DEPARTMENT OF ENERGY & CLIMATE CHANGE

The Renewable Heat Incentive stand-by mechanism for budget management

Government response to consultation on Renewable Heat Incentive interim cost control

June 2012

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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

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
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