

PARLIAMENTARY DEBATES

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OFFICIAL REPORT

First Delegated Legislation Committee

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

Monday 3 February 2020

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The Committee consisted of the following Members:

Chair: IAN PAISLEY

† Brown, Alan (*Kilmarnock and Loudoun*) (SNP)
 † Charalambous, Bambos (*Enfield, Southgate*) (Lab)
 † Clarkson, Chris (*Heywood and Middleton*) (Con)
 † Duguid, David (*Banff and Buchan*) (Con)
 † Hayes, Helen (*Dulwich and West Norwood*) (Lab)
 † Heald, Sir Oliver (*North East Hertfordshire*) (Con)
 † Holmes, Paul (*Eastleigh*) (Con)
 † Mackinlay, Craig (*South Thanet*) (Con)
 † Moore, Damien (*Southport*) (Con)
 † Nici, Lia (*Great Grimsby*) (Con)
 † Russell, Dean (*Watford*) (Con)

† Stewart, Iain (*Lord Commissioner of Her Majesty's Treasury*)
 Streeting, Wes (*Ilford North*) (Lab)
 † Tarry, Sam (*Ilford South*) (Lab)
 † Thomson, Richard (*Gordon*) (SNP)
 † Whitehead, Dr Alan (*Southampton, Test*) (Lab)
 † Zahawi, Nadhim (*Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy*)

Medha Bhasin, *Committee Clerk*

† **attended the Committee**

First Delegated Legislation Committee

Monday 3 February 2020

[IAN PAISLEY *in the Chair*]

Draft Electricity Supplier Obligations (Excluded Electricity) (Amendment) Regulations 2019

4.30 pm

The Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy (Nadhim Zahawi): I beg to move,

That the Committee has considered the draft Electricity Supplier Obligations (Excluded Electricity) (Amendment) Regulations 2019.

The draft instrument, which was laid before the House on 9 September 2019, amends the Electricity Supplier Obligations (Amendment & Excluded Electricity) Regulations 2015. The existing legislation supports the competitiveness of energy-intensive industries by providing for a scheme exempting eligible businesses from a proportion of the cost of funding renewable electricity. The draft instrument will amend the existing legislation to include the manufacture of grain mill products; clarify the application of state aid requirements, which exclude undertakings in difficulty from the scheme; and improve the scheme's overall operation.

Alan Brown (Kilmarnock and Loudoun) (SNP): The Minister says that the exclusion relates to renewable energy. Will he confirm that it does not relate to the cost of nuclear energy, including the strike rate mechanism for Hinkley Point C?

Nadhim Zahawi: I was coming to the importance of the energy-intensive industries that are excluded. We exclude sectors that apply for that exclusion from any renewable obligations by up to 85%. I will address that further later on.

Alan Brown: The draft impact assessment says that this exclusion will be worth around £2.8 million per business in terms of the contract for difference mechanism for energy-intensive industries. I am just trying to get a handle on the total cost. Does that include the strike rate mechanism for Hinkley Point C? While the Minister is at it, will he explain whether this includes future capacity market auctions? There will obviously be a further round of CfD bids in the future. Will these industries be automatically exempt from them as well?

Nadhim Zahawi: The regulations deal with the cost of current renewables. Obviously, in the future, other mechanisms will be in place.

The sectors eligible for the existing exemption scheme employ around 350,000 workers and account for more than a quarter of total UK exports. Many are located in areas of economic disadvantage and provide good, well-paid jobs in those areas. While our industrial gas

price is internationally competitive, our electricity prices for medium and large industrial users were the highest in western Europe in 2018. Clearly, electricity costs have a significant impact on the competitiveness of such enterprises. The industries affected operate in international markets, so higher electricity costs place them at a competitive disadvantage, resulting in the risk of carbon leakage, as it is referred to, where companies move production to countries with a less ambitious climate policy.

The existing legislation covering energy-intensive industries allows eligible businesses to receive an indirect exemption of up to 85% of the cost of funding renewable electricity schemes. Where an eligible business applies successfully for the exemption, its electricity supplier receives a reduction in its costs, which it passes on to the eligible business. This approach mitigates the cost of renewable electricity schemes, supports industrial competitiveness and provides certainty for business. The costs of the exemptions are distributed to all other electricity users.

“What does this SI do?”, I hear you ask, Mr Paisley. The regulations add the grain mill products sector to the list of eligible sectors and clarify the application of state aid requirements, which exclude undertakings in difficulty from the scheme. The regulations will also improve the scheme by ensuring that a business that uses a new meter will have to accrue only three months of data before applying, instead of having to wait until they have data from the previous year, as they have to now.

Where electricity meters are shared by more than one business, the proportion of electricity exempted will be updated more rapidly—it is currently done on an annual basis—making the system much more agile and responsive. Certificates will expire at the end of June, rather than March, reducing the risk of business facing a gap in the exemption. Businesses will also be able to submit quarterly reports on any day in that quarter, resulting in increased flexibility for them.

Alan Brown: When the Minister was clarifying what the regulations do, he mentioned that the scheme now includes grain mills and flour businesses. How many additional businesses will apply for an exemption? Will he estimate how many jobs that will protect?

Nadhim Zahawi: I am grateful to the hon. Gentleman for that question. For clarification, I want to return to his earlier point on the nuclear CfD. The EII applies to renewables costs only and not to the indirect cost of the nuclear CfD. Of course, it does apply to future renewable CfD auctions.

On the hon. Gentleman's question, it will depend on the sector and the companies that apply from that sector. We are adding grain mills and, if they apply, they will be eligible. More than 200 UK businesses already benefit from energy-intensive industry exemptions, and we estimate they save about £300 million in electricity costs. We anticipate that about 15 businesses will be eligible through this further extension of the scheme.

The regulations will extend and improve the existing legislation supporting the competitiveness of energy-intensive manufacturing industries in the UK. I commend them to the Committee.

4.37 pm

Dr Alan Whitehead (Southampton, Test) (Lab): It is a pleasure to serve under your chairmanship, Mr Paisley. In one sense, the regulations look pretty simple: they add one new category of energy-intensive industries to the list drawn up in, I think, the Electricity Supplier Obligations (Amendment and Excluded Electricity) (Amendment) Regulations 2017, following the 2015 regulations that first established the scheme. The 2017 regulations changed the way of rewarding energy-intensive companies from what was originally, in effect, a grant system to an exemption system. That change came in during 2017, with an 85% exemption. At that time, some companies were excluded from the arrangements.

The Minister mentioned that part of the regulations deal with companies in difficulty, which were not eligible for the exemption given to other companies through the 2017 regulations. However, in these regulations, the definition of a company in difficulty remains as a negative; that is to say a company “not in difficulty” is referred to in relation to the European Commission’s guidelines on state aid for rescuing and restructuring non-financial undertakings in difficulty. Now, of course, we no longer have to have regard to state aid concerns—for the time being we have to, but for the purpose of legislating we do not have to. Assuming the Government continue to ensure that companies that are in difficulty are not eligible for the exemption, one assumes it would be necessary to produce an alternative definition of a company that is not in difficulty, or, alternatively, a definition of a company that is in difficulty, but that does not appear in the SI. All that appears is a definition according to the European Commission’s guidelines on state aid and a catch-all phrase that says that if we are not subject to state aid, it does not apply, but, logically, something else should apply. An ongoing problem arises because we have no definition of what a company in difficulty looks like in terms of eligibility for the exemptions, and apparently no method whereby the Government can easily, without being taken to court by somebody, define what it is about a company that puts it in such difficulties as to make it ineligible for these definitions, flour milling or otherwise—it is all the people who are within the definition of eligible companies. I would be grateful if the Minister could set out this afternoon the alternative definition of a company in difficulty, overcoming the state aid issue presently in the regulations.

A second point that needs clarification arises from that. In the 2017 regulations, an issue arose, which was clarified in those regulations, about the extent to which companies that were competitive with companies that had been placed in the exemption register could obtain the exemption because of the fact that, even though those companies were not in the register, the business that they did in the area of the company that was in the register was competitive to that company and therefore should have been included in an exemption. When the 2017 regulations were passed, it was stated that the Government very much wanted to include the companies that were in direct competition with companies that received the exemption, but did not receive the exemption because they had not been put on the register, within the ambit of the receipt of exemptions. Indeed, the Government put in an application to the EU at that time on that particular assumption, but the EU said, “No, this can only apply to companies that are strictly

within the guidelines.” Therefore, in the 2017 regulations, the Government indicated that they were unable to extend applicability, because they had not succeeded in achieving such a position. Now, of course, we are in a position where the EU is presumably not going to tell us who should and should not get exemptions according to EU state aid regulations.

In the light of what the Government stated in the explanatory notes and in the 2017 regulations, have matters now substantially changed in terms of companies possibly receiving exemption contributions, even though they are not on the list because they are in direct competition? Now that there is no state aid provision to worry about, might those companies conceivably mount legal actions to put themselves inside the exemption status, because they are competitors in a way the Government felt sympathetic about previously but were unable to act on because of what the EU had said? Does the Minister intend to pursue the unsuccessful 2017 effort to include those companies? Does he think that, in the absence of state aid restrictions, those companies might have a case to be included in the exemptions—flour milling or otherwise—that now apply? That is the second area on which I would very much like some guidance as to the Minister’s thoughts and the direction the Government intend to take.

The third area on which I would like some clarification relates to the fact that the regulations were written and announced quite a long time ago, but have not come before us until today, which is why they are the Electricity Supplier Obligations (Excluded Electricity) (Amendment) Regulations 2019. Part of the regulations, as they apply now, provides for the more efficient metering of companies that can receive money under the exemptions. There is certainly a suggestion, because of the extended period during which the regulations were not brought before us, that those companies might have received allowances and remuneration under the exemptions in a way that they would not have, had the regulations been introduced earlier. Does the Minister have a handle on whether that is the case and whether some remuneration might have been sent out without entirely accurate methods of determining what it was? Could some of that money have been recovered had the regulations been introduced earlier?

The final point on which I seek the Minister’s thoughts is one that he raised in his introductory remarks. These regulations introduce a new actor in the eligibility criteria in the regulations that first came forward in 2015. Indeed, they not only introduce a new actor, but they quantify—the explanatory notes certainly do—the cost to the bill payer of this new inclusion in the exemptions. They suggest there will be a further effect on customer bills of 20p per year for domestic customers and £600 per year for medium energy users—that is not a tiny amount, although it perhaps does not look substantial in terms of the total amount added to the exemptions. However, the Government said a while ago that they did intend any further impositions on bill payers as a result of levies, and this inclusion is, effectively, a further levy on bill payers. It is not a large levy, but it is a levy nevertheless.

Can the Minister say whether the Government have introduced a new policy of further levies on customers as a result of policy changes, or does he stand by the original statement made a while ago that it is the end of levies, and that this is perhaps an exception to the

[Dr Alan Whitehead]

general rule that will not be repeated? If I get some reasonable assurances on all those issues, the Opposition will be happy not to take the statutory instrument to a vote, and we will not oppose it. We see, in principle, the general sense of the regulations, but a number of points need to be clarified before we can reach that stage. It may be that if we cannot get to that point completely and the Minister agrees to write to me on several of those matters, we will be happy, nevertheless, not to take this to a vote.

4.49 pm

Alan Brown: It is a pleasure to serve under your chairmanship, Mr Paisley. I pay tribute to the officials sat in the Box beside you. It always amazes me how they manage to get answers to bail out the Minister before he finishes his opening remarks.

This SI is an ad-hoc arrangement indicative of a reactive Government and the fact that, over the years, energy policy has kept chopping and changing. We need a strong focus and a coherent policy that will deliver the lowest-cost renewable energy to bring down the overall energy cost for households and businesses. That means scrapping the nuclear white elephants and forgetting the mad plan for small modular reactors. It is one for the future—it is fantasy—and we should focus here and now on renewables.

The Minister explained that the costs for Hinkley Point C nuclear are not exempted for energy-intensive industry, so it makes no sense that there is an exemption from offshore wind costs. Offshore wind now has a £40 strike price per megawatt hour, whereas Hinkley Point C has a £92.50 strike price for a 35-year concession, compared with a 15-year concession for offshore wind. Industries are exempted from offshore wind costs, but not nuclear. That sends out the wrong message about the value of renewable energy.

The Minister said that 200 businesses currently have exemptions. Where are those 200 businesses located and how many jobs does that support? Perhaps the Minister can write to me; I do not expect a response right away. How many energy-intensive businesses have been assessed as ineligible to date? As the explanatory memorandum points out, those that are deemed ineligible will have to pay more costs for their energy, to carry the exemptions of new businesses that come on stream. How many have been classed as ineligible, and will that be reviewed?

How do the Government assess the business impact element that deems energy-intensive industries less competitive compared with rivals and therefore eligible for this exemption? Do they take any other factors into account? The Minister mentioned the fact that gas energy is very competitive in the UK compared with international rivals, but electricity is not. Are they looking at any other comparators? For example, the value of the pound has plunged, which is supposed to be good for manufacturing and exports. Where do all those things fit in the bigger picture?

Paragraph 7.4 of the explanatory memorandum suggests the cost per household is just £4 per annum, which, I accept, on balance should not be too big a burden, although we have to recognise that we have fuel-poor households. However, paragraph 10.4 suggests that if the Government look to change the exemption threshold,

it would have a big effect on householders, including the fuel-poor. What is the scale of the impact assessments the Government make and how often do they look at this? Do they recognise that a tipping point could be reached?

Paragraph 14.1 of the explanatory memorandum suggests that the Government will conduct a review in 2023. What will be the terms of reference for that review? Will it report in 2023 and start beforehand? How will it be reported back to Parliament? Why 2023? That seems quite arbitrary.

How sustainable is it to continue to have householders carry the cost of energy for energy-intensive industries? Will the long-awaited energy White Paper address this looking ahead? How does this policy fit in with the net-zero targets and how does it incentivise switches to cleaner or local renewable energy for energy-intensive industries?

What assessment have the Government made of the energy demands of those companies, their carbon footprint, and how proposals such as carbon capture and underground storage can be used to bring down their carbon footprints, as well as other ways to reduce their energy costs?

Going forward, we need onshore wind: it is the cheapest form of electricity generation, which should help both energy-intensive companies and householders. According to the Committee on Climate Change, we need to almost triple our onshore wind capacity by 2035, so what plans do the Government have to do that, and how do they fit in with these measures?

I am not minded to vote against the regulations, as we have accepted similar measures for other energy-intensive industries in the past, and this is just an add-on to those. However, it would be good to hear some further clarifications.

4.55 pm

Craig Mackinlay (South Thanet) (Con): It is always a pleasure to serve under your chairmanship, Mr Paisley. I just have some observations about where we are going with these measures.

I fully agree that for energy-intensive industries—a category that we are extending today to include flour milling—where there is the threat of foreign energy prices putting some of our industries out of business, with resultant job losses, this has to be a sensible policy. But—and this is a big but—if we are to make sure that EIIs do not suffer disadvantage on the global market, which is what this sensible policy is trying to achieve, consumers, smaller businesses and others will bear the burden of maintaining the required CfD amounts. That is where we are going with this. I can imagine that over time, more and more industries will say, “We have a problem. We are facing foreign competition, because energy per kilowatt hour in China, India, the US or other countries is that much lower.” For those industries in the UK, although they have the advantage of being on-site, the energy difference will be enough to solicit an import to do the substitution.

We have to be very careful. Our laudable aim of zero carbon will achieve little if all we do is offshore some manufacturing, when the offshore manufacturer is not producing the tonne of steel for the same number of kilowatt hours as could perhaps be achieved in a cleaner factory in the UK.

Alan Brown: On the topic of not offshoring manufacturing, does the hon. Gentleman agree with Matt Cole that the UK Government should include in future CfD auctions an incentive for bidders to use UK-based supply chains? At the moment, there is no quality assessment, so it is “lowest price wins”, but that could be changed with the correct tender assessment process.

Craig Mackinlay: I understand the hon. Gentleman’s point about domestic supply chains. I am not an interventionist in supply chains and the UK economy in the same way that his party is, so I probably would not agree with him about that.

To develop my point to a conclusion, if—for example—steel is being produced in a foreign jurisdiction in a way that is not so efficient per tonne and number of kilowatt hours, and we then use fossil fuels to import that steel on a ship, we do nothing for the planet in terms of overall CO₂ reductions.

I welcome the proposals, but I envisage various industries arguing for this policy to be extended over time, which will cost domestic consumers more and more, so some care is required. Much as I support what is being done today, there is a greater discussion to be had about the whole renewables industry and how it is financed, because at the end of the day, those who are suffering fuel poverty will only have their poverty exacerbated by such moves.

4.59 pm

Nadhim Zahawi: I will take the last point first. My hon. Friend the Member for South Thanet raises a powerful point. At the beginning of my remarks, I referred to carbon leakage. We need to get smart about how we support industry, and of course move towards net zero, for which we are the first developed nation in the world to legislate. It is the law of the land that we will get to net zero by 2050.

However, I will share an example that I hope will allay some of my hon. Friend’s fears. I think it was nine years ago or less when we delivered the first offshore wind contracts. They came in at about £140 per megawatt hour; they are now at £40 per megawatt hour, and we account for something like 36% of global offshore energy production. That is an extraordinary tale of innovation and backing from Government, to repurpose, effectively, our energy production towards renewables—towards net zero. The hon. Member for Kilmarnock and Loudoun tried to make it a trade-off between nuclear, renewables and offshore, but I do not think it is as simple as that. I am a chemical engineer by background and the hon. Gentleman will know, I hope, that, while offshore wind and solar are of course important parts of the portfolio mix that we will produce as we transition to net zero, we need a baseload, because if the sun is not shining and the wind is not blowing, we will have a problem. That is why nuclear is an important part of the mix.

As to our investment in nuclear, I was at Hinkley Point C last week, to see the first-in-a-generation nuclear reactor project. It is remarkable, not just for what we are building, but for the apprenticeships coming through in the industry. It is a real revival of the nuclear industry. We are also investing in innovation around SMRs with Rolls-Royce, and in the future of advanced modular reactors.

Alan Brown: Obviously there has always been an argument that Hinkley Point C is required to provide the baseload, but when the original case was made for it we were told that if it was not commissioned by December 2017 the lights would go out, because there would not be sufficient baseload in the UK to keep the lights on. We are clearly way past December 2017. I think that the very earliest it will be commissioned, with a good tailwind, is 2025. It could be beyond that, so it kind of negates that argument for baseload, does it not?

Nadhim Zahawi: Not quite, because obviously the baseload is still needed. We have been able through efficient and safe operation to mitigate the delay, but obviously we do not want further delay.

Dr Whitehead: How dispatchable and flexible does the Minister think nuclear power in the future will be, bearing in mind that that is what we particularly will need, in terms of baseload, for the future variability of the majority of our energy supply? Does he think nuclear power can provide that dispatchability and flexibility to ensure that the system works as well as he hopes it will?

Nadhim Zahawi: It needs to be part of the mix—that is my very strong view. We will, quite rightly, have a portfolio tilted heavily towards renewables, and leaning into offshore wind even more than we have done to achieve the 36% that we have achieved; but it is certainly worth our continuing to make the investment. The technology is moving fast—whether that is fusion, in 10 or 20 years’ time, or AMRs or SMRs, which we are also very excited about. It absolutely needs to be part of the portfolio mix.

I want to return briefly to the points that the hon. Member for Kilmarnock and Loudoun made. The reason for the 2023 review date is that it is aligned with the Commission’s review of the energy and environmental aid guidelines in 2022. As to his question about the grain mill sector, it submitted sufficient evidence that satisfied our trade in electricity intensity criteria. We consulted businesses in a robust and open way, and published the Government’s response on 17 October. I made the point about nuclear earlier.

The shadow Minister asked a number of important questions about state aid and an alternative definition. Of course, state aid will be very much part of the free trade agreement negotiations, when they begin, and will be included in the level playing field position paper that the Government will publish soon. As the hon. Gentleman will know better than most, during the implementation period the UK will be bound by EU law, including state aid law, until the end of 2020.

Dr Whitehead: We are legislating this afternoon and presumably need to consider the circumstances under which state aid will not be applicable, because we will be bound by EU law only temporarily. Is the Minister saying that in the long-term future, we will continue to act as if the state aid rules are unchanged? Alternatively, is he saying that we will not do that and that we will need new legislation at the end of the transition period to effect that position?

Nadhim Zahawi: Let me be clear: during the implementation period, we have to follow EU state aid rules. The legislation that we are considering today will continue to apply under EU state aid rules. Therefore, the EU definition will continue to apply. We will issue guidance around that test. I cannot say to the hon. Gentleman today what the negotiations will produce, other than that we will deliver a position paper on the issue. That is what he must assume the decision he is making today is based upon.

Dr Whitehead: We still do not know what constitutes a company in difficulty.

Nadhim Zahawi: So let me come to the hon. Gentleman's second point around whether we can include companies that do not pass the direct exemption, although it can be indirect because part of their business may come into competition with those companies that are exempt. Again, that will depend on the UK's future subsidy regime. During the transition period, EU state law will continue to apply. I hope that offers him clarification.

On the hon. Gentleman's final point about whether this is a further levy, it is not a new levy. It is a redistribution of the existing CfD levy. As he rightly pointed out, the amendment will mean a 20p addition to annual household bills.

I thank you, Mr Paisley, and hon. Members for their valuable contributions to the debate. The regulations will extend and improve the existing scheme that exempts

eligible energy-intensive businesses from a proportion of the cost of funding renewable electricity. It is worth remembering that it is only a proportion of the cost, not the full cost. That will support the competitiveness of our energy-intensive manufacturing industries in the UK.

Alongside the regulations, we will support our manufacturing industries to become more energy and resource efficient and reduce their greenhouse gas emissions through several programmes, including the industrial energy transformation fund, which offers £315 million of additional support; a low carbon hydrogen production fund, which offers £100 million of further support; and the transforming foundation industries industrial strategy challenge fund, which is £166 million.

The Government are serious about delivering their net zero commitment by 2050 and leading the world. That is not just good for the environment, but good business, which I know is dear to your heart, Mr Paisley, and the hearts of your constituents. Therefore, I commend the regulations to the Committee.

Question put and agreed to.

Resolved,

That the Committee has considered the draft Electricity Supplier Obligations (Excluded Electricity) (Amendment) Regulations 2019.

5.9 pm

Committee rose.