EXPLANATORY MEMORANDUM TO

THE ELECTRICITY SUPPLIER OBLIGATIONS (EXCLUDED ELECTRICITY) (AMENDMENT) REGULATIONS 2019

2019 No. XXXX

1. Introduction

1.1 This Explanatory Memorandum has been prepared by the Department for Business, Energy and Industrial Strategy (BEIS) and is laid before Parliament by Command of Her Majesty.

1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument amends the Electricity Supplier Obligations (Amendment & Excluded Electricity) Regulations 2015 (the 2015 Regulations), which make provision for indirectly exempting eligible energy-intensive industries (EIIs) from a proportion of the costs of funding Contracts for Difference (CFD).

2.2 The CFD scheme is a policy designed to encourage investment in large scale renewable electricity generation. The costs of funding this policy – by means of a compulsory levy on electricity suppliers, which they pass on to their customers – expose EIIs to high electricity bills. As EIIs operate in international markets, these costs place them at a competitive disadvantage and increase the risk that companies may choose to move their production abroad. The 2015 Regulations allow eligible EIIs to apply to reduce the levy paid by their electricity supplier.

2.3 EIIs that are eligible for the reduction in the CFD levy (the CFD exemption) under the 2015 Regulations are also eligible for reductions in the costs of funding two other policies that support renewable electricity generation, namely the Renewables Obligation (RO) (in England and Wales and in Scotland) and the small-scale Feed-In Tariff (FIT) schemes[1].

2.4 This instrument amends the 2015 Regulations by adding flour milling to the eligible sector list in the Schedule to the 2015 Regulations, adding provisions to exclude undertakings in difficulty (UIDs) from being eligible for the exemption schemes and making a number of changes to improve the operation of the exemption schemes.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 We consider that the exception in section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015 applies to this instrument, as it makes provision varying a levy, or in the alternative, makes provision in connection with provision imposing or

[1] See (for the RO in England and Wales) amendments to the Renewables Obligation Order 2015 made by the Renewables Obligation (Amendment) (Energy Intensive Industries) Order 2017; (for the RO in Scotland) amendments to the Renewables Obligation (Scotland) Order 2009 made by the Renewables Obligation (Scotland) Amendment Order 2017; (for FIT) amendments to the Feed-in Tariffs Order 2012 made by the Feed-in Tariffs (Closure, etc.) Order 2018.

varying a levy. This is because the Contracts for Difference (Electricity Supplier Obligations) Regulations 2014 (the ESO Regulations) impose a requirement on licensed electricity suppliers in Great Britain to make payments to fund the CFD scheme to the Low Carbon Contracts Company (LCCC), the Government-owned company responsible for administering the CFD scheme. The cost this imposes on suppliers is passed onto bill payers who do not have a choice as to whether they make this payment – it is compulsory. On this basis these payments have been classified as a notional or imputed tax by the Office for National Statistics and, as a result, they are subject to the Levy Control Framework until 2020/21 and the Control for Low Carbon Levies thereafter[2].

3.2 The 2015 Regulations amended the ESO Regulations to grant a partial exemption to certain licensed electricity suppliers from the payments required by the ESO Regulations (this is explained further in section 6.2 below). This instrument in turn amends the 2015 Regulations.

Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)

3.3 The territorial application of this instrument includes Scotland and Northern Ireland.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

4.3 The EII exemption schemes only apply to businesses in Great Britain. Businesses in Northern Ireland do not pay the costs of funding the CFD or FIT schemes as they have not been introduced in Northern Ireland. The RO scheme has been introduced in Northern Ireland, and eligible EIIs in Northern Ireland receive equivalent relief for a proportion of the costs of funding the RO via compensation paid by the UK Government rather than an exemption scheme.

5. European Convention on Human Rights

5.1 The Minister for Business and Industry has made the following statement regarding Human Rights:

"In my view, the provisions of the Electricity Supplier Obligations (Excluded Electricity) (Amendment) Regulations 2019 are compatible with the Convention rights."

6. Legislative Context

6.1 The Energy Act 2013 contains powers enabling the Secretary of State to implement measures to reform the electricity market to encourage low carbon electricity generation and ensure security of supply. The reforms which have been implemented

[2] In 2011 Government introduced the Levy Control Framework (LCF) to govern the budget for low carbon electricity schemes that are paid for through consumer bills. The Government will continue to monitor spend against the LCF budget until 2020/21. The Autumn Budget 2017 announced the Control for Low Carbon Levies, which will monitor spend from when the LCF ends until 2024/25 .The Control sets out that the Government will not consider introducing new low carbon electricity levies until the burden of these costs is forecast to have a sustained and significant fall in real terms.

are known as Electricity Market Reform. One of the mechanisms for reform is the CFD scheme. This scheme was implemented by secondary legislation.

6.2 The 2015 Regulations came into force in April 2015 and provide a mechanism for allowing eligible EIIs to apply for the CFD exemption, which takes effect by way of a reduction to the compulsory levy paid by their electricity suppliers. Certificates granting the CFD exemption are known as "EII certificates". The exemption schemes constitute State aid, for which approval has been granted.

6.3 This instrument amends the 2015 Regulations in order to implement the outcome of a consultation that set out proposals for improving the exemption schemes and in order to clarify State aid requirements excluding UIDs and undertakings if they were to be subject to an outstanding recovery order made by virtue of Article 108(2) of the Treaty on the Functioning of the European Union (where a business has previously received unlawful State aid and not repaid it) from eligibility for the exemption schemes.

7. Policy background

What is being done and why?

Policy objectives of support for renewable electricity

7.1 Several policies have been developed to increase the share of electricity generated from renewable and low carbon sources. Specifically, the Government has put in place the CFD, RO and FIT schemes, amongst others, to incentivise low carbon and renewable electricity deployment. The costs of funding these schemes are recovered through levies or an obligation on electricity suppliers and these are ultimately passed on to domestic and non-domestic electricity consumers' bills.

Impact of support for renewable electricity on EIIs

7.2 EIIs are those businesses in sectors where electricity costs are a high proportion of their Gross Value Added (which is a measure of the value of the goods and services they produce). The costs of the renewable electricity (CFD, RO, and FIT) schemes are passed through in bills to EIIs from electricity suppliers and, as EIIs operate in global markets where prices are set internationally, they are often unable to pass these costs through to the end customer. Therefore EIIs that face higher electricity costs are placed at a competitive disadvantage. This increases the risk that businesses may choose to move their production abroad, including to countries that have less ambitious climate policies. Typical EIIs in the UK include chemicals, steel, cement, aluminium, glass, paper, plastics and ceramics.

Objectives of the EII exemption

7.3 The 2015 Regulations provide that eligible EIIs can apply to receive an indirect exemption from up to 85% of the costs of funding the renewable electricity schemes. Where an eligible EII successfully applies for the exemption, its electricity supplier will receive a reduction in the costs of renewable electricity schemes which it is expected to pass on to its EII customer.

7.4 This mitigates the costs of funding the renewable electricity schemes for EIIs, supports industrial competitiveness and by being set in legislation provides long-term certainty for businesses. The costs of the exemption for EIIs are redistributed to all

other electricity users, including domestic and ineligible business users, increasing their bills. The cost to household consumers of funding the EII exemption schemes is estimated to be around £4 a year in their electricity bill.

Objectives of changes to the 2015 Regulations

7.5 The amendments made by this instrument to the 2015 Regulations include the following:

- the addition of the flour milling sector to the eligible sector list for the exemption schemes, which will support the competitiveness of the sector;
- the clarification of State aid requirements excluding UIDs and undertakings subject to an outstanding recovery order from eligibility for the exemption schemes (these provisions will not apply if the State aid decisions approving the EII exemption schemes cease to be relevant in future);
- improvements to the operation of the exemption schemes so that:
    - an eligible EII that begins to use a new meter will only now have to wait until it has 3 months of data in order to apply for the exemption;
    - in the case of electricity meters that are shared by more than one business or that measure electricity where only a proportion is used for activities that are on the eligible sector list (and the rest is used for activities that are not on the eligible sector list), the proportion of electricity which is exempted will be updated more quickly when there is a change in meter-sharing arrangements or the start or cessation of an activity that is not on the eligible sector list, resulting in businesses receiving the correct exemption more quickly;
    - EII certificates will expire at the end of June instead of the end of March, which will increase the time available for businesses to submit the previous calendar year data and for BEIS to process applications and issue new certificates, resulting in a reduced risk of businesses facing a gap in receiving the exemption;
    - EIIs will be able to submit their quarterly reports on any day of the quarter, resulting in increased flexibility for businesses in complying with the administrative requirements of the exemption schemes.

8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act 2018.

9. Consolidation

9.1 We do not have plans to consolidate the 2015 Regulations. In the event of further amendments to the 2015 Regulations, we will consider a full consolidation.

10. Consultation outcome

10.1 These Regulations were informed by the responses to the consultation on widening eligibility for EIIs for exemption from the indirect costs of renewable energy schemes

and on related issues[3], as well as ongoing engagement with interested stakeholders throughout 2018 and 2019. Through the consultation and follow-up engagement, we have taken account of the views of a wide range of stakeholders, including electricity suppliers, trade associations and businesses in energy intensive sectors, as well as sectors that are not eligible for the exemption schemes. We also consulted the Scottish and Welsh Ministers, the Northern Ireland Department for the Economy, Ofgem and the National Grid.

10.2 Our initial consultation commenced on 22 June 2018 and closed on 7 September 2018. The consultation took forward the Government's commitment, set out in the Industrial Strategy White Paper, to "consult on widening eligibility for the exemption schemes for energy-intensive industries to address potential intra-sectoral competitive distortions, taking into consideration the impact on consumer bills". It invited evidence from sectors seeking to be considered for inclusion in the eligible sector list and put forward proposals for improving operation of the exemption schemes based on early experience of administering the schemes. We received fifty-seven responses.

10.3 In response to the 2018 consultation, the flour milling sector submitted new evidence that the sector satisfies the trade intensity and electricity intensity criteria set out by the Government to identify the sectors most at risk from high electricity prices and therefore should be added to the eligible sector list for the exemption schemes. The proposals to improve the operation of the EII exemption schemes, set out in section 7.5, received wide support.

10.4 The consultation covered two other areas for which the decisions taken do not involve any amendments to the 2015 Regulations:

- We consulted on whether to maintain the eligibility threshold for the exemption schemes at 20% electricity intensity or to lower it. Respondents were split, with a small majority preferring to lower the threshold. However, given the impact of lowering the current eligibility threshold on bills for other electricity consumers, including fuel poor households, and the limited evidence we received that the current threshold is causing competitive distortions, we have decided to maintain the current threshold.
- We proposed not to redistribute money recovered from EIIs if they were to receive too much exemption back to electricity suppliers (who could pass on the savings to consumers). Most respondents agreed with this proposal as it would avoid adding complexity and administrative cost, bearing in mind that the amount likely to be recovered is relatively small and it would be difficult to ensure the money was redistributed to the correct consumers.

10.5 In June 2019 we wrote to stakeholders to seek views on some additional changes that we proposed to make that had not been covered in the 2018 consultation. We received eight replies, with four respondents asking questions or expressing concern about the impact on undertakings in difficulty. The proposed changes were to:

- remove provisions in the 2015 Regulations that have not been used and we consider are not required, relating to alternative evidence that is acceptable from applicants and circumstances where the exemption proportion may be estimated;

[3] https://www.gov.uk/government/consultations/widening-eligibility-for-renewable-electricity-cost-relief-schemes

- extend the validity of EII certificates that have already been issued in line with our decision on the expiry date for newly issued EII certificates;
- clarify the State aid requirements setting out that UIDs and undertakings if they were to be subject to outstanding recovery orders are not eligible for the exemption schemes.

11. Guidance

11.1 We will revise the existing guidance to EIIs to incorporate the changes made to the 2015 Regulations. The application form will also be revised, as necessary, alongside the guidance and made publicly available.

12. Impact

12.1 Eligible businesses in the flour milling sector will receive a reduction in their electricity bills, which will support their competitiveness. Due to commercial sensitivity we cannot provide the bill impact for individual businesses. A typical newly eligible EII would benefit by around £2,800,000 a year on average between 2020 and 2030 (in 2017 prices) (though this figure may not be representative of flour milling businesses specifically). All other electricity users including the public sector, charities and voluntary bodies, households, ineligible EIIs and other business users will cover the costs of the exemption for the flour milling sector through increases in their electricity bills passed on by their electricity suppliers, as estimated in the table below:

Estimates of the maximum average annual impact of introducing the additional sector 2020 – 2030 (2017 prices)

	Bill Impact	**Price impact (£/MWh)**	**Percentage of bill**
Households	20p	<10p	0.03%
Small business energy users	£10	<10p	0.04%
Medium business energy users	£600	<10p	0.04%
Currently eligible EIIs	£800	<10p	0.01%
Ineligible EIIs	£5,000	<10p	0.05%
Newly eligible EIIs	-£2,800,000	-£30	-25%

12.2 An Impact Assessment on the impact of the CFD exemption was prepared in respect of the 2015 Regulations. The amendments made by this instrument do not change the background, rationale or objectives of the policy outlined in that Impact Assessment. The Impact Assessment prepared in respect of this instrument is submitted with this Explanatory Memorandum and will be published alongside it on the legislation.gov.uk website.

13. Regulating small business

13.1 The legislation applies to small businesses as it is expected that some electricity suppliers and EIIs will fall into this category.

13.2 We expect the changes in this instrument to have a neutral effect on small electricity suppliers as they will continue to pass the benefit or cost of the EII exemption onto their customers. We expect small businesses who are eligible EIIs to continue to benefit from the exemption through their suppliers passing on the reduction in CFD, RO and FIT costs. There will be a small bill increase for small businesses who are not eligible EIIs as a result of the addition of the flour milling sector, as set out in the table above.

13.3 Overall, we do not expect that this instrument will have a disproportionate effect on small businesses.

14. Monitoring & review

14.1 We plan to undertake an evaluation and review of the EII exemption schemes in 2023 to assess whether they are achieving the objective of supporting the competitiveness of energy intensive businesses and reducing the risk of investment leakage to countries with less ambitious climate policies.

15. Contact

15.1 Carolyn Campbell at the Department for Business, Energy and Industrial Strategy Telephone: 0207 215 3991 or email: carolyn.campbell@beis.gov.uk can be contacted with any queries regarding the instrument.

15.2 Rory Wallace, Deputy Director for Energy Intensive Industries and Agri-Tech at the Department for Business, Energy and Industrial Strategy, can confirm that this Explanatory Memorandum meets the required standard.

15.3 Nadhim Zahawi MP, Minister for Business and Industry at the Department for Business, Energy and Industrial Strategy, can confirm that this Explanatory Memorandum meets the required standard.