



Department for
Business, Energy
& Industrial Strategy

COMPENSATION FOR THE INDIRECT COSTS OF THE EU EMISSIONS TRADING SYSTEM AND THE CARBON PRICE SUPPORT MECHANISM

Updated guidance for applicants

Revised December 2017

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, including the energy market, while keeping energy costs down for businesses and consumers, and maintaining competitiveness.
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 factor in the price of carbon when making production and investment decisions. To further improve the functioning of the carbon market, the UK has introduced a Carbon Price Support (CPS) mechanism.
3. The Government recognises that carbon pricing through the EU ETS and CPS will have a knock-on effect on the wholesale electricity price and increase retail electricity prices in the short to medium term. Rising electricity costs can pose a risk to the UK's most electricity-intensive businesses, 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 sought and obtained approval from the European Commission to compensate those electricity intensive industries whose competitiveness may be most at risk. This guidance sets out how businesses can claim compensation for the indirect costs of the EU ETS and CPS.
5. The Government's current commitment is to provide compensation until 2020.

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1. Eligibility

6. There are two steps to assessing whether a business is eligible to claim compensation for the indirect costs of the EU ETS/CPS:
 - The business must manufacture a product in the UK within an eligible sector (defined by 4-digit NACE code).
 - The business must pass a 5% filter test.
7. In this guidance the “applicant” refers to the legal entity manufacturing a product in the UK. This will typically be a business registered at Companies House.
8. Please note that these schemes have been approved under a separate State Aid notification to the compensation/exemption schemes for renewable energy policy costs and therefore use an earlier version of NACE Codes and have a different business level test.

1.1 Eligible Sectors

9. The European Commission provided guidance to EU Member States on the compatibility criteria it will apply to State aid measures in this area through the “Guidelines on certain State aid measures in the context of the greenhouse gas emission allowance trading scheme post 2012” (hereafter referred to as the Commission’s Guidance) which is available at [http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012XC0605\(01\)&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012XC0605(01)&from=EN). This sets out the list of eligible sectors and products.
10. In drawing up this list, the Commission used a test set out in the Commission’s Guidance. According to this test, sectors and sub-sectors are deemed to be exposed to a significant risk of carbon leakage 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 (GVA)¹.
11. The list of eligible sectors applies to compensation for the indirect costs of both the EU ETS and CPS². Applicants will need to establish that they manufacture a product which falls within one of the eligible 4-digit NACE codes in Table 1 below³ or in the case of NACE Codes 2111 and 2416 the products specified in Table 1. If a business does not

¹ GVA is defined as earnings before interest, taxes, depreciation and amortisation and staff costs (including employer’s pension and national insurance contributions (averaged over either the period 2005-11 or, if that is not available, the most recent period of at least six months).

² Indirect ETS and CPS costs – the ETS and CPS costs faced by electricity generators and passed through to the industrial consumer through their electricity bill.

³ The first 4 digits of an 8-digit Prodcom code represent the sector of a product.

manufacture a product in Table 1 it will not be eligible. Businesses that sell or resell eligible products without having manufactured them are not eligible.

Table 1: The list of eligible sectors

NACE code	Description
1310	Mining of Iron Ore
1430	Mining of chemical and fertiliser minerals
1711	Preparation and spinning of cotton-type fibres
1810	Manufacture of leather clothes
2111	Only the following sub-sector within manufacture of pulp: 21111400 – Mechanical Pulp
2112	Manufacture of paper and paperboard
2413	Manufacture of other inorganic basic chemicals
2414	Manufacture of other organic basic chemicals
2415	Manufacture of fertilisers and nitrogen compounds
2416	Only the following products within NACE 2416 (manufacture of plastics in primary forms): 24161035 – Linear low-density polyethylene 24161039 – Low-density polyethylene 24161050 – High-density polyethylene 24163010 – Polyvinyl chloride 24164040 – Polycarbonate 24165130 – Polypropylene
2470	Manufacture of man-made fibres
2710	Manufacture of basic iron and steel and of ferro-alloys
2742	Aluminium production
2743	Lead, zinc and tin production
2744	Copper production

1.2 The 5% test

12. In order to ensure that compensation is appropriately targeted, businesses will also need to pass the '5% test'. To do this they will need to show that their indirect carbon costs (the combined costs of EU ETS and CPS) in 2020 will amount to 5% of their GVA. Annex A sets out a worked example of how the 5% test is calculated.
13. The '5% test' is based on the quantitative test which the European Commission applied when developing the list of eligible sectors and sub-sectors. In order to pass the 5% test a business must:
 - Meet the test on a mean average basis over the historic years concerned – 2005-11; 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, emissions factor and GVA data:
 - A carbon price of £19/MWh, real 2007 prices.
 - Average GVA data over the reference period (2005-11) in 2007 prices. GVA is calculated as EBITDA plus staff costs. GVA is in real terms and calculated by adjusting nominal GVA using HMT's GDP deflator⁴. To support applications the least favourable year can be excluded from this average.
15. For the purposes of the 5% test, electricity costs and GVA should be calculated at the aggregate "business" level – "business" meaning the legal entity which is manufacturing the eligible product.
16. In order to ensure that we do not compensate businesses that only pass this test because over the baseline period they have negative GVA, any years with negative GVA will be treated as having a value of zero.
17. If available, businesses must use data for the period 2005-11. For a business which did not operate for part or all of the reference period eligibility will be calculated using the reference period available, and more recent data, with a minimum of two quarters of data required. Once a business has four years of historic production on record, eligibility will be recalculated using the average of the last three years on record.
18. We recognise that there is a risk that some businesses which manufacture eligible electricity intensive products may fail the 5% test by virtue of their structure – for

⁴ <https://www.gov.uk/government/statistics/gdp-deflators-at-market-prices-and-money-gdp-june-2017-quarterly-national-accounts-june-2017>.

example a business may manufacture other non-intensive product(s) which lowers its overall aggregate level of electricity intensity. A business may therefore 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 business activity which does not relate to the manufacture of the eligible product(s); or
- A business operating in the market and which manufactures the same product in the UK has passed the 5% test and is eligible for compensation.

2. How Compensation Is Calculated

19. Whilst the 5% test requires a calculation at the aggregate 'business-level', the amount of compensation due is calculated using installation level data. Businesses with multiple installations will therefore need to provide the information required in Part 2 of the application form for each installation. In this scheme an installation is defined as a stationary technical unit where one or more activities associated with the manufacture of the eligible product are carried out. This includes any other directly associated activities on that site.

2.1 Efficiency Benchmarks

20. As required in the Commission Guidance, we will use European Commission efficiency benchmarks when calculating compensation, if they are available. These benchmarks are at the PRODCOM level and are 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 and can be accessed at: <http://eur-lex.europa.eu/LexUri/LexUriServ.do?uri=OJ:C:2012:387:0005:0013:EN:PDF>

21. Some eligible products do not have specific benchmarks (usually due to data limitations) and the Commission has therefore set a 'fall back' value that can be used. The fall back benchmark is 0.8 meaning 80% of electricity used for the manufacture of the product is taken into account in the calculation formula. Where there is no specific benchmark, the Government will apply this fall back benchmark.

2.2 Aid intensity

22. The Commission Guidance states that the aid intensity must not exceed 80% in 2017 and 2018; and 75% in 2019 and 2020. We will apply this maximum aid intensity level. However we have set an overall budget limit for these schemes and if there is a risk of budget overspend we may choose to reduce the aid intensity. If we do this we will update this guidance and notify businesses in receipt of EU ETS / CPS compensation first.

2.3 CO₂ emissions factor

23. The cost of the EU ETS faced by electricity generators is based on the amount of carbon consumed and emitted. For each Member State, the European Commission assessed the average carbon content of electricity supplied by fossil fuel plants. This is then used to establish a CO₂ emissions factor. For the UK this is 0.58 tCO₂/MWh. This factor is fixed. In line with the Commission's Guidance, we will use this figure in calculating compensation. The same factor will be applied to all sources of electricity supply whether it is eligible auto generation, electricity supply contracts or grid supply.

2.4 EUA forward Price

24. '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.

2.5 Accounting for products with an efficiency benchmark

25. For products with an efficiency benchmark, compensation will be determined using 'baseline output' of the product. For installations operating every year from 2005 to 2011, this will be the average production of the eligible product in tonnes per year at the installation over the reference period 2005- 2011. A given calendar year (e.g. 2009) may be excluded from this seven-year reference period.
26. For installations which did not operate for part or all of the reference period or for new installations, the baseline output will be defined as the available data (which should be at least six months) scaled up to reflect expected yearly production at the installation 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 latest three years and this baseline will be fixed for subsequent years.

2.6 Accounting for products without an efficiency benchmark

27. Where a product does not have an efficiency benchmark we will use 'baseline electricity consumption' and the fall-back benchmark to calculate the amount of compensation due. For installations operating every year from 2005 to 2011, 'Baseline electricity consumption' is the average electricity consumption in MWh associated with the manufacture of the eligible product at the installation over the reference period 2005-2011. A given calendar year (e.g. 2009) may be excluded from that seven-year reference period.
28. For installations which did not operate for part or all of the reference period or for new installations, the baseline output will be defined as the available data (which should be at least six months) scaled up to reflect expected yearly production at the installation 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 latest three years and this baseline will be fixed for subsequent years.

2.7 Calculating EU ETS compensation

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

BOX 1 - MAXIMUM COMPENSATION AMOUNT CALCULATION

$$\text{Maximum Aid in Year } t = A_i t \times C_t \times P_{t-1} \times E \times BO \times G_{t-1}$$

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 CO₂ emission factor (0.58) at calendar year t; P_{t-1} is the EUA forward price at calendar year t-1⁵ (£/tCO₂); E is the applicable product-specific electricity consumption efficiency benchmark; BO is the baseline output; and G is the percentage of electricity consumption which is liable for EU ETS rates in t-1⁶.

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

BOX 2 - MAXIMUM COMPENSATION AMOUNT CALCULATION

$$\text{Maximum Aid in Year } t = A_i t \times C_t \times P_{t-1} \times EF \times BEC \times G_{t-1}$$

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 CO₂ emission factor (0.58) at calendar year t; P_{t-1} is the EUA forward price at calendar year t-1 (£/tCO₂); EF is the fall-back electricity consumption efficiency benchmark; BEC is the baseline electricity consumption (MWh); and G is the percentage of electricity consumption which is liable for EU ETS rates in t-1.

2.8 Calculating CPS compensation

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

BOX 3 - MAXIMUM COMPENSATION AMOUNT CALCULATION

$$\text{Maximum Aid in Year } t = A_i t \times C_t \times R_t \times E \times BO \times G_{t-1}$$

⁶ See section 2.12 on which forms of electricity generation are eligible for indirect ETS and CPS compensation.

In this formula, $A_i t$ is the aid intensity at financial year t , expressed as a fraction (e.g. 0.8); C_t is the applicable CO₂ emission factor (0.58) at financial year t ; R_{t-1} is the Carbon Price Support rate at financial year t ⁷ (£/tCO₂); E is the applicable product-specific electricity consumption efficiency benchmark; BO is the baseline output; and G is the percentage of electricity consumption which is liable for CPS rates in $t-1$.

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

BOX 4 - MAXIMUM COMPENSATION AMOUNT CALCULATION

Maximum Aid in Year $t = A_i t \times C_t \times P_{t-1} \times EF \times BEC \times G_{t-1}$

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 CO₂ emission factor (0.58) at financial year t ; R_t is the Carbon Price Support rate at financial year t (£/tCO₂); EF is the fall-back electricity consumption efficiency benchmark; BEC is the baseline electricity consumption (MWh) (see paragraph [-] below for an explanation of this); and G is the percentage of electricity consumption which is liable for CPS rates in $t-1$.

33. Although the CPS rates are given on a financial year basis, the production baseline period will remain on a calendar year basis so that the data can be used consistently for both the EU ETS and CPS compensation schemes.

2.9 Installations that increase or reduce their consumption

34. If, over the aid granting period, an installation significantly extends its production then baseline output or baseline electricity consumption can be increased in proportion to this significant capacity extension.

35. For the purposes of the EU ETS and CPS compensation schemes, 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 installation's technical configuration and functioning takes 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

⁷ 'Carbon Price Support rates' are published annually by HMRC. Rates have been agreed up to 2016-17 and are published here: <https://www.gov.uk/government/publications/carbon-price-floor-reform>

results from a physical capital investment (or a series of incremental physical capital investments).

36. 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.
37. If an installation significantly reduces its production of eligible products in a given calendar year, aid will be reduced corresponding to the baseline output/electricity consumption as follows:
- if less than 50% there will no reduction in the aid amount.
 - if between 50% and 75% an installation will only receive 50% of the aid amount.
 - if between 75% and 90% an installation will only receive 25% of the aid amount.
 - if by 90% or more an installation will not receive any compensation.
38. If an installation has a significant capacity reduction in one calendar year this will also apply to next year's compensation. A business can submit production forecasts to prevent this capacity reduction from being applied to the next year's compensation calculations. These will only be taken into account if the forecasts are seen as sufficient evidence.

2.10 Changes to ownership of installations

39. In many cases, a change in ownership of an installation will be largely irrelevant and there should be no break in compensation. We will need to receive a Part 1 of the application form with the relevant sections completed to ensure payment can continue un-interrupted. We will not need to reassess eligibility and will backdate compensation to the date of the transfer of the installation.
40. In cases where businesses have sold an installation but still have other installations eligible for compensation, we will need to remove the sold installation from the baseline.
41. Where a business closes an installation but still has other installations we will remove the installation concerned from the baseline and re-baseline.

2.11 Installations making several products or a mixture of products with or without benchmarks

42. Compensation will only be due for the electricity associated with the manufacture of eligible products. Where an installation is manufacturing both eligible and ineligible products the business will need to isolate the electricity usage associated with the eligible product using 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

- Base the electricity usage associated with the manufacture of an eligible product on the amount of that product being made (in tonnage) as a proportion of total production of all products.

2.12 Installations with on-site electricity production

43. For those applicants with non-grid electricity consumption, we will use data on the grid/non-grid split from the most recent calendar year to calculate compensation. For example for compensation in 2017 we will use 2016 data.
44. In some cases, businesses will generate some or all of their electricity on site rather than purchasing all electricity through the grid. In many cases auto generation will be treated the same as grid generated electricity.
45. Where the auto generation is not subject to EU ETS/CPS costs, In the case of auto generation, compensation will be due as follows:

For EU ETS and CPS:

- Renewable auto-generation: no compensation will be due.
- Biomass co-firing: compensation will be due according to the percentage of fossil fuels used. In these cases, businesses should provide information which is consistent with that which is provided to HMRC for the purposes of the Carbon Price Support calculation. The calculation of compensation of eligible electricity will be based on the % of the previous year's fossil fuel use (for example compensation for 2018 will be based on the percentage of fossil fuel used in 2017 and reported in the end of year report in early 2018).

For EU ETS only:

- Non-renewable Combined Heat and Power (CHP): compensation will be due for the electricity generated and used for production purposes only and not for any electricity which is exported to the grid.

For CPS only:

- Non-renewable CHP: electricity generated through good quality CHP (the GQCHP Programme) is exempt from the CPS and will therefore not be compensated.
- Electricity generated from waste gases: this does not result in CPS costs and does not therefore warrant compensation.
- Other generation deemed not liable to pay CPS rates by HMRC as set out here: <https://www.gov.uk/government/publications/excise-notice-ccl16-a-guide-to-carbon-price-floor>. This notice also provides guidance on how CHP is treated in the context of the CPS and includes information on the GQCHP Programme.

3. Scheme Administration

46. The compensation schemes for the indirect costs of the EU ETS/CPS are administered by the Department for Business, Energy and Industrial Strategy (BEIS) with payments being made quarterly and in arrears.

3.1 The process

47. There will be three administrative processes which will need to be undertaken by claimants:

- 1) **The initial application 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 changes in levels of production, site closures or new installations. A satisfactory declaration will prompt the quarterly payment and should avoid unnecessary under/overpayments.
- 3) **Annual Return:** setting out annual totals for tonnage produced and auto-generation at installation level for eligible products only, if possible.

3.2 The initial application form

48. The application form consists of two parts. Part 1 asks for information to help manage the schemes and Part 2 asks for electricity consumption and financial data. These forms are available on the GOV.UK website and should be completed by all businesses wishing to apply for relief from the indirect costs of EU ETS/CPS. They should be submitted via email to energyintensiveindustries@beis.gov.uk. The application form will require businesses to submit the following information:

For eligibility purposes:

- Business's name and evidence of its legal status (e.g. Companies House registration number).
- Contact name and details including role in the business.
- Business's overall electricity usage over the reference period (or over an alternative period outlined in this guidance if applicable).
- The aggregated GVA over the baseline period.
- The product(s) produced by the applicant as defined at the 8-digit 'Prodcom' level, which falls within one of the eligible 4-digit NACE codes.

For compensation calculation purposes:

- Details of installations being claimed for.

- The output of eligible product (tonnage, from 2005-11, or over an alternative period outlined in this guidance, if applicable) for each installation being claimed for.
- The electricity usage associated with the output of other (non-eligible) manufactured products at the relevant installations, if applicable.
- Details of any electricity from auto-generation or other non-grid sources – the nature of the generation and how much is used for the manufacture of eligible product.
- Bank account details.

49. Following receipt of the initial application form, BEIS will assess the applicant's eligibility and issue a letter to the business which will confirm whether or not the business is eligible for compensation, for which product(s) compensation will be payable, the quarterly payment rate, and when quarterly declarations will be due.

50. Successful applicants will be compensated from the start of the month in which their application is received. There is no facility for the backdating of claims.

3.3 Quarterly Declaration

51. Quarterly declarations should also be submitted via email to energyintensiveindustries@beis.gov.uk. The form will require businesses to submit the following information:

- Confirmation that the business is still in operation.
- Confirmation that no significant changes have occurred.
- If significant changes have occurred, or are predicted to occur, details of these changes e.g. changes in production or details of any closed, opened or purchased installations.

52. 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, BEIS 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 business's compensation claim will be stopped. Non-receipt of the email reminder cannot be used as a reason for non-return of the declaration form.

53. Where changes occur which significantly affect the levels of annual production (changes to levels of production as set out in the baseline output and baseline electricity consumption sections) and therefore the amount of annual compensation due, BEIS will recalculate 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.

54. Where the annual return indicates under or overpayment, adjustments will be made to payments going forward into the following year. The correction will be made as quickly as possible and will apply to historic, as well as prospective, compensation payments.

55. Following receipt of the quarterly declaration and provided everything is as expected, BEIS will make a payment directly into the business's bank account.

3.4 Annual Return

56. Businesses will be required to submit an end of year return which will require a breakdown of production for the calendar year broken down by PRODCOM codes in tonnes and by installation. Where the end of year return indicates over or underpayment, adjustments will be made to payments going forward into the following year.

3.5 Appeals

57. Businesses can appeal against decisions made regarding their eligibility or level of compensation if they consider that a decision is incorrect.
58. 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 accompanied by any supporting evidence/documents that are to be relied on. Appeals will be determined on paper not via any oral hearing.
59. 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 BEIS 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.

3.6 Change of details

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

3.7 Value Added Tax

61. Compensation payments for the EU ETS/CPS schemes are not subject to Value Added Tax.
62. When reporting electricity costs in the initial application, Value Added Tax should be excluded.

3.8 Data Protection and Transparency

63. We recognise that businesses will be required to provide commercially sensitive data to BEIS and, unless we consider that we are legally required to do so (e.g. by the Freedom of Information Act 2000, the European Environmental Information Regulations 2004 or the approved terms of our State aid notification to the

Commission), we are not intending to make public commercially sensitive business data.

64. The Government will be required to submit an annual report to the European Commission. This report will contain detailed information on the compensation paid out and the management of the scheme. It will not be published as it will contain commercially confidential information.
65. In addition, for CPS, the European Commission requires that in respect of businesses receiving compensation of €500,000 or more we must, for transparency purposes, specifically their name, the total amount of aid received (within bounded ranges), the date the aid was awarded, the relevant region of operation (NUTS 2), NACE code(s) and the type of business (i.e. small or medium-sized enterprises (SME) or large company)⁸. This information will be published on: <https://webgate.ec.europa.eu/competition/transparency/public/search/home>. We will upload the relevant information to this website within six months of the 31st December of the year during which the aid reached the €500,000 threshold.
66. Otherwise, unless BEIS considers that it is legally required to make further information available, BEIS will only publish the names of businesses receiving the exemption, and will not publish details of unsuccessful applicants.
67. For the purposes of the Data Protection Act, your contact is The Data Protection Officer, Department for Business, Energy and Industrial Strategy, 1 Victoria Street, London SW1H 0ET. Telephone number 020 7215 6635.

⁸ An SME is defined as an “enterprise which employs fewer than 250 persons and has an annual turnover not exceeding €50 million, and/or an annual balance sheet total not exceeding €43 million”.

4. Monitoring and Assurance

68. 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. We will undertake additional validation and checks if we feel they are necessary.

69. BEIS will monitor applications and compensation paid and will from time to time undertake further validation or investigation. This will include but is not limited to -

- 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 the information being provided is significantly different from that declared with Companies House.
- A random check of all cases, by a BEIS official. In some cases, an independent verifier may also be used.

Annex A – The 5% Test Calculation

An example calculation of the 5% test

$$\text{COST IMPACT} = \frac{\text{CONSUMPTION (MWh)} \times \text{PRICE IMPACT (£/MWh)}}{\text{GVA (£)}}$$

CONSUMPTION and GVA are averages over the baseline period, excluding the least favourable year from this average. The terms are defined as:

- CONSUMPTION is average electricity consumption (MWh) by the business over the period 2005 to 2011, excluding the least favourable year.
- PRICE IMPACT is impact of the EU ETS and CPS in 2020, assumed to increase electricity prices by 19 £/MWh in real 2007 prices.
- GVA = Average real gross value added (GVA) (£) over the period 2005 to 2011 in 2007 prices, excluding the least favourable year. GVA is calculated as “Earnings before interest, taxes, depreciation and amortisation (EBITDA) plus staff costs (including directors’ remuneration, 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 (exc. 2006)
Electricity (MWh)	50	50	60	60	40	40	50	50
EBITDA (a)	2,500	3,000	3,500	3,000	(100)	0	500	
Staff costs (b)	5,000	5,500	6,000	5,500	4,000	3,000	4,000	
GVA (a + b)	7,500	8,500	9,500	8,500	3,900	3,000	4,500	
Deflator	1.06	1.03	1	0.97	0.96	0.94	0.92	
Real GVA	7,950	8,755	9,500	8,245	3,744	2,820	4,140	6,067

- 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 multiplying 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 7,950
- Step 3 – electricity consumption and real GVA is averaged over the period. Excluding 2006 from this average maximises the cost impact, so we exclude this year. For example electricity consumption in each year is summed and divided by the number of years – $(50 + 60 + 60 + 40 + 40 + 50) / 6 = 50$
- Step 4 – cost impact is calculated by multiplying average electricity consumption by the price impact of £19/MWh. For example average electricity consumption of $50 \times 19 = 950$
- Step 5 – cost impact as a proportion of GVA is calculated by dividing the average cost impact (950) by average real GVA (6,067) = 16%

In the example above the business has cost impact as a proportion of GVA of 16%.

