next parliament and to secure investment decisions to deliver 3-7GW every five years from 2030 to 2044.
[11] The Assessment states that the RAB model is a type of economic regulation typically used in the UK for monopoly infrastructure assets such as water, gas and electricity networks. Under the RAB model, the company receives a licence from an economic regulator, which grants it the right to charge a regulated price to users in exchange for provision of the infrastructure in question. In the case of a nuclear RAB, electricity suppliers would be charged as users of the electricity system and would be able to pass these costs onto their consumers who also use the electricity system.
[12] The British Industry Supercharger subsidy scheme was referred by DBT to the SAU on 6 November 2023 and the SAU's report was published on 22 December 2023, see Final report (publishing.service.gov.uk).
[13] In the information provided under section 52(2) of the Act.
[14] If a recipient falls under one or more of the sensitive sectors categories, this would lower the threshold for SSoPI to £5 million.

1.11 The SAU notified DESNZ and DBT on 3 May 2024 that it would prepare and publish a report within 30 working days (ie on or before 17 June 2024).[15] The SAU published details of the referral on 7 May 2024.[16]

[15] Sections 53(1) and 53(2) of the Act.
[16] Referral of the proposed Energy Intensive Industry (EII) Businesses Exemption from Nuclear Regulated Asset Base (RAB) Policy Costs subsidy scheme by the Department for Energy Security and Net Zero (DESNZ) and the Department for Business and Trade (DBT) - GOV.UK (www.gov.uk).

2. General observations and summary of the SAU's observations

2.1 The Assessment uses the four-step structure 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 The Assessment specifies four different but related policy objectives, which are clearly stated. However, the Assessment should:

(a) In Step 1, clearly identify the market failure it seeks to remedy, and provide more evidence and a more detailed explanation of the link between the market failure and the policy objectives.

(b) In Steps 1 and 3, provide a more detailed explanation of how the Scheme would address carbon leakage given that the Assessment's electricity price analysis was based on certain comparator European countries, whereas the anecdotal evidence relied on in the Assessment referenced potential movement of production to countries outside Europe.

2.3 More generally, the Assessment should explain how exempting EIIs from 100% of the costs of the nuclear RAB is appropriate to achieve the policy objectives and to create a change in beneficiaries' behaviour given that those beneficiaries will already have been relieved of much larger costs through existing schemes, including through the British Industry Supercharger scheme. Relatedly, the Assessment should explain more clearly why the more limited increase to electricity costs from the nuclear RAB could not be absorbed as day-to-day costs in the absence of the Scheme, as well as addressing specifically in the analysis the beneficiaries' receipt of other subsidies, including those in the British Industry Supercharger scheme.

2.4 The Assessment could, in Step 3, include a more systematic evaluation of the Scheme's potential impact on competition and investment more widely.

2.5 Our report is advisory only and does not directly assess whether the Scheme complies with the subsidy control requirements. The report does not constitute a recommendation on whether the Scheme should be implemented by DESNZ and DBT. 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.[17]

[17] Section 59(3)(b) of the Act.

3. The SAU's evaluation

3.1 This section sets out our evaluation of the Assessment, following the four-step structure used by DESNZ and DBT.

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.[18]

Policy objectives

3.3 The Assessment sets out that the policy objectives of the Scheme are to:

(a) minimise the risk of carbon leakage by reducing the pressures on EIIs to offshore production to jurisdictions with weaker environmental protections;

(b) create a level playing field for GB EIIs with comparable countries;

(c) mitigate the risk of disinvestment and protect jobs in key industries; and

(d) encourage EII decarbonisation and electrification.

3.4 The Assessment also sets out background information about GB nuclear energy policy and sets out the relationship between the existing British Industry Supercharger scheme and this Scheme.

3.5 In our view, the Assessment clearly sets out specific policy objectives.

[18] Further information about Principles A and E can be found in the Statutory Guidance (paragraphs 3.32 to 3.56) and the SAU Guidance (paragraphs 4.7 to 4.11).

Market failure

3.6 The Statutory Guidance sets out that a market failure occurs where market forces alone do not produce an efficient outcome.[19]

3.7 The Assessment sets out its market failure argument as follows:

(a) EIIs are particularly exposed to electricity prices, and if exposed to new policy costs there will be several negative impacts. For example, GB EIIs would be undercut by foreign competitors who are not subject to the same costs, or would experience disinvestment and the shift of production to other territories.

(b) Capital is mobile and will relocate to jurisdictions where it can make the most profit, potentially leading to greater imports of energy intensive goods or production locating in regions with lower carbon costs. This could lead to 'an increase in emissions intensive production and greater global emissions' which is known as carbon leakage.

(c) There is a negative externality from carbon emissions that arise from the production activities of businesses, stemming from businesses not internalising the cost of their carbon emissions when setting their production levels.

(d) There is an international coordination failure with governments having different levels of net zero ambitions, with some jurisdictions having 'less stringent environmental regulations', 'lower carbon/policy costs' or 'more generous subsidies for existing policy costs than GB'.

(e) According to the Assessment, if left unaddressed these factors could lead to increased global emissions through carbon leakage as production moves to more emissions-intensive jurisdictions.

3.8 The Assessment further discusses evidence of the electricity price gap with other countries and how it results in carbon leakage, including setting out some evidence of carbon leakage and the price gap due to environmental regulations (mainly from academic literature), the international electricity price gap for EIIs (based on a comparison between the UK and 14 EU countries), the price gap due to disparities in subsidies (based on comparison between GB and France, Germany and the Netherlands), and evidence from the 2022 EII Exemption Scheme consultation on the impacts of high electricity prices on certain GB EIIs.

3.9 The Assessment explains that it has used electricity costs in Germany, the Netherlands and France as a benchmark because they have similar economies

[19] Statutory Guidance, paragraphs 3.35-3.46.

and climate ambitions as GB but have chosen to subsidise electricity costs for their large industrial users in a way that GB has not done to date. The Assessment also states that DESNZ and DBT have 'not chosen to use countries with lower levels of environmental protection as a benchmark because this would not be aligned with GB's net zero legislative commitments'.

3.10 The Assessment should clearly identify the market failure the Scheme seeks to remedy. In our view, the Assessment should provide more evidence and a more detailed explanation of the link between the market failure and the policy objectives. In particular, the Assessment should clearly demonstrate how the Scheme will remedy the market failure[20] and include a more detailed explanation and supporting evidence regarding the EII businesses that would potentially relocate outside of Europe due to high electricity prices.[21] Although the Assessment states that it uses electricity costs in Germany, the Netherlands and France as a benchmark, to the extent that carbon leakage would, in fact, be experienced to jurisdictions outside Europe (as suggested by the anecdotal evidence referenced in the Assessment), the Assessment could better explain why jurisdictions outside Europe should not be relevant for analysing the benefits of preventing carbon leakage.[22]

3.11 Whilst the Assessment usefully references public evidence as regards differing national carbon footprints in terms of electricity grid greenhouse gas emissions, in our view, the Assessment could be strengthened by more clearly demonstrating that the price gap between the UK and EU countries (due to the disparity of subsidies given in France, Germany and the Netherlands) would result in carbon leakage.[23] The Assessment could also better link more clearly the nuclear RAB exemption scheme with policy choices made in other EU countries aiming to shield EIIs from certain costs.

3.12 The Assessment mentions that 'EIIs are often critical employers within deprived regions through either direct employment or supply chains' and explained that the existing EII Exemption measure supports many businesses in areas that are designated as Priority 1 on the levelling-up priority index.[24] Consequently, the Assessment could be improved by clarifying whether the Scheme also addresses an equity rationale. This could be, for example, protecting employment

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[20] Statutory Guidance, paragraph 3.47. See also the summary of the SAU's observations in the Report on the British Industry Supercharger subsidy scheme, paragraph 2.2(b).
[21] The Assessment referred to evidence from responses to the 2022 EII Exemption Scheme consultation on the impacts of high electricity prices on certain GB EIIs which referred to potential leakage to the US, Turkey, Morocco and China.
[22] To the extent that the Assessment has used Germany, the Netherlands and France as benchmarks, rather than jurisdictions outside Europe, because this acts as a lower bound for the assessment of the benefits of preventing carbon leakage, it should explain this.
[23] The extent to which information on the carbon intensity of individual EU countries' grids supports the position in the Assessment could be considered further.
[24] The Department for Levelling Up, Communities and Housing maintains an Index of Priority Places for the Levelling Up Fund - Levelling Up Fund Round 2: updates to the Index of Priority Places - GOV.UK (www.gov.uk).

opportunities in disadvantaged areas of the country where EIIs may otherwise be under threat of closing down.

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

3.13 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.[25]

3.14 The Assessment sets out that the Scheme is the most appropriate mechanism for addressing the identified electricity price gap faced by EIIs as it aims to bring the treatment of policy costs from the nuclear RAB for EIIs in line with the treatment of costs from other renewables schemes and other similar costs.

3.15 The Assessment sets out several policy options that were considered as alternative policy options to the Scheme. These were:

(a) Continuing with the existing support made up of a Compensation Scheme[26] and the existing EII Exemption Scheme, as extended by the British Industry Supercharger scheme.

(b) Utilising loans or equity investment on commercial terms.

(c) Utilising grants.

(d) Utilising a compensation model.

(e) Utilising a partial exemption instead of a full exemption.

3.16 In our view, the Assessment demonstrates that DESNZ and DBT considered several policy options for achieving the policy objectives and explains why these alternatives would not be appropriate. However, it focusses on options which would deliver the narrowly defined objective of ensuring that electricity prices for eligible EIIs do not increase by the cost of the nuclear RAB. To be improved, the Assessment should:

(a) explain how the Scheme is the most appropriate tool to address carbon leakage or the other policy objectives set out in paragraph 3.3 beyond creating a level playing field for GB EIIs with comparable countries; and

[25] Statutory Guidance, paragraphs 3.54-3.55.
[26] DESNZ and DBT set out that some eligible EIIs in GB have access to a Compensation Scheme which provides relief for the indirect costs of the Emissions Trading Scheme and Carbon Price Support Mechanism which are passed on by electricity suppliers.

(b) consider alternative, non-subsidy approaches that could potentially deliver these objectives.[27]

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

3.17 The second step involves an evaluation of the assessment against:

(a) Principle C: First, 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.[28]

Counterfactual assessment

3.18 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').[29] 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.

3.19 The Assessment articulates a counterfactual baseline scenario where EIIs would be exposed to 100% of the policy costs of the nuclear RAB and, therefore, face higher electricity costs. The Assessment explains that without the subsidy:

(a) In the short term, there is a risk of carbon leakage because GB-based EIIs would be disadvantaged by higher industrial electricity prices (see paragraph 1.7 above). EIIs would not be able to pass through these higher prices and would thus be undercut by imports, most likely those with lower levels of climate regulation. It would also negatively impact investment decisions and jobs in GB. Hence, the policy objective would not be met. DESNZ and DBT referenced evidence of the negative impacts of high electricity prices when the Government consulted on the British Industry Supercharger scheme to support their case.

[27] Including, for example, those discussed in the Summary of consultation responses and government response on Addressing carbon leakage risk to support decarbonisation.
[28] Further information about Principles C and D can be found in the Statutory Guidance (paragraphs 3.57 to 3.71) and the SAU Guidance (paragraphs 4.12 to 4.14).
[29] Statutory Guidance, paragraphs 3.60-3.61.

(b) Over the longer term, DESNZ and DBT anticipate that domestic production would decrease, and some firms would face an increased risk of closure as they become uncompetitive internationally, thus compounding the carbon leakage. DESNZ and DBT submitted that EII firms had told them that higher electricity prices in GB than in the EU, driven by policy costs, have already led some firms to disinvest and that this trend of job and firm losses would continue absent the Scheme. The Assessment cites evidence since 2008 of 20% job losses in EII manufacturing sectors and that EII manufacturing employment declined twice as fast as non-EII manufacturing sectors. In addition, data from a third party report suggests that 30% of firms in sectors eligible for relief are loss-making.

3.20 In our view, the Assessment explains the likely short-term and longer-term counterfactuals well. However, the Assessment could be improved by providing more evidence of the most likely future development to show:

(a) Whether and how, absent the subsidy, EII firms are at risk (as described above) because of high electricity costs or other cost and revenue drivers, particularly those drivers under the firm's control that management can partially or wholly mitigate.

(b) Where is production likely to relocate to, and how would the move affect carbon leakage?

3.21 In making the commercial case for GB-EIIs requiring this subsidy, the Assessment also cites evidence that was used for the British Industry Supercharger scheme assessment. However, the British Industry Supercharger scheme has been implemented, meaning EIIs' electricity costs will already be reduced by approximately £24/MWh. Therefore, the Assessment could be improved by citing new evidence (such as by analysing the financials of target EIIs) to make the case for a subsidy scheme with a further incremental saving (see paragraph 3.34 below). Moreover, the Assessment would have been strengthened by providing evidence and analysis of what proportion or numbers of EII eligible businesses would be expected to partially or wholly close or relocate outside the UK in the absence of this subsidy.

Change in behaviour and additionality assessment

3.22 The Statutory Guidance sets out that subsidies must bring about something that would not have occurred without the subsidy.[30] In demonstrating this, public authorities should consider the likely change or additional net benefit.

[30] Statutory Guidance, paragraph 3.64

3.23 The Assessment explains that the Scheme will make GB a more attractive place to invest, decrease the risk of carbon leakage, increase production for eligible firms and incentivise EIIs to decarbonise where high electricity prices are a barrier to decarbonisation. More specifically, it identifies the following benefits arising from the subsidy that would not otherwise occur in the counterfactual scenario:

(a) Increased GB competitiveness: The reduction in overall energy costs for GB EIIs will bring costs further into line with international competitors and therefore (i) allow GB EIIs to remain competitive and profitable, (ii) safeguard existing jobs, and (iii) provide further opportunities for inward investment. The Assessment cites evidence that for the sectors eligible for relief, 30% of firms are loss-making.

(b) Increased production/investment for eligible EIIs: The main benefits derived from the reduction in electricity prices for eligible firms are: (i) increased production; (ii) increased investment; (iii) avoidance of firm closure; and (iv) reduced carbon leakage. The Assessment explains that the Scheme reduces the electricity price that recipient firms face, translating into a rise in firm electricity consumption. It notes that this leads to an increase in Gross Value Added.

(c) Incentivisation of EIIs to decarbonise: The Scheme satisfies the additionality principle in that investment in decarbonisation by EIIs, such as steel, would not happen in GB without lower electricity prices.

3.24 The Assessment notes that the value-for-money assessment estimates that over a 10-year appraisal period, the reduction in electricity prices for eligible firms would lead to significant benefits that would exceed the annual costs. It highlights that while some firms are already paying high electricity prices, it is not clear that they would continue to do so in the long term, creating the risk of disinvestment and moving to countries with cheaper operating costs, which could result in carbon leakage. The Assessment explains that the proposed measures would help safeguard and create jobs in strategic sectors by reducing barriers to inward investment and increasing GB competitiveness, as well as encouraging decarbonisation in the longer term through greater electrification made possible through lower electricity costs.

3.25 Notably, the Assessment highlights that the eligibility for the subsidy has been designed in such a way that only the most energy and trade-intensive businesses benefit from any exemption, such as by including business-level and sector-level tests to identify most at-risk sectors and firms with a five-year monitoring and evaluation framework to assess the need for ongoing support. This ensures that the subsidy scheme is targeting businesses most exposed to high energy costs because of their high energy usage, who are a) most at risk of carbon leakage and

b) whose efforts to decarbonise will have a significant impact on GB's overall decarbonisation goals.

3.26 In our view, the Assessment should expressly set out the likely change in economic behaviour that this subsidy scheme is designed to bring about, including by:

(a) Clearly identifying why a reduction in electricity costs would be sufficient to resolve financial concerns leading to the closure or exit of EIIs from GB while also appreciating other revenue and cost drivers that might stymie the policy objective.

(b) Considering how the financial assistance arising from this Scheme is appropriately targeted in light of the savings for EIIs from the British Industry Supercharger Scheme and will change the beneficiaries' behaviour, ie whether providing an electricity price discount under this Scheme would be necessary to create this incentive when EIIs are already benefitting from existing schemes, including the saving from the British Industry Supercharger scheme.

3.27 Moreover, as the Scheme aims to reduce electricity costs (which firms would incur in the normal operation of the business), the Assessment should clarify whether the Scheme compensates for business-as-usual costs related to the normal day-to-day running of the business. We note that even if electricity costs are business-as-usual, the additionality test could still be met by setting out how target EIIs as beneficiaries could not fund the increase in electricity costs, which the Assessment could have explained by reference to the policy objectives.[31]

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

3.28 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.[32]

[31] Statutory Guidance, paragraphs 3.66 and 3.67.
[32] Further information about Principles B and F can be found in the Statutory Guidance (paragraphs 3.72 to 3.108) and the SAU Guidance (paragraphs 4.15 to 4.19).

Proportionality

3.29 The Assessment states that the support in the Scheme is proportionate to achieve the policy objective as it targets an electricity price gap to an extent that reduces the risk of carbon leakage and incentivises electrification where applicable. Electricity prices will be reduced 'to a commensurate level with our nearest comparable neighbours without seeking to undercut them'. The Assessment further states that an exemption of 100% of nuclear RAB policy costs would bring it in line with EII relief from similar costs.

3.30 The Assessment outlines that the nuclear RAB will increase electricity costs over the next decade (see paragraph 1.7 above). By preventing this cost increase from materialising for EIIs, the Assessment states that analysis using 2020 figures shows that the Scheme is not seeking to negatively impact competition but to provide 'sufficient support to maintain electricity prices in line with competitor countries.'

3.31 Overall, the Assessment considers a number of aspects relevant to proportionality, such as Benefit Cost Ratio (BCR), Net Present Value (NPV) and Social Net Present Value calculations that are outlined in Step 4 of the Assessment.

3.32 However, we consider that the Assessment should explain more clearly how DESNZ and DBT concluded that the reduction in electricity costs for EIIs is necessary and avoids over-compensation. Whilst the Assessment shows EII electricity price disparities between GB and the Netherlands, France and Germany, as noted previously (see paragraph 3.10) it is unclear why the focus lies on these countries in particular. This appears particularly important given the comparison to these countries appears to drive the justification for the size of the proposed relief. Whilst the Assessment does mention that those comparator nations were selected based on having similar economies and climate ambitions as GB, it could be improved by including evidence of carbon leakage to those countries (whether in terms of relocation of production activity or imports).

3.33 Furthermore, the Assessment sets out trade intensity levels as a measure of international competition and therefore as an indication of businesses' inability to pass on cost increases. The Assessment could be improved by considering whether different eligible markets (and potentially even eligible firms within these markets) will likely face differing levels of trade intensity and will therefore not be uniformly constrained in passing on costs. In such a scenario, granting the subsidy to all beneficiaries may lead to overcompensation in some cases.

3.34 The Assessment should also consider other subsidies given to the same recipients for similar purposes (including under the British Industry Supercharger scheme) as part of the assessment of the proportionality of subsidies to individual

beneficiaries, and how these have been taken into account when setting Scheme limits, in line with the Statutory Guidance.[33]

Design of subsidy to minimise negative effects on competition and investment

3.35 The Assessment lists most of the scheme characteristics identified in Chapter 3 of the Statutory Guidance as potentially relevant to the likelihood and extent of distortive impact on competition or investment, including the nature of the instrument, the breadth of beneficiaries and selection process, the size of the subsidy, its timespan, the nature of costs being covered, the performance criteria, ringfencing and monitoring and evaluation. However, there is little explanation in the Assessment as to how these characteristics help to minimise distortions in the present case.

3.36 On the nature of the instrument, the Assessment provides a high-level overview of the proposed subsidy and why it is proportionate. Whilst helpful, the Assessment should consider whether a less distortive form of instrument could be deployed whilst still meeting the identified policy objectives.[34] The Assessment addresses this requirement at a high level under Principle E but could be improved by addressing this in more detail.

3.37 Whilst the Assessment sets out at a high level the eligibility criteria (see paragraph 1.8 above), the Assessment should explain (a) how the thresholds applicable for these tests were chosen, and (b) the extent to which they contribute to minimising negative effects.

3.38 Moreover, given the open-ended nature of the Scheme, the Assessment should explain in greater detail the Scheme's five-yearly review process, including the proposed remit of these future reviews. For instance, the Assessment could discuss how the cost / benefit analysis outlined in Step 4 will be monitored and updated in light of potential future extensions of the nuclear RAB policy costs to cover additional nuclear power plants beyond Sizewell C.

Assessment of effects on competition or investment

3.39 The Assessment recognises that the Scheme could impact 'domestic trade within the UK single market', as certain EIIs will not be eligible for support. Moreover, the Assessment states that, as a result of the eligibility criteria, eligibility for the EII nuclear RAB exemption is skewed towards large and medium-sized firms. As eligible firms will experience a decrease in production costs, the Assessment submits that, all else being equal, the Scheme could confer a competitive advantage on such businesses compared to non-eligible firms in the same sector.

[33] Statutory Guidance, paragraphs 3.91 and 3.92.
[34] Statutory Guidance, paragraph 3.82.

The Assessment further states that this competitive advantage 'may entrench the market positions of major firms'.

3.40 However, the Assessment submits that the Scheme does not disproportionately benefit market leaders as:

(a) it does not prevent currently non-eligible businesses from becoming eligible and applying to the Scheme in future; and

(b) relief is proportionate to energy consumption following principles that are applied 'consistently and objectively' across all beneficiaries.

3.41 The Assessment further evaluates the potential for displacement of imports to Northern Ireland (NI) from the EU in favour of imports from GB. Given its scope, the Assessment states that the Scheme is unlikely to significantly displace imports to NI from the EU in favour of imports from GB as the size of the subsidy is not aimed at undercutting EU competitors (but bringing GB EII electricity costs in line with those of their EU competitors) and the relief is only available to roughly 300 businesses in GB.

3.42 In relation to the impact on investment, whilst not explicitly discussed under a competition and investment section within Step 3, the Assessment does mention that it seeks to mitigate the risk of disinvestment in GB and protect jobs in key industries. The Assessment outlines under Step 2 that the main benefits stemming from a fall in electricity prices are, among others, increased production, increased investment and avoidance of firm closure. DESNZ and DBT provided an estimate for the overall benefits of the Scheme over a 10-year period.

3.43 The Assessment covers various key competitive impacts arising from the Scheme at an aggregate level. We particularly note the consideration in the Assessment of the impact of the Scheme on non-eligible companies and the recognition of the potential of the Scheme to entrench the market positions of major firms. However, the Assessment could be improved by explaining in more depth why the benefits of the Scheme outweigh the expected distortion and how the Scheme has been designed to minimise potential negative competitive impacts.

3.44 Moreover, we consider the Assessment could be improved by including case studies on those sectors likely to be more heavily represented and benefitting from the Scheme.[35] Such case studies could be used to showcase characteristics of affected markets and could in turn help with the competitive impacts section of the Assessment.

[35] Statutory Guidance, paragraph 3.82.

3.45 Finally, whilst we recognise the Assessment's analysis of impacts on EU imports to NI, the Assessment could be improved by including a more comprehensive evaluation of the Scheme's potential impact on international trade and investment.

Step 4: Carrying out the balancing exercise

3.46 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; (b) international trade or investment.[36]

3.47 The Assessment includes a cost-benefit analysis showing the BCR for the Scheme and its NPV over a 10-year appraisal length and based on the anticipated payment figures for the Sizewell C plant.[37] The Assessment further notes that the BCR represents very high value for money. It provides an overview of the potential benefits that formed part of the value for money analysis:

(a) Increased production leading to higher domestic profits and an expansion of employment. The analysis provides an estimated benefit over a 10-year period of additional wages due to the reduction in electricity prices.

(b) Increased investment for existing businesses. The analysis calculates the benefits over a 10-year period of additional investment due to the reduction of electricity prices, using regression analysis.

(c) Prevention of firm closure.

3.48 The Assessment further states that EIIs are often critical employers within deprived areas in the UK through either direct employment or indirectly through supply chains.

3.49 The Assessment sets out two types of costs of the Scheme:

(a) The environmental costs of increased production (due to increased consumption related to lower electricity prices).[38]

(b) Additional costs in terms of electricity bills for households and non-eligible businesses, as the costs which would otherwise be borne by eligible

[36] See Statutory Guidance (paragraphs 3.110 to 3.114) and SAU Guidance (paragraphs 4.20 to 4.22) for further detail.
[37] DESNZ and DBT stated that the value for money appraisal was based on the figures for the Sizewell C plant only.
[38] DESNZ and DBT rely on elasticity-price calculations, based on internal literature review, to show that a decrease in electricity prices would lead to an increase in consumption. However we consider that the price elasticities do not provide a strong argument that reducing electricity prices for EIIs will lead to reduced costs and thus increase production. Both the price elasticity of investment and energy consumption/production are shown to be relatively inelastic meaning that businesses are not very responsive to price changes.

businesses would be transferred to households and non-eligible electricity businesses.

3.50 The Assessment then considers the net zero impact. It states that as the Scheme exempts EIIs from costs relating to policies which contribute to net zero objectives, it may lead to a rise in the level of emissions within GB, as it is assumed that businesses will consume more electricity as the price falls, and may lower the incentives to invest in energy efficiency for EIIs in the short term. However, the Assessment also notes that these risks are mitigated by the fact that (i) businesses remaining in GB may consider strategic investment in electrification in the longer term, thereby reducing the impact of the Scheme on emissions; (ii) analysis shows that lowering electricity prices may enable future fuel switching and subsequently increase domestic decarbonisation; and (iii) incentives to invest in energy efficiency will remain given the significant proportion of energy costs for EIIs.

3.51 In our view, the Assessment demonstrates that DESNZ and DBT have considered some of the expected benefits of the Scheme and its potential negative effects in line with the Statutory Guidance.

3.52 The Assessment could however be improved with a clearer explanation of how it weighed the benefits and negatives against each other, and by reference to the stated policy objectives, to arrive at its conclusion. For example, on the benefits, the Assessment should include benefits related to avoiding the risk of carbon leakage.[39] Whilst the Assessment does consider net zero impact, the balancing exercise would be strengthened by including a fuller consideration of carbon leakage.

3.53 In relation to negative effects, the Assessment should consider in the balancing assessment the costs of any wider impact on competition (eg between eligible recipients, and between eligible and non-eligible businesses), or on international trade or investment, as set out under Principle F. This is particularly the case given that the Assessment states in relation to Principles B and F (see paragraph 3.39) that the Scheme may ‘entrench the market position of major firms’. Furthermore, the Assessment could have provided evidence supporting the view that some of the negative effects of increasing carbon emissions may be mitigated by long-term investment in electrification and increased incentive to switch away from fossil fuels.

[39] Avoidance of carbon leakage is listed as one of the benefits in the value for money analysis provided by DESNZ and DBT in supplementary evidence, however the analysis stated that this benefit is difficult to quantify. Avoidance of carbon leakage is not listed as one of the benefits in the Assessment itself.

Energy and Environment Principles

3.54 This step involves an evaluation of the Assessment with regard to compliance with the energy and environment principles, where these are applicable to the scheme.[40]

3.55 The Statutory Guidance summarises the scope of the different energy and environment principles that apply to different types of subsidies.[41] DESNZ and DBT have conducted an assessment of the Scheme against Principles A, B, F and G. We are satisfied that the other energy and environment principles are not applicable to this Scheme.

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

3.56 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.[42]

3.57 The Assessment sets out that the Scheme is consistent with both limbs of Principle A.

3.58 In relation to limb 1, energy system and energy market, the Assessment sets out that while the Scheme will exempt EIIs from nuclear RAB policy costs, the cost of the exemption applied to EIIs will still be met by non-eligible bill payers: therefore, the objective of supporting new nuclear, which is required to meet decarbonisation targets, will still be met. In this respect, the Assessment explains that the impact on non-eligible bill payers is limited to what is necessary to achieve the objective of the reduction in electricity costs for EIIs, representing a very small increase of an additional £[✂] per year on household bills and £[✂]/MWh for non-eligible businesses. The Assessment further states that support will be given to those EIIs most exposed to high electricity prices so the impact on other electricity users will also be limited to what is necessary to mitigate the risk of carbon leakage, safeguard jobs in strategic sectors and enable decarbonisation through electrification longer term.

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[40] See Schedule 2 to the Act.
[41] 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.
[42] Statutory Guidance, paragraphs 4.19-4.28.

3.59 In relation to limb 2, environmental protection, the Assessment explains that ensuring that domestic EIIs can remain competitive and profitable will mitigate the risk of carbon leakage (and associated environmental impacts) which would not be possible without the proposed subsidy.

3.60 In our view, the Assessment has set out how the Scheme complies with both limbs of Principle A. We consider that the Assessment could be further improved by more clearly explaining:

(a) How an increase of the electricity bills of non-eligible businesses or household bills (even if more limited than the impact considered in the British Industry Supercharger scheme in terms of size) is compatible with offering an affordable energy system. Alternatively, if relevant, explaining how the objective balances the aims of the first limb of Principle A in line with paragraph 4.21 of the Statutory Guidance.

(b) How the Scheme will support a decrease in carbon emissions at a global level, for instance by providing evidence of the percentage of imports coming from countries with no environmental policy, and by showing how the reduction of carbon leakage associated with the Scheme outweighs the increase of electricity consumption in the UK generated by lower electricity prices for eligible EIIs (see in this respect paragraph 3.10).

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

3.61 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 it caused.[43]

3.62 The Assessment refers to evidence that domestic demand in some sectors is increasingly being met by international firms in countries that do not impose environmental policy costs like GB. It reiterates some of the previous statements made in relation to the Scheme's objectives to reduce carbon leakage (and thereby avoid potentially greater global emissions) and to provide greater incentives and opportunity for EIIs to carry out electrification. It also confirms that the policy costs that the measures exempt EIIs from will still be met by other billpayers, so overall climate obligations will still be met.

3.63 The Assessment indicates that the subsidy does not 'seek to' relieve beneficiaries from liabilities as a polluter. The Assessment could be improved by bringing this

[43] Statutory Guidance, paragraphs 4.29-4.35.

statement more closely in line with the statement envisaged in paragraph 4.33 of the Statutory Guidance.[44]

Principle F: Subsidies in the form of partial exemptions from energy-related taxes and levies

3.64 Subsidies in the form of partial exemptions from energy-related taxes and levies in favour of energy-intensive users should be assessed against Principle F. The Assessment should clearly demonstrate that the value of any such exemption does not exceed the total value of the relevant tax or levy. If the exemption does exceed this, then the Assessment should ensure that it has accounted for this in the assessment of the scheme under the general subsidy control principles.[45]

3.65 The Assessment explains that the Scheme exempts eligible EIIs from 100% of their associated nuclear RAB policy costs. As the exemption is calculated for each individual eligible business, this means the subsidy will not exceed the total amount of the policy costs concerned.

3.66 We are satisfied that the Assessment explains how this principle is met.

Principle G: Subsidies in the form of compensation for increases in electricity costs

3.67 Under Principle G, subsidies in the form of compensation for electricity-intensive users given in the event of an increase in electricity costs resulting from climate policy instruments shall be restricted to sectors at significant risk of carbon leakage due to the cost increase. The assessment should clearly demonstrate the existence of the carbon leakage.

3.68 The Assessment states that, although the Scheme provides EIIs with an exemption from nuclear RAB costs, rather than compensation, DESNZ and DBT have assumed that Principle G does apply.

3.69 The Assessment describes how the eligibility criteria ensure that only sectors at the highest risk of carbon leakage due to electricity costs resulting from climate policy instruments will be eligible for support. We refer back to our comments in relation to the eligibility criteria set out above at paragraph 3.37.

[44] Statutory Guidance, paragraph 4.33 states that public authorities giving subsidies in relation to energy and environment are advised to include a clear statement in the terms of the subsidy or scheme to the effect that receipt of the subsidy does not relieve the recipient from any liabilities arising from its responsibilities as a polluter under the relevant law of England and Wales, Scotland, and Northern Ireland.
[45] Statutory Guidance, paragraphs 4.53-4.56.

Other requirements of the Act

3.70 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.[46] DESNZ and DBT confirmed that no other requirements or prohibitions set out in Chapter 2 of Part 2 of the Act apply to the Scheme.

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[46] Statutory Guidance, chapter 5.