



Department  
for Business  
Innovation & Skills



Department  
of Energy &  
Climate Change

**COMPENSATION FOR THE  
INDIRECT COSTS OF EU  
EMISSIONS TRADING  
SYSTEM IN 2013/14 AND  
2014/15**

Guidance for applicants

MAY 2013

# Contents

<b>1. Introduction</b>	<b>3</b>
<b>2. Eligibility</b>	<b>4</b>
2.1 Eligible NACE Codes	4
2.2 The 5% test	5
<b>3. How compensation will be calculated</b>	<b>7</b>
3.1 Efficiency Benchmarks	7
3.2 Aid Intensity	8
3.3 CO2 Emissions factor	8
3.4 Calculating compensation	8
3.5 Baseline Output	9
3.6 Baseline electricity consumption	10
3.7 Installations that have changed ownership and structure since historic period	11
3.8 Installations making several products	11
3.9 Autogeneration	12
<b>4. Scheme Administration</b>	<b>12</b>
4.1 The process	12
4.11 The initial claim form	13
4.12 Deadlines for claims and backdated claims	13
4.13 Quarterly declaration	14
4.14 Appeals	14
4.13 Change of details	15
<b>5. Validation</b>	<b>15</b>
<b>Annex A - the 5% test calculation</b>	<b>17</b>

# Compensation for the Indirect costs of EU Emissions Trading System in 2013/14 and 2014/15

## 1. Introduction

1. The UK Government is committed to reducing carbon emissions in a way that is consistent with meeting legally binding targets – a reduction of greenhouse gas emissions by at least 80% by 2050. This requires a transformation of the UK economy while ensuring secure, low carbon energy supplies to 2050. At the same time Government is committed to ensuring that the UK economy remains competitive.
2. A key driver for investment in low carbon technologies, including electricity generation, is carbon pricing. The EU Emissions Trading System (EU ETS) has created a Europe-wide market for carbon, meaning that businesses and investors are required to factor in the price of carbon when making production and investment decisions.
3. The Government recognises that carbon pricing through the ETS will have a knock-on effect on the wholesale electricity price, increasing retail electricity prices in the short to medium term. Rising electricity costs can pose a key risk to the competitiveness of the most electricity-intensive businesses in the UK, particularly those which operate in internationally competitive markets and are unable to pass these costs through to consumers.
4. In recognition of this, the Government has committed to compensate those electricity-intensive industries whose competitiveness may be most at risk to help offset the indirect cost of the EU Emissions Trading System, in line with the European Commission's published guidelines. The Government has also committed to establishing a compensation scheme to address the indirect costs of the Carbon Price Support (CPS) mechanism, subject to state aid clearance. That scheme is currently being considered by the European Commission. In developing these schemes, the Government published a consultation document in October 2012. The results from the consultation and the Government's response have been published alongside this guidance.
5. This guidance sets out how businesses can claim compensation for the indirect costs of EU ETS only. Government intends to publish guidance for Indirect CPS cost compensation later in the year, following State Aid clearance. This guidance relates to compensation for the indirect costs of EU ETS costs incurred during the period from January 2013 to April 2015 only.
6. Claims can be submitted from 3 June 2013, when the form will be made available on the GOV.UK website.

## 2. Eligibility

7. There are two steps to assessing whether a business is eligible to claim compensation for the indirect costs of EU ETS -

- 1) The business must manufacture a product in the UK within an eligible NACE code.
- 2) The business must pass the 5% filter test.

In this guidance “business” refers to the legal entity manufacturing a product in the UK within an eligible NACE code.

### 2.1 Eligible NACE codes

8. The European Commission has provided framework guidance to European Member States, setting out which sectors and sub-sectors can be eligible for compensation for the indirect costs of EU ETS. In the first instance, the business will need to establish that they are manufacturing a product in the UK which falls within one of the eligible NACE codes set out below.

NACE code	Description
2742	Aluminium production
1430	Mining of chemical and fertiliser minerals
2413	Manufacture of other inorganic basic chemicals
2743	Lead, zinc and tin production
1810	Manufacture of leather clothes
2710	Manufacture of basic iron and steel and of ferro-alloys
2112	Manufacture of paper and paperboard
2415	Manufacture of fertilisers and nitrogen compounds
2744	Copper production
2414	Manufacture of other organic basic chemicals
1711	Preparation and spinning of cotton-type fibres
2470	Manufacture of man-made fibres
1310	Mining of iron ores

2416	<p>Only the following prodcom codes within 2416 (manufacture of plastics in primary forms)</p> <p>24161039 – Low-density polyethylene</p> <p>24161035 – Linear low-density polyethylene</p> <p>24161050 – High-density polyethylene</p> <p>24165130 – Polypropylene</p> <p>24163010 – Polyvinyl chloride</p> <p>24164040 - Polycarbonate</p>
2111	<p>Only the following sub-sectors within manufacture of pulp</p> <p>21111400 – Mechanical pulp</p>

9. In practice any business manufacturing any product in the UK which falls under an eligible NACE code may qualify for compensation for the indirect ETS costs<sup>1</sup> associated with the manufacture of that product. For example,

- all businesses manufacturing basic iron and steel products in the UK with a 'Prodcom' code with the prefix '2710' may qualify; and
- all businesses manufacturing paper and paperboard products in the UK with a 'Prodcom' code with the prefix '2112' may qualify.

10. The exception to this general rule is NACE codes 2416 and 2111, where only businesses manufacturing products in the UK within those specific 'Prodcom' codes listed in the above table may be eligible for compensation.

## **2.2 The 5% test**

11. Within the eligible NACE codes, there will be some products which are relatively less electricity-intensive to manufacture. As such, the competitiveness of businesses making these products is likely to be less exposed to electricity price increases.

12. In order to ensure that compensation is appropriately targeted, businesses will also need to demonstrate that they pass the '5% test'.

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<sup>1</sup> Indirect ETS costs – the ETS costs faced by electricity generators and passed through to the industrial consumer through their electricity bill.

13. In order to satisfy the 5% test, businesses will need to show that their indirect carbon cost (the combined cost of EU ETS and CPS<sup>2</sup>) in 2020 will amount to 5% of their GVA<sup>3</sup>. This is based on the quantitative test which the Commission applied when developing the eligibility list<sup>4</sup>. In order to be eligible, a business must:

- meet the test on a mean average basis over the historic years concerned – 2005 to 2011; and,
- be above the 5% line for at least 3 of those 7 years.

14. In calculating the indirect cost for the purpose of eligibility for compensation, a business will need to apply the following carbon price, emission factor and gross value added data:

- A carbon price of £33 per tonne of CO<sub>2</sub> equivalent. This figure is based on the nominal 2020 Carbon Price Floor adjusted to real terms and 2007 prices<sup>5</sup>.
- The UK's regional emission factor of 0.58. This is set out in Annex IV of the Commission's guidelines on certain state aid measures in the context of the EU ETS post 2012<sup>6</sup> ("the Commission's Guidelines").
- Average gross value added (GVA) data over the reference period 2005-2011 in 2007 prices. GVA is calculated as "earning before interest, taxes, depreciation and amortisation (EBITDA) plus staff costs (including employer's pension and national insurance contributions)". GVA is in real terms and calculated by adjusting nominal GVA using HMT's GDP deflator<sup>7</sup>.

15. For the purposes of the 5% test, costs and GVA should be calculated at the aggregate "business" level – "business" meaning the legal entity which is manufacturing the eligible product.

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<sup>2</sup> Cost of carbon taken to be £33 tCO<sub>2</sub> in real 2007 prices. A 0.58 emissions factor to be used for the calculation as this is in line with the Commission's assessment.

<sup>3</sup> GVA defined as earnings before interest, taxes, depreciation and amortisation and staff costs including employers' pension and national insurance contributions (averaged over the period 2005-2011)

<sup>4</sup> Sectors or subsectors deemed to be exposed to significant risk of carbon leakage on a quantitative basis if the intensity of trade with third countries is above 10% and the sum of indirect additional costs induced by the implementation of the ETS directive would lead to an increase in production costs, amounting to at least 5% of gross value added. Gross value added has been defined as: Earnings before interest, taxes, depreciation and amortisation and staff costs including employers' pension and national insurance contributions.

<sup>5</sup> Commission Decision 2010/2/EU.

<sup>6</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2012:158:0004:0022:EN:PDF>

<sup>7</sup> [http://www.hm-treasury.gov.uk/data\\_gdp\\_fig.htm](http://www.hm-treasury.gov.uk/data_gdp_fig.htm)

16. The purpose of the 5% test is to ensure that the limited amount of compensation available is targeted at those businesses whose competitiveness will be most affected by an increase in the price of electricity – i.e. those businesses who operate in internationally competitive markets and which are electricity intensive.

17. Annex A sets out a worked example of how the 5% test is calculated.

18. We recognise there is a risk that some businesses which manufacture eligible electricity intensive products may fail the '5% test' by virtue of their structure – for example, if the business also manufactures other non-intensive product which lowers its overall aggregate level of electricity intensity. For this reason, a business may also be treated as passing the '5% test' if it can demonstrate to the satisfaction of the Secretary of State that:

- The business only fails the '5% test' because of the inclusion of significant costs which do not relate to the manufacture of the eligible product; or
- The eligible product concerned typically meets the 5% test – i.e. most of the businesses operating in the market and who are manufacturing the same product in the UK pass the 5% test and are eligible for compensation.

19. In order to demonstrate the first condition, the business concerned will need to provide details of the electricity usage associated with the manufacture of the product in question, and to assess the GVA associated with the manufacture of the product. In assessing the second condition, we will consider the extent to which other businesses making the same product in the UK are eligible for compensation.

### **3. How compensation will be calculated**

20. Whilst the 5% eligibility test requires a calculation at the aggregate 'business-level', the information required to calculate the amount of compensation is focused at the installation<sup>8</sup> level. Businesses with multiple installations will, therefore, need to provide information associated with each of their installations.

#### **3.1 Efficiency Benchmarks**

21. The Commission's Guidelines set out that the formula for calculating the maximum compensation payable to a business will take account of electricity consumption efficiency benchmarks for each product. The Commission has developed efficiency benchmarks at 'Prodcum 8 level'<sup>9</sup> for specific electricity intensive products within the eligible sectors. These benchmarks are intended to compensate businesses for electricity usage, based on the most efficient process for the manufacture of that specific product. We will apply these benchmarks when calculating the level of compensation due.

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<sup>8</sup> For the purposes of this scheme an 'installation' means a stationary technical unit where one or more activities associated with the manufacture of the eligible product are carried out and any other directly associated activities on that site.

<sup>9</sup> PRODCOM is the title of the EU production statistics collected at an 8 digit level. For each 4 digit NACE/SIC code, the physical volume of production during the period is reported

22. However, the Commission has not developed efficiency benchmarks for all products within the eligible sectors. This is due to a number of sector specific issues, including data limitations (for example, for some products there may be too few data points or an insufficient number of comparable plants). Where a benchmark for a specific 'Prodcom code' does not exist the Commission has set a 'fallback' value that can be used. Therefore, where a benchmark does not exist for an eligible product, Government will apply the fallback benchmark of '0.8' - meaning 80% of electricity used for the manufacture of the product is taken into account in the calculation formula.

23. Details of the specific efficiency benchmarks which will be used in calculating compensation are set out in the European Commission's Electricity consumption efficiency benchmarks for products covered by the NACE codes (<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2012:387:0005:0013:EN:PDF>)

### **3.2 Aid intensity**

24. The Commission guidelines state that the aid intensity must not exceed 85% of the eligible cost increase in 2013, 2014 and 2015. In line with the Commission guidance, we intend to apply this aid intensity level. However, we have set an overall budget limit for the scheme. It is expected that the budget limit will be sufficient, but if the risk of budget overspend is considered to be high following receipt of applications, we may choose to reduce the level of aid intensity accordingly. In order to provide businesses with as much clarity as possible, any decision to adjust the level of aid intensity will be taken in the first few months of the scheme.

### **3.3 CO2 Emission Factor**

25. The cost of EU ETS faced by electricity generators is based on the amount of carbon consumed and emitted. In order to assess how much indirect ETS cost is passed through in the electricity price faced by industrial consumers, it is necessary to include a 'value' which represents this pass-through cost.

26. The Commission guidelines set out maximum CO2 emission factors for Member States to include in calculating the level of compensation. The Commission's figure for the UK is 0.58 tCO<sub>2</sub>/MWh. This value is based on the average carbon content of electricity supplied by fossil fuel plants in the UK. The Commission used this value taking into account the role that fossil-fuel generated electricity plays in setting the price of electricity.

27. We will be applying the emissions factor of 0.58tCO<sub>2</sub>/MWh. The same factor will be applied to all sources of electricity supply whether it is auto generation, electricity supply contracts or grid supply. The exception to this is renewable auto-generation which will not be eligible for compensation (as electricity generated by this means will not be subject to ETS costs). See also section on 'Autogeneration'.

### **3.4 Calculating compensation**

28. In order to calculate the amount of compensation due, we will apply the following formulae.

Where efficiency benchmarks are available for the products in question the amount of compensation payable in year 't' will equal:

### **BOX 1 - MAXIMUM COMPENSATION AMOUNT CALCULATION**

$$A_{max,t} = A_i t \times C_t \times P_{t-1} \times E \times BO$$

In this formula,  $A_i t$  is the aid intensity at year  $t$ , expressed as a fraction (e.g. 0.85);  $C_t$  is the applicable CO<sub>2</sub> emission factor (0.58) at year  $t$ ;  $P_{t-1}$  is the EUA forward price at year  $t-1$ <sup>10</sup> (EUR/tCO<sub>2</sub>);  $E$  is the applicable product-specific electricity consumption efficiency benchmark; and  $BO$  is the baseline output.

Where there is no published benchmark available for the product in question the amount of compensation payable in year 't' will equal:

### **BOX 2 - MAXIMUM COMPENSATION AMOUNT CALCULATION**

$$A_{max,t} = A_i t \times C_t \times P_{t-1} \times EF \times BEC$$

In this formula,  $A_i t$  is the aid intensity at year  $t$ , expressed as a fraction (e.g. 0.8);  $C_t$  is the applicable CO<sub>2</sub> emission factor (0.411) at year  $t$ ;  $P_{t-1}$  is the EUA forward price at year  $t-1$  (EUR/tCO<sub>2</sub>);  $EF$  is the fall-back electricity consumption efficiency benchmark; and  $BEC$  is the baseline electricity consumption (MWh).

## **3.5 Baseline output**

29. For products with an efficiency benchmark, 'baseline output' of the product will be a key element of the calculation formula. In line with the Commission's guidance, 'baseline output' is the average production of the eligible product in tonnes per year over the reference period 2005- 2011 for installations operating every year from 2005 to 2011. A given calendar year (e.g. 2009) may be excluded from this seven-year reference period.

30. With regard to new installations, if an installation did not operate at all during the reference period – i.e. for at least one year from 2005 to 2011 - then the baseline output will be defined as yearly production until there are four years of operation on record. Once there are four years of historic production on record, 'baseline output' will be calculated as the average of the three years preceding the aid-granting period (January 2013 to April 2015).

31. If, over the aid granting period, production capacity at an installation is significantly extended within the meaning of the Commission's guidelines, the baseline output can be increased in proportion to that capacity extension.

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<sup>10</sup> 'EUA forward price' will be calculated using the mean average of the daily one-year forward EUA prices (closing offer prices) for delivery in December of the year for which the aid is granted, as observed in a given EU carbon exchange from 1 January to 31 December of the year preceding the year for which the aid is granted. For example, for aid granted for 2015, it is the simple average of the December 2015 EUA closing offer prices observed from 1 January 2014 to 31 December 2014 in a given EU carbon exchange.

32. For the purposes of this scheme a 'significant capacity extension' means a significant increase in an installation's initial installed capacity whereby all of the following occur:

- one or more identifiable physical changes relating to the installations technical configuration and functioning take place other than the mere replacement of an existing production line, and
- the installation can be operated at a capacity that is at least 10 % higher compared to the installation's initial installed capacity before the change and it results from a physical capital investment (or a series of incremental physical capital investments).

33. In these examples, the business must submit evidence demonstrating that these criteria have been met and that the significant capacity extension has been verified as such by an independent verifier.

34. If an installation reduces its production level in a given calendar year by between 50 and 75 % compared to the baseline output, the installation will only receive half of the aid amount corresponding to the baseline output. If an installation reduces its production level in a given calendar year by between 75 and 90 % compared to the baseline output, the installation will only receive 25 % of the aid amount corresponding to the baseline output. If an installation reduces its production level in a given calendar year by 90% or more compared to the baseline output, the installation will receive no compensation.

### **3.6 Baseline electricity consumption**

35. For products without an efficiency benchmark, we will use 'baseline electricity consumption' and the fall-back benchmark to calculate the amount of compensation due. 'Baseline electricity consumption' is the average electricity consumption in MWh associated with the manufacture of the eligible product over the reference period 2005-2011 for installations operating every year from 2005 to 2011. A given calendar year (e.g. 2009) may be excluded from that seven-year reference period.

36. With regard to new installations, if an installation did not operate during the reference period – i.e. for at least one year from 2005 to 2011 - then the baseline electricity consumption will be defined as yearly consumption until there are four years of operation on record. Once there are four years of historic production on record, 'baseline electricity consumption' will be calculated as the average of the three years preceding the aid-granting period.

37. If, over the aid granting period, an installation significantly extends its production capacity (as defined in the 'baseline output section above), the baseline electricity consumption can be increased in proportion to this capacity extension.

38. If an installation reduces its production level in a given calendar year by between 50 and 75 % compared to the baseline output, the installation will only receive half of the aid amount corresponding to the baseline electricity consumption. If an installation reduces its production level in a given calendar year by between 75 and 90 % compared to the baseline output, the installation will only receive 25 % of the aid amount corresponding to the baseline electricity consumption. If an installation reduces its production level in a given calendar year by 90 % or more compared to the baseline output, the installation will receive no compensation.

### **3.7 Installations that have changed ownership and structure since historic period**

39. In many cases, a change in the ownership of an installation will be largely irrelevant. However, there may be cases where the costs associated with installations under current ownership were previously included as part of the costs of sites which are now part of a different business. Wherever possible, BIS will seek to use historic data. As such, the following approach will be taken -

- In the first instance, BIS will seek to make use of historic data. With this in mind, businesses should seek to provide information associated with the installation in question relating to the historic period.
- Where this is simply too difficult, or where there is sufficient doubt concerning the data, the business will be treated as a 'new entrant' – i.e. 'baseline electricity consumption' or 'baseline output' will be defined as yearly consumption until there are four years of operation on record. Once there are four years of historic production on record, 'baseline electricity consumption' or 'baseline output' will be calculated as the average of the three years preceding the aid-granting period.

### **3.8 Installations making several products**

40. Compensation will be due for the electricity associated with the manufacture of eligible product. In order to assess this, we will take the following approach –

- Where an installation is manufacturing only eligible product, the 'baseline electricity consumption' will be taken to be the total average electricity consumption in MWh over the reference period 2005- 2011 for the installation. (i.e. electricity costs which fall outside the direct manufacture of the product can be included, as these should be minimal).
- Where an installation is manufacturing both eligible and ineligible product (or where an installation makes products with efficiency benchmarks and without benchmarks) the business will need to isolate the electricity usage associated with that product using the one of the following methods –
  - Provide evidence which clearly demonstrates the proportion of their electricity usage associated with the manufacture of the product in question – preferably, in the form of metered records; or
  - Estimate the electricity usage associated with the manufacture of eligible product using a formula based on the proportion of the different products being made (in tonnage) – e.g. the % of overall tonnage of all product which is made up of the product in question = the % of electricity costs which attract compensation<sup>11</sup>.

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<sup>11</sup> As set out in the Commission's guidance.

### 3.9 Autogeneration

41. In some cases, businesses will generate some or all of their electricity on site rather than purchasing electricity supplied through the grid. In most cases, autogenerated electricity will be treated the same as grid generated electricity.

42. The exception to this rule is where the auto-generated electricity in question is not subject to ETS costs. In such cases, the following rules will apply -

- Renewable generation - no compensation will be due ;
- Biomass co-firing – compensation will be due according to the percentage of fossil fuel used. In these cases, businesses should provide information which is consistent to that which is provided to HMRC for the purposes of Carbon Price Support calculation.
- Combined Heat and Power (CHP) – compensation will be due for the electricity generated and used for production purposes and not for any electricity which is exported to the grid.

## **4. Scheme administration**

43. The Compensation for Indirect EU ETS costs will be administered by the Department for Business Innovation & Skills (BIS), with payments being made quarterly and in arrears.

### 4.1 The process

44. The key information required to assess the amount of compensation due relates to the reference period 2005 to 2011. Therefore, BIS will be able to assess the amount of compensation due to a business – up to the end of the financial year 2014/15 - at the outset of an application. The amount of compensation due will only change if an installation's level of production subsequently significantly changes during the compensation period. For this reason, the majority of the administrative process relating to the scheme will occur at the point of claim.

45. There will be two administrative processes which will need to be undertaken by claimants

- 1) **The initial claim form** – completed at the outset of the claim. This forms the basis of the decision on eligibility and the calculation of compensation;
- 2) **The quarterly declaration** - confirming that circumstances are largely unchanged or notifying significant<sup>12</sup> changes in levels of production. This declaration will prompt the quarterly payment and should avoid unnecessary under/overpayments.

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<sup>12</sup> Significant – as defined in *baseline output* and *baseline electricity consumption* sections.

#### 4.11 The initial claim form

46. The claim form will be available from 3 June on the GOV.UK website. The form should be completed by the business and submitted via email to [energyintensiveindustries@bis.gsi.gov.uk](mailto:energyintensiveindustries@bis.gsi.gov.uk). The form will require businesses to submit the following information:

- For eligibility purposes:
  - Businesses name and evidence of its legal status (e.g. companies house registration number)
  - Contact name and details including role in the business
  - Businesses overall electricity usage from 2005 – 2011
  - GVA associated with businesses different products and businesses aggregated EBITDA/ GVA from 2005 - 2011
  - The eight digit 'Prodcom' codes for the products for which the business will be claiming
  
- For calculation purposes:
  - Details of installations being claimed for
  - The output of eligible product (tonnage, from 2005 – 2011) for each installation being claimed for
  - The electricity usage associated with that output – for installations making only eligible product, this can be all electricity consumption
  - The electricity usage associated with the output of other manufactured product at the relevant installations.
  - Details of any electricity from auto generation – the nature of the generation and how much used for manufacture of eligible product.
  - Predicted levels of production at each installation for the calendar year
  - Bank account details

47. Following receipt of the initial claim form, BIS will issue a letter to the business which will confirm whether or not the business is eligible for compensation, for what products compensation will be payable, the quarterly payment rate, and when quarterly declarations will be due.

#### 4.12 Deadline for claims and backdated claims

48. Claims can be made for the period from 1 January 2013 – i.e. from when the indirect costs of EU ETS are expected to occur. In order to make a claim from 1 January 2013, claims must be received by 31 July 2013.

49. From after 31 July 2013, claims will be valid from the start of the month in which they are received. There will be no facility for the backdating of claims.

#### 4.13 Quarterly Declaration

50. The quarterly declaration will also be submitted via email to [energyintensiveindustries@bis.gsi.gov.uk](mailto:energyintensiveindustries@bis.gsi.gov.uk). The form will require businesses to submit the following information:

- Confirmation that no significant changes have occurred i.e.
  - Changes in production over the last month;
  - Predicted levels of production for the calendar year;
  - Any other significant changes.
- Details of any changes that have occurred
- End of year reconciliation – for the December return. This will ask businesses to declare quarterly levels of production for the calendar year - broken down by 'Prodcom' codes in tonnes and by installation.

51. The quarterly declaration should be submitted immediately following the three month period in question – i.e. from the first day after the period in question. If the quarterly declaration has not been submitted after a month has passed following the period in question, BIS will issue a reminder to the business via email. If the declaration has not been returned by the business by the time the next quarterly declaration is due (i.e. by the first day after the subsequent three month period), the businesses compensation claim will be stopped. Non-receipt of the email reminder cannot be used as a reason for non-return of the declaration form.

52. Where changes occur which significantly affect the predicted levels of annual production<sup>13</sup>, and therefore the amount of annual compensation due, adjustments will be made – (i.e. BIS will calculate the annual amount of compensation due, taking into account the new information). Adjustments will be made to the level of quarterly payments due for the remainder of the calendar year, and a letter issued to the business accordingly. Where the end of year declaration indicates under or overpayment, adjustments will be made to payments going forward into the following year.

53. Following receipt of the quarterly declaration, BIS will make payment directly into the businesses bank account.

#### 4.14 Appeals

54. Businesses can appeal against decisions made regarding their eligibility or eligible product if they consider that a decision is incorrect – for example, where a business is making an electricity-intensive product which falls within the list of eligible 'Prodcom' codes, but has not been awarded compensation or where the business considers the amount of compensation has been incorrectly assessed.

55. Appeals should be made in writing and can be sent via email or letter. They should clearly state that an appeal is being made, set out the grounds for appeal and be

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<sup>13</sup> i.e. changes to levels of production as set out in 'baseline output' and 'baseline electricity consumption' sections

accompanied by any supporting evidence/documents that are to be relied on. Appeals will be determined on paper not via any oral hearing.

56. Appeals must be made within 20 working days of the date of the original decision (i.e. the date of the decision letter). Following receipt of an appeal, BIS will send an acknowledgement of receipt within two weeks and will seek to make a decision on the appeal within eight weeks of receipt of appeal.

#### **4.15 Change of details**

57. Any change of business details – e.g. names, addresses, and bank account details - should be provided to BIS as soon as possible in writing.

### **5. Validation**

58. The information provided by businesses, including the nature of the product businesses are making, the scale of production and the costs being faced must be accurate

59. However, in some cases BIS will undertake additional validation and checks. These may include the following –

- Visiting the business;
- Further discussions, by phone or email, to verify / understand submitted data.

60 Potential triggers for further validation or investigation will include -

- Where a business is claiming a significant amount of compensation.
- Where a case is complex – for example, a restructured business or an installation manufacturing several products.
- Where a significant capacity extension has occurred.
- Where the information being provided is significantly different from that declared with Companies House.
- A random 5% check of all cases, by a more senior BIS official. In some cases, an independent verifier may also be used.

## Annex A - The 5% test Calculation.

### Calculation of increase in production costs as a percentage of gross value added

Where:

- CONSUMPTION is average electricity consumption (MWh) by the business over the period 2005 to 2011
- PRICE IMPACT is impact of the CPF in 2020, assumed to increase electricity prices by 19 £/MWh in real 2007 prices.
- GVA = Average real GVA (£) over the period 2005 to 2011 in 2007 prices. Where gross value added is calculated as “Earnings before interest, taxes, depreciation and amortisation (EBITDA) plus staff costs (including employers’ pension and national insurance contributions)”. GVA is in real terms and calculated by adjusting nominal GVA using HMT’s GDP deflator. Adjustment factors are shown in the following worked example.

#### Worked Example

A firm has the following figures for electricity consumption, EBITDA, and staff costs:

	2005	2006	2007	2008	2009	2010	2011	Average
<b>Electricity (MWh)</b>	50	50	60	60	40	40	50	<b>50</b>
<b>EBITDA (a)</b>	2,500	3,000	3,500	3,000	(100)	0	500	
<b>Staff costs (b)</b>	5,000	5,500	6,000	5,500	4,000	3,000	4,000	
<b>GVA (a + b)</b>	7,500	8,500	9,500	8,500	3,900	3,000	4,500	
<b>Deflator</b>	1.05	1.02	1	0.97	0.96	0.93	0.91	
<b>Real GVA</b>	7,875	8,670	9,500	8,245	3,744	2,790	4,095	<b>6,417</b>

- Step 1 – GVA in each year is calculated by summing EBITDA and staff costs. For example, in 2005 the business made £2,500 profit with staff costs of £5,000 and had GVA of 7,500 (2,500 + 5,000)
- Step 2 – real GVA is calculated by multiply GVA by the deflator For example, in 2005 nominal GVA of 7,500 is multiplied by 1.05 to give a real GVA (in 2007 prices) of 7,875
- Step 3 – electricity consumption and real GVA is averaged over the period. For example electricity consumption in each year is summed and divided by the number of years – (50 + 50 + 60 + 60 + 40 + 40 + 50) / 7 = 50
- Step 4 –cost impact is calculated by multiplying average electricity consumption by the price impact of £19/MWh. For example average electricity consumption of 50 × 19 = 950
- Step 5 – cost impact as a proportion of GVA is calculated by dividing the average cost impact (950) by average real GVA (6,417) = 15%

In the example above the business has cost impact as a proportion of GVA of 15%.

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