DFE-53097

# 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.

26 March 2012

# 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**. 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:

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SW1A 2AW
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**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

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. 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

**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

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 degression-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 |
| **Total** | **864** |

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:

| | | |
|---|---|---|
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| | | |

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 | |
|---|---|
| | **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 degression 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.

# Contents

## General information

This document sets out the Government's response to the consultation, "The Renewable Heat Incentive: consultation on interim cost control". The consultation was open between 26 March and 23 April 2012 and copies of the consultation document can be found on the Department of Energy and Climate Change (DECC) website. The consultation applied to England, Scotland and Wales.

There were 53 responses, received from a variety of organisations, summarised below:

- Trade Associations (13)
- Certification bodies (1)
- Companies (30, including manufactures, installers, suppliers, users and utilities)
- Individuals (1)
- Universities (1)
- Public sector (4)
- Charities/community organisations (3)

# Executive summary

- We received 53 responses to our consultation. Many of the respondents recognised the need to ensure that RHI costs are managed. However, many also expressed views that: the mechanism is unlikely to be needed; the consultation raised concerns about the Government's commitment to the Renewable Heat Incentive (RHI); the potential for suspension would have a negative impact on the market.

- In response to the question asked about the preferred length of the notice period, given the trigger levels that would be needed, respondents' preferences were as follows:

    - 30% (16) preferred a one month notice period and trigger set at 80% of budget;
    - 19% (10) preferred a one week notice period and trigger set at 97% of budget;
    - 6% (3) preferred no notice;
    - although not a consultation question, 8% (4) argued for a longer notice period to allow for project completion;
    - not all respondents answered the question.

- We recognise that the potential for the RHI scheme to be suspended is a difficult issue for market confidence. But we must be prepared for the unexpected so that we are not caught unable to act, given the timeframes for introducing legislation. Therefore, we are pressing ahead with the introduction of the stand-by mechanism for budget management.

- The mechanism will work such that the scheme is suspended for the remainder of the financial year if we forecast that the budget could be breached. To enable sustainable growth in renewable heat year-on-year, we have identified that no more than £70m should be spent on the RHI in 2012/13. Spending more would be likely to exhaust next year's budget through the cost of installations already receiving RHI funding, leading to a boom and bust approach.

- Given the £70m cap, we believe that the cost control mechanism should suspend the scheme at 97% of the annual budget, or £67.9m, with one week's notice. We want to avoid a premature suspension or overspend; a longer notice period increases the risk of both of those.

- However, we will provide a weekly update on the DECC website setting out progress towards the suspension trigger, alongside a methodology used to calculate the forecast. This will allow the market to make informed judgements about the likelihood of suspension.

- Those installations that have already been approved will not be affected. Applications made before the notice period will be processed as normal. Applications made during the notice period will be processed if the installation has been commissioned before the suspension date. Applications made after the suspension date will not be processed.

- We currently estimate that RHI expenditure in 2012/13 will be around £42m. While this amount could vary, weekly RHI application rates would need to increase by around 500% by the end of the year to reach £70m. Therefore, we assess the likelihood of suspending the scheme as low.

# Introduction

## Why the stand-by mechanism for budget management is being proposed

1. The Government is fully committed to the Renewable Heat Incentive (RHI) and to supporting the deployment of renewable heat. It is central to delivering our Strategic Framework for Low Carbon Heat, as well as being an essential policy to help us deliver our legally binding renewables target and our carbon emissions reductions. We are already seeing participation in the RHI across small businesses, industry and the public sector and remain fully committed to expanding the range of technologies eligible for the RHI and to introducing longer term support for renewable heat in the domestic sector.

2. On 26 March we issued a consultation on an interim cost control measure for the RHI. The consultation proposed a simple mechanism that would suspend the RHI scheme to new applicants until the next financial year if our evidence showed that the available budget could be breached. The intention of the measure is to ensure that the scheme does not exceed its budget and enable us to develop a more sophisticated longer-term cost control mechanism for implementation by the beginning of the 2013/14 financial year.

3. We have learned lessons from other schemes and recognise that to ensure the sustainability of the RHI we must have a way of maintaining budgetary control, as well as providing assurance to stakeholders about how we will do this. We want the RHI to promote investment in renewable heat and believe this can be achieved with the right budget management framework in place.

4. Any changes to RHI Regulations need to be debated in Parliament and, therefore, we must work within the Parliamentary timetable. Parliament is not in session for a large part of the summer which means that if we do not make regulations before the summer Parliamentary recess, then it will not be possible to have regulations in place before November. While we do not expect extreme growth in the RHI in this period, we are aware that heating systems are frequently replaced during the summer. If RHI spending were to exceed budgets. It would be difficult in retrospect to justify a lack of action now.

## Update on scheme applications and delivery

5. Since we published the consultation on interim cost control, Ofgem has continued to receive applications for the RHI. As of 27 May 2012 Ofgem had received 533 applications (43 preliminary), had accredited 88 installations and rejected two (on account of these installations having received a grant). Ofgem has completed a series of presentations around Great Britain to support potential applicants in ensuring that they provide the right information upon application and have in place the correct metering arrangements. This is expected to increase the quality of applications and the rate at which they can be processed.

6. We now expect the 2011/12 spend to be approximately £3m, although this will only be confirmed once all applications made in that year have been processed and meter readings for heat generated in that year received. We expect the cost of installations already in place in 2011/12 to be £16m in 2012/13 and currently predict total 2012/13 RHI expenditure of around £42m.

7. We are aware that there may be concerns about the current backlog of applications for accreditation. Ofgem is working to resolve the delays that are causing this through reallocation of staff resource in the short term, as well as through reviewing approval processes to identify where these can be improved. Ofgem is committed to working with applicants to achieve accreditation and is helping applicants to provide consistent and complete applications. While this can take some time, so far only two applications have had to be rejected.

### Why is this measure needed?

8. We do not believe that rapid cost reductions are likely in renewable heat technologies in the way that has been seen with solar PV technologies. There are also significantly more barriers to the deployment of renewable heat. Clearly, if application rates continue to be low relative to the budget then the stand-by mechanism would not be needed and suspension would not occur.

9. However, there is a high degree of uncertainty about how the market will respond to the RHI and it is right to be cautious and be prepared for unexpected changes in application rates.

# Proposals and Responses

### What we proposed

10. The stand-by mechanism would suspend the scheme to new applications for the financial year if estimated expenditure shows that the scheme is likely to go beyond its available budget. Accredited/registered installations would not be affected and owners would continue to receive their RHI tariff. If suspension occurs, the scheme would reopen to new applications in the following financial year.

11. Applications submitted to Ofgem prior to a suspension would be processed as usual, but those submitted during the suspension would not be accepted. Registrations by biomethane producers and applications for additional capacity would be treated in the same way.

12. The exception for processing applications during the notice period is where, to prevent last minute speculative applications for installations that are incomplete, applications must 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 planned heat are complete.

13. Those with preliminary accreditation – which is available for medium and large biomass, energy from waste installations, biogas and deep geothermal – would not generally be able to apply for full accreditation during a suspension. The exception would be where the preliminary accreditation application was made before the stand-by mechanism legislation is in force, since we do not propose to change the terms of existing preliminary accreditations.

14. As part of our consultation on the longer-term approach to budget management we intend to set out in more detail over the summer what would happen to the tariffs in the following year if suspension were triggered.

15. Progress towards the RHI budget and trigger for suspension will be closely monitored by DECC, using Ofgem data on existing accreditations and applications to the RHI, and updated weekly online.

## What we asked

16. We recognise that a notice period would bring benefits to those who are in the final stages of preparing their RHI application. But it is important to avoid announcing a suspension so far in advance that it drives an increase in applications or encourages people to put in applications that are not in reality ready to go.

17. There is a trade off between the amount of notice of a suspension that can be given and the level of forecast expenditure at which the suspension is triggered; with a longer notice period there is less certainty about the volume of installations that will come forward during that period. The consultation therefore asked whether it would be preferable to have no notice, one week's notice or one month's notice and why.

18. The options identified were:

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

## What respondents said

19. Many of the respondents were supportive of interim cost control measures while also confirming the view that renewable heat is unlikely to experience the same kind of surges as solar PV. Others questioned the need for cost control, given that applications to the RHI are currently low, and suggested that under-spend was a greater risk.

20. There were 53 responses to the consultation. In response to the question asked in the consultation, 30% of respondents (16) preferred a one month notice period, compared to 19% of respondents (10) who preferred a one week notice period and 3% (3) preferring no notice. Some respondents argued for a longer period than offered in the consultation (as long as three or six months) to allow time to complete a project within the notice period. Not all respondents answered the question.

21. Respondents in favour of one month's suspension preferred this option to allow time for installations to be completed. Installers noted that very few installations will have a lead time of less than one month. Those in favour of a one week notice period said that this would allow applicants to complete applications. They also commented that this notice period would reduce the number of speculative applications that could be made following the announcement of a suspension.

22. Both those who preferred one month and those who preferred one week asked for clear information that was transparent, up-to-date and easily accessible, so that industry would be able to predict a likely suspension and act accordingly. Some respondents stated they would support any notice period, as long as there was transparency, with progress towards the trigger being published on a weekly basis. One respondent also asked for further information about the level of investment being made in RHI technologies.

23. A key concern raised in many responses was that scheme suspension could lead to a stop-start market and have a negative impact on market confidence. Other respondents expressed the concern that the introduction of the interim cost control policy itself and the possibility of suspension would have a similarly negative effect on market confidence. Some stakeholders took the consultation to mean that the RHI would be cancelled or tariffs decreased for existing installations despite the current low deployment rates.

24. Respondents asked for assurance that once longer-term cost control measures come into force the power to suspend the scheme will end. The proposed interim cost control measure should, therefore, be time-limited and revoked once longer-term cost control measures have been developed and implemented. Many respondents were keen to see a long-term cost control measure introduced as soon as possible to provide vision and clarity and retain industry confidence in the scheme. They expressed support for a more sophisticated longer-term cost control mechanism, including predictable tariff degression.

25. To mitigate the potentially negative impact of any suspension on market confidence, some respondents suggested we should allow installation owners who had preliminary accreditation to apply for full accreditation during the suspension period. This would provide certainty for larger projects. Other suggestions included reopening

at the old tariff rate for installations put in during the suspension or providing certainty about the rates that will be in place upon reopening.

26. Many respondents suggested that a reserve system or extension to preliminary accreditation should be considered to provide certainty for investors and support growth in an environment of cost control. At present, preliminary accreditation is only available to certain technologies, and stakeholders pointed out that other technologies such as ground source heat pumps could also benefit.

27. Many of the responses referred to recent changes to Feed-in Tariffs (FITs), suggesting that amendments to FITs have eroded investor confidence in DECC's commitment to renewables and suggesting that RHI cost control would make this worse. Others, particularly those writing on behalf of renewable energy manufacturers and installers, suggested that cost control was unnecessary as, unlike solar PV, there would not be the same level of rapid growth of renewable heat. One respondent suggested removing the inflation-linked increases for RHI tariffs for new applications, in order to avoid closing the scheme.

## Government consideration

28. Government remains fully committed to renewable heat. However, we must ensure that the RHI remains fiscally sustainable in the long term. Whilst current application levels to the RHI are low relative to the available budget, there is a high degree of uncertainty about how the market will respond over time. The impact of an overspend would be significant, so it is better to plan measured and transparent actions, rather than carrying out an emergency review if budgets are breached.

29. Therefore, having considered the consultation responses alongside the impacts of overspend, we intend to take forward the interim cost control proposal that we consulted on, which will simply suspend the RHI scheme to new applicants until the next financial year if evidence shows that the budget could be breached.

## The budget

30. Since the consultation we have reviewed the RHI budget and possible scenarios which would lead to the 2012/13 budget being spent. Our analysis shows that if we spend all of the available £108m budget this year then the legacy cost would be likely to exhaust all of the available budget of £251m for 2013/14 and leave no funds available for new installations. This is the case because, unless they are accredited on 1 April in any year, installations will tend to receive higher annual payments in the second financial year of them receiving the RHI. The later in the financial year they are accredited, the higher the ratio between their legacy payments next year and the total they will receive this year. This is illustrated by the fact that we expect to have spent £3m on RHI installations in 2011/12 but estimate that expenditure on those installations will be £16m in 2012/13.

31. To spend £108m on the RHI this year, weekly application rates would need to increase from their current levels by around 1500% by the end of this year. If new RHI installations were unable to be supported at all in 2013/14, we believe that the

impact on the supply chains that would have been created by that growth would be significantly worse than the impact of a temporary suspension in 2012/13 followed by the scheme re-opening in April 2013. Job losses could be expected and businesses may cease to be viable. Those making long-term investment decisions in renewable heat technology could face significant losses.

32. Therefore, to ensure sustainable growth and the ability to stay within budgets over time, we have concluded that the RHI budget limit will need to be reduced to £70m this year. This limit allows for a high rate of growth, as it would require weekly application rates to increase to around 500% of current rates by the end of this year. The £70m budget is not expected to be reached unless the current rate of applications of roughly 10MW per week (of which only around 5MW per week are projects completed since the RHI opened) were to rise steadily to 50MW per week by the end of the year.

33. The £70m budget also ensures that the funding available for next year would support the supply chain that would have developed, though we expect that some degression would be necessary. This does not affect budgets for the remainder of the spending review period to 2014/15. Those budgets are still at a level which allows for a sufficient amount of renewable heat to be on track to meet the heat proportion of our 2020 renewables target. Given current levels of applications to the RHI, we still consider a suspension unlikely under a budget of £70m.

34. We recognise that this may come as a disappointment to market participants. However, allowing expenditure higher than £70m this year would simply delay the scheme suspension and then prolong it once it did begin. The potential for boom and bust would be greater under such an approach.

## The trigger and notice period

35. The stand-by mechanism for budget management would suspend the scheme at 97% of the annual budget, with one week's notice. Therefore, if our forecast shows that we expect to spend £67.9m in 2012/13, we would give notice of suspension and the scheme would be suspended one week later. Given the uncertain levels of deployment in the market, we are concerned that one month's notice at 80% increases the risk of both premature or unnecessary suspension and overspend because of the uncertainty of what would happen during the month of notice. Having a higher trigger with a shorter notice period reduces that risk and is more appropriate when considered alongside a budget of £70m. At a forecast spend of 97% of budget, we would be much more sure that a suspension was going to be necessary.

36. We will provide weekly updates on the DECC website of the forecast 2012/13 RHI expenditure. In addition, to respond to stakeholder concerns about wanting greater advance notice than one week, we propose to provide informal notice in advance of the formal notice of scheme closure. We would do this one month before we estimated that the scheme would need to close via the DECC website. This would be indicative notice only, and the set trigger and formal notice period would then be applied as described in paragraph 35 above.

37. While the majority of respondents were supportive of a notice period of one month or less, we appreciate that some stakeholders felt a longer notice period was needed. Given that this is a new market and there is little existing market data on which to base forecasts, it is difficult to anticipate how many installations are in the pipeline. If we provided a longer notice period we would need to set an even more conservative trigger level, increasing the likelihood of suspension

## Suspension

38. The stand-by mechanism will not affect installations which have been accredited or registered at the time when notice of suspension is given. Their eligibility and tariff rate will remain as before.

39. Applications received prior to the notice period will be processed as before, subject to the eligibility criteria and application requirements.

40. For applications received during the suspension notice period, the installation will only be accredited if it has been commissioned and if the accreditation date will be prior to the start of the suspension period.

41. Applications received during the period of suspension will not be processed. All of the above applies to applications for additional capacity as well as for new installations. Applicants will need to re-apply when the scheme re-opens at the beginning of 2013/14.

42. The stand-by mechanism will not be retrospective, therefore installation owners who successfully applied for preliminary accreditation prior to the regulations coming into force will be able to apply for full accreditation during the suspension period. Owners who applied for preliminary accreditation after the regulations come into force will not be able to apply for full accreditation during the suspension; they will need to re-apply once the scheme opens again in April 2013/14.

43. New applications for preliminary accreditation made during a suspension will only be considered once the scheme re-opens.

44. We understand stakeholder requests for greater certainty around the scheme, in particular their suggestion to extend preliminary accreditation. We are considering this within our work to develop a package of longer-term measures for budget management, on which we intend to consult in the Summer. This will allow us time to undertake the policy development needed to make the accreditation process more robust. If preliminary accreditation was extended as it currently stands we believe this leaves open the possibility of a large increase in speculative applications, which would increase the chance of hitting the trigger for suspension of the scheme early, or even needlessly.

## Forecasting

45. An important consideration for us is that our intended actions are transparent and many responses to the consultation asked for data and spending estimates to be available. Therefore, we intend to provide clear and transparent information on progress towards the suspension trigger. This will be published weekly on DECC's website and will enable potential applicants to track progress towards possible implementation of the stand-by measure and plan their installations accordingly. These will formally begin from the date that the amending regulations come into force and we intend to start providing forecasts shortly on the DECC website.

46. A detailed forecasting methodology will be published alongside these forecasts and legally binding requirements for the way that the forecasting will be done are included in the regulations. Forecasts will be based upon applications received, with information from deployment used wherever possible, including using metering data to estimate the amount of heat used by installations coming online.

47. Because our forecasting will be based on application and accreditation data, the higher the quality of the data the better the forecasting methodology will be. Poor data quality is likely to result in a more conservative approach to forecasting which could result in premature suspension of the scheme. We would encourage RHI applicants and participants to take care to disclose accurate, high quality data in order to improve the forecasting for the stand-by mechanism but also to ensure that the longer-term approach to cost control is well designed. High quality data provision as part of the application process will also speed up the accreditation process.

## Biomethane

48. While planning our forecasting approach we identified that we do not have a reliable start date for information about the registrations of biomethane installations received to date. Because the planning process for biomethane is very long and there are no timing restrictions for biomethane registrations, it is currently possible to register a long time before biomethane injection is planned to begin. This means that it is difficult to obtain an accurate picture of when registered biomethane installations will begin to inject into the gas grid, based on the application data. If we are unable to adequately take account of this, we risk either overestimating the cost to the RHI and triggering a suspension unnecessarily, or underestimating the cost and increasing the chance of budget overspend.

49. To ensure that we can forecast the annual payments for biomethane accurately, we will require biomethane producers to have begun injecting into the grid before they are able to register for the RHI. This does not affect biomethane producers already registered. Furthermore, as part of the planned July consultation, alongside the longer-term proposals for budget management, we plan to consider in more detail how the process for biomethane applications can be made more consistent with that of other RHI technologies.

## Timing of this measure

1. In the responses to the consultation, stakeholders asked that interim cost control should be time-limited and revoked once longer-term measures were in place. Therefore, we propose bringing forward legislation which covers only the 2012/13 financial year, until longer-term cost control can be implemented. If, for unforeseen reasons, longer-term cost control is not implemented by the beginning of the 2013/14 financial year we will amend the legislation to extend the stand-by mechanism for a further year.

## Next steps

2. Taking account of the responses to the consultation, regulations to deliver the stand-by mechanism for budget management are being laid before Parliament in June 2012 and alongside this document, subject to Parliamentary scrutiny, for them to come into force before Summer Recess. The regulations will be called The Renewable Heat (Amendment) Regulations 2012.

3. We will consult on a longer-term framework, which will include measures to respond to some of the concerns raised in responses to this consultation, in the Summer.

# Annex

Responses to this consultation were received from:

| | |
|---|---|
| Matthew Hindle | Anaerobic Digestion and Biogas Association |
| Chris Reynolds | Chemical Industries Association |
| Roger Salomone | EEF |
| Amisha Patel | Energy UK |
| Christian Rakos | European Pellet Council |
| Bill Wright | Electrical Contractors Association |
| Terry Seward | Heat Pump Association |
| Richard Leese | Mineral Products Association |
| Charlotte Partridge | Micropower Council |
| Andrew Burke | National Housing Forum |
| Paul Thomson | Renewable Energy Association |
| Peter Clark | Scotch Whisky Association |
| Janice Fenny | Scottish Land and Estates Limited |
| | |
| Richard Pagett | Ascertiva Group Limited |
| Julian Tranter | Abacus Wood Limited |
| Grant Feasey | AES Limited |
| Carl Thomson | Agri Energy |
| Chetan Lad | British Gas |
| Paul Sellars | BritishEco Limited |
| Vera Tens/ Hamish McLeod | BSW Timber Ltd |
| Fraser Weir | Buccleuch Energy |
| Doran B Binder | Carbonic Savings Limited |
| Ali Marsh | Centre for Green Energy |
| Emma Cook | Ecotricity |
| Diego Sanchez -Lopez | EDF Energy |
| Brian Seabourne | EON |
| Tim Pratt | Farm Energy Centre |
| Bruno Prior | Forever Fuels |
| Robert Kyriakides | Genersys Plc |
| Simon O’Neill | GT Energy |
| Bob Foley | GTC |
| David Parfitt | Henley Heating and Plumbing Ltd |
| Scott Greening | Ice Energy Heat Pumps |

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|---|---|
| Simon Lomax | Kensa Engineering |
| Sumit Joshi | Land Energy |
| Paul Weaver | Mansell Energy |
| Martin Fahey | Mitsubishi Electric |
| Steve Roberts | Myriad CEG |
| David Osman | N Power |
| Tony Penton | NUS Consulting Group |
| Helen Taylor | Perthshire Biofuels |
| Peter Hughs | Resource Finita |
| Richard Lowes | Scotia Gas Network |
| Alice Gunn | SSE |
| | |
| Stuart Turner | Lincolnshire County Council |
| Deborah Southwell | London Borough of Islington |
| Michelle Drewery | Peterborough City Council |
| Katrina Chalmers | Scottish Government |
| | |
| Amanda Williams | Bournemouth University |
| | |
| Scott Restrick | Energy Action Scotland |
| Liz Marquis | Energy Agency |
| Mike Smyth | Wey Valley Wood Fuel Energy Cooperative |
| | |
| Dr Dan Kitcher | |