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Department for Business, Energy and Industrial Strategy
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Response to BEIS Consultation: Review of the EII compensation scheme for indirect costs of funding renewable electricity policies

Dear Sirs,

UKPIA represents the eight main oil refining and marketing companies operating in the UK. The UKPIA member companies – bp, Essar, Esso Petroleum, Petrolneos, Phillips 66, Prax Refining, Shell and Valero – are together responsible for the sourcing and supply of product meeting over 85% of UK inland demand, accounting for a third of total primary UK energy[1].

As acknowledged in the Consultation Document, electricity prices for UK EIIs are amongst the highest in Europe. The majority of UK industries therefore face higher electricity costs than most countries in the EU-27, leading to competitive distortions and increased risk of carbon leakage.

It is therefore important that the UK continues to consider use of a full set of policies (including electricity pricing policy) to manage the risk of carbon leakage and loss of competitiveness and at the same time, longer term policies to support early investment in EII decarbonisation projects, many of which may increase electricity consumption. Many UK policies are also currently under review (including free allocation of allowances under the UK ETS, to be followed by further review of the role of free allocation); this creates policy uncertainty which may delay investment decisions.

It is important too that the EII compensation and exemption schemes are not undermined by policy changes elsewhere, for example, the Ofgem Access and Forward-looking Charges Significant Code Review and Targeted Charging Review. Policy certainty is critical for investment decisions and is of particular importance for decarbonisation projects in sectors looking to electrification to drive emissions reductions.

[1] BEIS Digest of UK Energy Statistics (DUKES) 2021 Tables 3.2-3.4.

UKPIA welcomes the opportunity to respond to the consultation on review of the EII compensation scheme for indirect costs of funding renewable electricity policies. Our responses to the questions posed in the consultation document are given in Attachment 1.

Yours faithfully,

Andrew Roberts

Dr Andrew Roberts
Director – Downstream Policy

cc:	Michael Duggan	BEIS
	Simon Stoddart	BEIS
	Mike Mackay	BEIS

Attachment 1

UKPIA Response to BEIS Consultation on review of the EII compensation scheme for indirect costs of funding renewable electricity policies

Q1. What benefits does the electricity relief exemption scheme provide to energy intensive industries including, how the scheme addresses the issue of carbon leakage for you?

The electricity relief exemption scheme provides only limited benefits for the refining sector. Although UKPIA has not yet been able to determine the exposure of individual refineries to the indirect costs of funding renewable electricity policies due to the complexity of the electricity supply to each of the six major refineries, most source their supply using on-site or adjacent CHP plants, although electricity generated is usually exported to the grid and re-imported for reasons of supply resilience.

Where refineries are exposed to indirect costs of funding renewable electricity policies through Renewable Obligation (RO), Feed-in-Tariff (Fit) or Contracts-for-Difference (CfD) charges, the business-level test can restrict eligibility under the exemption scheme (see response to Question 3).

For the refining sector, the exemption scheme does not address carbon leakage or competitiveness issues, due to the limited eligibility for individual refineries imposed by the business-level test (again, see response to Question 3).

Q2. Do you agree with our proposal to replace the reference to UID with AIEA in the guidance?

Yes – for consistency, the Exemption Scheme guidance should use the same terminology as used in the EU-UK Trade and Cooperation Agreement and the Subsidy Control Act 2022.

Q3. Do you agree that we, where relevant, use a five year rather than three-year baseline to reflect the impact of the Covid Pandemic to businesses? Please explain why.

No. Firstly, the main objective of the Exemption Scheme is to compensate EIIs at risk of carbon leakage and loss of competitiveness from the higher cost of electricity in comparison to EU and other countries. EIIs located in EU countries may also be eligible for compensation under the revised EU State Aid guidelines for climate, environmental protection and energy (the "CEEAG")[2], which use a three-year baseline. Eligibility criteria for domestic EIIs should be as close as possible to those under the CEEAG to avoid competitive distortion.

Secondly, a longer baseline period may delay eligibility as the electricity cost as a proportion of GVA will be averaged out over a longer period. The impact of the COVID pandemic would be better addressed by exclusion of 2020 and 2021 from the baseline calculation, as the results of the business-level test, where both electricity cost and GVA may have been reduced by shutdowns, may well not be comparable with competing companies whose sites were subject to longer or shorter shutdown periods.

UKPIA note that the sector-level test used under the existing scheme limited eligibility further to those found to have a trade intensity of at least 4% and an electricity-intensity of at least 7% and introduced a business-level test, where businesses need to show that their

[2] EU Guidelines on State aid for climate, environmental protection and energy 2022, 2022/C 80/01.

electricity costs amount to 20% or more of their Gross Value Added (GVA) over a reference period[3]. This threshold for eligibility is different and likely to be significantly higher than the criteria used under the CEEAG, where support (subject to other limitations) is available to[4]:

(a) Sectors at significant risk, for which the multiplication of their trade intensity and electro-intensity and EU-level reaches at least 2% and whose trade intensity and electro-intensity at EU-level is at least 5% for each indicator.

(b) Sectors at risk, for which the multiplication of their trade intensity and electro-intensity and EU-level reaches at least 0.6% and whose trade intensity and electro-intensity at EU-level is at least 4 and 5% respectively.

The sectors meeting these criteria at EU-level are identified in Annex 1 to the CEEAG and include the refining sector (NACE Code 19.20); a more restricted list of eligible sectors has been identified for the UK Exemption Scheme in Annex 1 of the Guidance[3]. UKPIA therefore believe the eligibility criteria and business-level test should be replaced by alternatives that are at last equivalent to those described under the CEEAG to avoid competitive distortion for potentially, a wide range of sectors eligible under the EU State Aid Guidelines (Annex 1 lists 91 sectors as being at significant risk and a further 25 at risk of carbon leakage, whereas 71 are eligible under the UK Scheme).

Q4. Should we consider accepting applications from businesses with fewer than two financial quarters of financial data?

No. UKPIA understand that the main objective of the Exemption Scheme is to compensate EIIs at risk of carbon leakage and loss of competitiveness from the higher cost of electricity in comparison to EU and other countries. For businesses that have been trading for only a short period, impacts on their success and competitiveness from UK electricity costs are likely to become apparent only after a longer time period than two financial quarters. The situation where a business can only be successful or competitive when it is entitled to subsidies must be avoided, unless there are exceptional circumstances, for example, the business is of direct strategic importance for the UK.

Q5. Is the 85% level of exemption sufficient to meet the objectives of this scheme for your business or sector? If not, please provide supporting evidence to demonstrate why not.

The competitiveness of the UK refining sector in comparison to refineries located in the EU and elsewhere, is influenced and compromised by many factors, not only higher electricity costs. Location and configuration factors in particular play a significant role.

Figure 3 from the Consultation Document indicates that wholesale UK electricity prices for extra-large industrial consumers are the third highest of the EU countries shown. With similar levels of exemption available to EIIs located in Member States that have implemented schemes covered by the EU State Aid guidelines for climate, environmental protection and energy, the objectives of the scheme are unlikely to be met where such schemes are in place. UK electricity prices for large scale industrial users are likely to remain higher than in these competitor countries even after the 85% level of exemption.

[3] Energy Intensive Industries (EIIS) Guidance for applicants seeking a certificate for an exemption from the indirect costs of funding Contracts for Difference (CFD), the Renewables Obligation (RO) and the small- scale Feed in Tariff (FIT).

[4] EU Guidelines on State aid for climate, environmental protection and energy 2022, 2022/C 80/01, Section 4.11.3.1, paragraph 405.

Q6. If we were to consider increasing the subsidy intensity level, what level would be appropriate? Please provide supporting evidence for your answer.

UKPIA believe the subsidy intensity level should be increased to 100%, to provide the maximum support possible for all sectors eligible under the EU State Aid guidelines, since by comparison with the majority of EU countries, wholesale UK electricity prices for extra-large industrial consumers net of renewable policy costs, can be higher than the EU country level net or total electricity price as shown in Figure 3 from the Consultation Document.

Q7. Do you agree that supporting industry to decarbonise through existing decarbonisation and net zero strategies is the appropriate approach for EIIs? Please add further information to support your response.

Yes, although further support, including under new policies, will be critical to deliver Net Zero.

The refining and downstream oil sector currently lies at the centre of the UK economy, sourcing and supplying over a third of UK primary energy requirements, using its extensive infrastructure assets to distribute and supply petroleum products throughout the country. It provides a secure supply of affordable energy for road and rail transport, aviation and marine applications, as well as for commercial and domestic heating. It also supplies feedstocks for the petrochemicals sector, along with specialised non-energy products such as lubricants, bitumen for use in road surfacing, and graphite for use in electric vehicle batteries and as electrodes in steel and aluminium manufacture.

The sector, therefore, has an opportunity to be at the heart of an orderly and just transition to a Net-Zero economy. However, it must also remain profitable to meet the significant investment challenge posed by development of major new hydrogen production, cluster-based carbon capture and storage facilities and the infrastructure required for distribution and supply of new energy carriers such as hydrogen and electricity replacing petroleum products. At the same time, much of the existing infrastructure must be retained and remain viable until it is no longer required.

Existing policy support such as that provided by the Industrial Energy Transformation Fund and CCS Infrastructure Fund has already proved valuable in bringing forward refinery-based projects including Hynet in the North West and Gigastack in the North East, with further major projects being proposed for support under the Net Zero Hydrogen Fund and Carbon Capture and Storage Infrastructure Fund.

Whilst the policies and strategies behind these funds have been shown to be effective, new policies will be required to deliver the British Energy Security Strategy and to maintain UK refinery and other EII competitiveness over the longer term. Examples include the EII Indirect Cost Compensation Schemes (both the UK ETS and CfD/RO/FIT schemes) and carbon leakage mitigation policies (free allowance allocation under the UK ETS and potentially, carbon border adjustment measures (CBAMs)).

Q8. Should any changes be made to the EII exemption as a result of this consultation, do you agree with our proposal to adjust the 2023/24 renewable obligation level as outlined in the 'Publication of the 2023/24 obligation level' section of the consultation document? If not, please explain why and, if possible, suggest alternative approaches.

UKPIA has insufficient information from its member companies to develop a response to this question.

Q9. Should any changes be made to the EII exemption as a result of this consultation, do you consider that a minimum of three months' notice between the revised obligation level being published and implemented is reasonable? If not, please explain why and, if possible, suggest alternative approaches.

UKPIA has insufficient information from its member companies to develop a response to this question.