

# **The Renewable Heat Incentive: consultation on interim cost control**

26 March 2012



# The Renewable Heat Incentive: Consultation on Interim Cost Control

Presented to Parliament by the Secretary of State for Energy and Climate Change by command of her Majesty.

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# Ministerial Foreword



We are extremely proud that this Government launched the Renewable Heat Incentive (RHI) last November. The first of its kind in the world, the RHI provides the long-term financial support to enable a significant shift away from fossil fuels to renewable heating in this country. It is an essential policy to help us meet our legally binding renewables targets but also crucial to reducing our carbon emissions. It will help us deliver our strategic framework for heat – which will be published shortly – and to build the kind of sustainable economy we need. We are already seeing participation in the scheme across small businesses, industry and the public sector. We remain fully committed to the RHI and look forward to renewable heating playing a much larger role in fulfilling our heat needs in the years to come.

However, the RHI is funded from Government spending and we have to ensure that we maintain value for money for the taxpayer and do not spend more than the annual budgets allocated to fund it. We have to learn lessons from the Feed-in Tariffs and ensure that we maintain budgetary control whilst providing appropriate certainty to stakeholders about how we will do this. The RHI must be a long-term, sustainable policy in order to be effective. For this reason, we plan to introduce a comprehensive cost control mechanism which ensures the long-term future of the RHI whilst also providing the transparency and certainty that the market needs to drive investment. We will be consulting on a degression-based mechanism in the summer which would automatically reduce tariffs should spending against the overall budget or deployment of certain technologies exceed forecasts.

Until we are able to introduce the longer-term solution, we need assurance that the scheme will not exceed its budget for the next financial year. Therefore, we are consulting on a short-term measure to give us the confidence that spending will not exceed our budget. The measure proposed is that we suspend the scheme until the next financial year if our evidence shows that the budget could be breached.

Current uptake levels are very low relative to the available budget and if this lower than anticipated uptake continues we will not need to use the proposed interim cost control mechanism. However, the RHI is a new policy in an immature market, which means that there is a high degree of uncertainty about deployment in the short-term. We recognise that suspending the scheme would be a serious event. However, we are consulting now because we want to be transparent about our future intentions. We will be publishing the data which would determine whether suspension occurs so that the market is aware of the estimated spend relative to our budgets. Then there would be no surprises if the RHI was suspended.

If we had no way of controlling short-term spending we could jeopardise the long-term future of the RHI and the renewable heat sector. We want to spend the budgets assigned to the RHI to promote investment in renewable heat, to put us on a path of sustainable growth in the sector for years to come. We want the RHI to be a flagship policy to decarbonise heating and help the shift to a sustainable, greener future.

Greg Barker  
Minister of State Department of Energy and Climate Change



## General information about this consultation

### How to respond

Comments on aspects of the proposals contained in this document are welcomed. Responses to this consultation should be sent to [rhi@decc.gsi.gov.uk](mailto:rhi@decc.gsi.gov.uk). The consultation closes on **23 April 2012**.

Responses should be clearly marked: Consultation on an Emergency Cost Control measure for RHI.

Hard copy responses and any enquiries related to the consultation, should be addressed to:

Geraldine Treacher  
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3 Whitehall Place, London,  
SW1A 2AW  
Tel: 0300 068 6858

Email: [geraldine.treacher@decc.gsi.gov.uk](mailto:geraldine.treacher@decc.gsi.gov.uk)

### Territorial extent

This consultation applies to England, Scotland and Wales.

### Additional copies

You may make copies of this document without seeking permission. An electronic version can be found at [http://www.decc.gov.uk/en/content/cms/consultations/rhi\\_cost/rhi\\_cost.aspx](http://www.decc.gov.uk/en/content/cms/consultations/rhi_cost/rhi_cost.aspx)

Other versions of the document in Braille, large print or audio-cassette are available on request. This includes a Welsh version. Please contact us under the above details to request alternative versions.

### Confidentiality and data protection

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information legislation (primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004).

If you want information that you provide to be treated as confidential please say so clearly in writing when you send your response to the consultation. It would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded by us as a confidentiality request. The Department will summarise all responses and place this summary on its website. This summary will include a list of names or organisations that responded but not people's personal names, addresses or other contact details

### Quality assurance

This consultation has been carried out in accordance with the Government's Code of Practice on consultation, which can be found at [www.bis.gov.uk/files/file47158.pdf](http://www.bis.gov.uk/files/file47158.pdf). If you have any complaints about the consultation process (as opposed to comments about the issues which are the subject of the consultation) please address them to:

DECC Consultation Co-ordinator  
3 Whitehall Place London  
SW1A 2AW  
Email: [consultation.coordinator@decc.gsi.gov.uk](mailto:consultation.coordinator@decc.gsi.gov.uk)

**What happens after the consultation**

Responses should be submitted by **23 April 2012**. At the end of the period we will summarise all responses and place this summary on our website at

[http://www.decc.gov.uk/en/content/cms/consultations/rhi\\_cost/rhi\\_cost.aspx](http://www.decc.gov.uk/en/content/cms/consultations/rhi_cost/rhi_cost.aspx)

The material received will inform the development of the statutory instrument to introduce the emergency measure.

## Executive summary

- The Renewable Heat Incentive continues to be a top priority for Government as a means to reduce our carbon emissions and because it is central to delivering our strategic framework for heat. It is therefore essential that the RHI policy is sustainable and that we have the ability to ensure that year to year spending does not exceed available funding.
- This consultation sets out a proposed interim cost control measure that would suspend the RHI until the next financial year should estimated spending reach a level where the budget could be breached.
- Only new applications would be affected. Accredited installations already receiving the RHI tariff from Ofgem would continue to receive that tariff. Applications submitted to Ofgem prior to the suspension would be processed as normal.
- Current application levels are low relative to the available budget and if these levels were to continue the proposed interim cost control measure is unlikely to be needed. However, there is a high degree of uncertainty about how the market will respond and we need to be prepared for unexpected changes in uptake. Having this interim approach set out in advance will ensure that Government is able to respond quickly if required and that stakeholders will be sighted on future action.
- The proposed circumstances under which suspension would occur will be specified in the RHI regulations and will include a predetermined trigger that would set off suspension and a fixed notice period before the suspension begins.
- We intend to frequently publish the data being used to monitor progress towards the trigger. This will allow the market to make informed decisions about the likelihood of suspension.
- We are proposing this policy as an interim measure. Over summer we plan to consult on a longer-term flexible degeneration-based mechanism which would automatically reduce tariffs should spending against the overall budget or deployment of certain technologies exceed forecasts.

## The Renewable Heat Incentive

1. The Renewable Heat Incentive (RHI) is a long-term tariff scheme to encourage the replacement of fossil fuel heating with renewable alternatives. It opened for applications in November 2011 and currently supports renewable heat installations in business, industry and the public sector as well as district heating schemes.
2. The RHI was introduced primarily to help meet the UK's target of 15% of our energy coming from renewables by 2020. Renewable heat will contribute approximately a third of this overall energy target, but, in order to make that contribution, around 12% of our total heat demand in 2020 will have to come from renewables, increasing from less than 2% currently.
3. In addition, renewable heat is also essential to the delivery of our carbon budgets and our target of an 80% reduction in carbon emissions by 2050. There is a lot we can achieve by reducing demand through better energy efficiency. But we cannot reduce demand for heat to zero, so we also need to reduce the emissions from the heat we will continue to generate. The strategic framework for heat, being published shortly, provides the vision for how we can make that happen and the RHI is a fundamental policy for our long-term carbon reduction ambitions.

## Budgets

4. The RHI is funded directly from Government spending and has been assigned annual budgets for the four years of this Spending Review period.

Financial year	Budget (£m)
2011/12	56
2012/13	133
2013/14	251
2014/15	424
<b>Total</b>	<b>864</b>

5. This includes budget for the Renewable Heat Premium Payment (RHPP) in 2011/12 and a spend of up to £25m for the second phase of the RHPP (expected to be spent primarily in 2012/13 but with flexibility for some spend in 2013/14).
6. The budgets are based on the estimated trajectory of growth needed to achieve 12% of renewable heat coming from renewables in 2020. Each annual budget is for money which will be paid for renewable heat generated by RHI accredited installations in a given year. New installations added each year have to be funded for that year and for the subsequent years they are in the scheme. Budgets beyond 2015 will be set as part of the standard Spending Review process and they will have to include payments made to existing as well as new installations in order that the RHI continues to support growth in renewable heat.

7. The budgets are not flexible; spending less than the allocated budget in one year does not permit that underspend to be transferred to future years. Spending more than the budget in any given year could result in a stop-start scheme, which would undermine supply chain development. Though we have forecasts for renewable heat growth, these are based on limited data given the relative infancy of that market in the UK. As we supplement our data and refine our assumptions, our forecasts and the budgets on which they are based will become more accurate.

## The scheme to date

8. The RHI opened for applications on 28 November 2011 and the application rate has been relatively steady. Many of the applications are for installations commissioned since 15 July 2009, before the scheme launched, and most installations have lead-in times of several months. This means that it is not possible to accurately gauge the positive impact of the RHI at this point. We are also aware that companies are reluctant to change their heating systems during the winter. So, while generation of heat will be lower in summer, the number of installations is likely to be higher.
9. We are encouraged to see that there is a variety of applications coming forward across industry, small businesses, supermarkets and schools. As of 18 March 2012 we have received 298 applications, 11 of which have been accredited. Based on the current number of applications received we expect to spend approximately £2m for the 2011/12 financial year.
10. For 2012/13 we are expecting around £15m of spend from installations that have already been accredited and predicting total expenditure on the RHI to be around £40m as a result of new installations coming on stream. Clearly, if uptake continues along these lines, the proposed interim cost control measure would not be needed and suspension would not occur. We continue to monitor uptake and the wider market closely to ensure that there are no surprises for Government and so that we can refine policy accordingly in future years.

## Why do we need this measure?

11. The experience of Feed-in Tariffs and solar PV uptake has taught us that we need to be prepared for unexpected and rapid surges in uptake and be transparent about what we plan to do should they happen.
12. There are differences between solar PV and renewable heat technologies; rapid cost reductions are less likely and there are more barriers to deployment. Nevertheless, uptake of renewable heat could vary based on volatile variables such as the price of oil. And given the infancy of the renewable heat market in the UK, we have to assume a significant level of variance from our modelling projections.
13. We recognise that suspending the scheme is likely to have a negative short-term impact on the renewables market. However, putting a protective measure in place will preserve the sustainability of the scheme and the renewable heat industry. We will alleviate some of the uncertainty that suspending the scheme could cause, by clearly setting out what would happen in the event of overspend and frequently publishing data to inform market participants about estimated RHI expenditure.

## Future cost control measures

14. In the longer-term, we propose to introduce a more sophisticated cost control mechanism which would include a flexible degression-based system. In this context, degression works by reducing tariffs gradually in the event of greater than expected uptake to avoid exceeding annual budgets. Such a mechanism would be designed to prevent the need to suspend the scheme and should address a root cause of very high uptake – i.e. tariffs that are too high.
15. We have been working with industry participants to inform the design of the longer-term mechanism to ensure that while controlling costs, we will also provide certainty about when tariffs will change and by how much.

## What is the proposal?

16. The proposed interim cost control mechanism is a simple system that suspends the RHI scheme. The terms of suspending the scheme would be set out clearly in advance, including the timing and use of any triggers. Accredited installations would not be affected and the owners of accredited installations will continue to receive their RHI tariff at the same tariff rates (adjusted for RPI).
17. The suspension would be in place for the financial year and the scheme would re-open at the start of the next financial year. This will enable budgets to be controlled until the longer-term cost control measures are in place and able to replace the interim mechanism. We anticipate that regulations for the longer term mechanism will be in force from February 2013.

## Calculating progress towards the budget

18. Progress towards a budgetary trigger relating to estimated spend will be carefully monitored and reported weekly online.
19. Calculated spend within the financial year will be based on spend to date combined with estimated expenditure for existing installations and applications that have been submitted. Estimated expenditure will be based on the best evidence available about the load factor and operation of installations for each tariff band. This may be a combination of evidence provided within applications, as well as other evidence on load factors such as the amount of metered heat being used by accredited installations.

## Triggers and notice periods

20. It would be possible to provide a notice period before suspending the scheme, during which time it the scheme would be open to applications. However there is a trade-off between the amount of notice and the extent to which the trigger would need to be set conservatively. This is because the uniqueness of the RHI means that there is very little evidence to inform an understanding of deployment and the rates at which deployment may take off.
21. Not using a notice period would enable the trigger to be set at or very close to the total available budget. This removes the risk of triggering a suspension which might not have

been needed. In practice, we expect stakeholders to pay close attention to progress towards the trigger so little or no official notice may be needed.

22. A short notice period would allow Government a reasonable amount of certainty about what might happen within that period and still enable the trigger to be set at a much higher percentage of the budget. For stakeholders, a notice period of a week might allow those with almost complete applications to ensure that they complete the paperwork before the suspension begins and avoid inadvertently submitting a day late. A notice period of a month might allow the final stages of an installation and the paperwork to be completed prior to the suspension.
23. If the notice period were to be longer and allow time for more installations to be planned and installed, this would increase uncertainty even further. It would also potentially be unfair that some smaller installations could be started and completed whereas larger installations could not. So, for example, while it might be possible to provide for a three month notice period, it would be very uncertain what might happen in that period – both in terms of demand already coming on-stream and the potential response to a suspension announcement – and this would necessitate the trigger being set very low, possibly 50% of the budget or less. For this reason we do not propose to pursue a three month notice period.
24. Possible options for notice periods and trigger levels are:

Option	Notice period	Trigger (% of budget)
1	1 month	80%
2	1 week	97%
3	No notice	100%

25. Whichever trigger is used, it would be activated if estimates indicate that the spend over the course of the financial year will be greater than the trigger's value.
26. New installations will have a much bigger impact on the budget if applications are made at the beginning of the financial year than at the end of the year, so the risk of breaching the budget within the 1 month notice period at the end of the year is lower. It could therefore be appropriate, particularly under option 1, to allow the trigger to be closer to the total budget at the very end of the year.

### Consultation Question

1. **Given the trade-off between the length of the notice period and the impact on how conservatively the trigger needs to be set, would it be preferable to have no notice, one week's notice, or one month's notice, and why?**

## What would happen if the scheme was suspended?

27. Should the trigger be set off, the scheme will be suspended until the start of the next financial year. Cost control measures can only apply to new RHI applications. If the scheme is suspended, installations already receiving the RHI will continue to receive their current tariff (adjusted for RPI) for the full 20 year duration. Similarly, applications submitted to Ofgem before the suspension date would still be processed.
28. New applications would not be accepted during the suspension. If it is decided that a notice period will be given (see consultation question) it might be necessary to make an adjustment for the suspension period, to prevent last minute speculative applications for installations that are incomplete. This requirement would be that applications made during the notice period should have been commissioned prior to the suspension date. An installation is commissioned if all of the necessary tests and procedures required by industry standards to show that the plant is able to deliver the heat required are complete. If accredited by Ofgem, these applications would be accredited and subsidy would then be paid to these participants.
29. Registrations for biomethane producers would be treated in the same way: no further application for registration would be permitted during the suspension, but applications for registration submitted before the suspension would continue to be processed by Ofgem.
30. Similarly, applications for additional capacity for accredited installations would not be processed during the suspension.
31. Preliminary accreditation is available for medium and large biomass and energy from waste installations, biogas, and deep geothermal. Those with preliminary accreditation are able to submit an application to convert to a full accreditation, provided that the installation has been built in line with the plans submitted and any conditions set out by Ofgem. Applications to convert preliminary accreditations granted after the interim cost control regulations come into force could not be submitted after suspension. However, we do not propose to change the terms of existing preliminary accreditations. Therefore, if an application for preliminary accreditation was made prior to the proposed interim cost control regulations, and accredited by Ofgem, it would be possible to apply to convert this during the suspension.

## Re-opening the scheme

32. If suspension is triggered this will be because supply chain and demand growth will have been very high. This would imply that tariffs offer a much higher rate of return on investment than was intended when the tariffs were set. Overly high tariffs would need to be corrected prior to the scheme reopening, to ensure sustainability of the RHI within current budgets.
33. The proposed longer term cost control package, which we will be consulting on during the summer, is expected to include a contingent degeneration system where tariff reductions are triggered if uptake reaches certain levels. As part of this, we will consult on how the tariffs should be recalibrated for re-opening in the eventuality of the scheme being suspended. This will include a transparent formula setting out clearly in advance what could be expected to happen.

## Next steps

34. We intend to run the consultation on the package of policy options for longer-term cost control over the summer. Proposals for air quality and biomass sustainability will be included in the consultation. Following the consultation, regulations will be laid before the end of the year and implemented as soon as possible subject to Parliamentary approval.

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