EXPLANATORY MEMORANDUM TO

THE RENEWABLE HEAT INCENTIVE SCHEME (AMENDMENT) REGULATIONS 2013

2013 No. xxxx

1. This explanatory memorandum has been prepared by the Department of Energy and Climate Change (DECC) and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument amends the Renewable Heat Incentive Scheme Regulations 2011 (S.I. 2011/2860) ("the RHI Regulations") in order to establish a long-term financial control mechanism for the non-domestic Renewable Heat Incentive scheme ("the RHI scheme") for the remainder of this Spending Review period (i.e. until the end of March 2015). This mechanism will replace the current mechanism of financial control under the RHI Regulations. Under this new mechanism, tariffs will be reduced if the levels of renewable heat deployment exceed that needed to achieve the RHI scheme's renewables objectives.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 The Secretary of State makes this instrument in exercise of powers conferred by sections 100 and 104 of the Energy Act 2008 ("the Act").

4.2 The RHI Regulations established the RHI scheme to facilitate and encourage the renewable generation of heat by giving subsidy payments to eligible generators of renewable heat and producers of biomethane. Currently the RHI scheme supports the generation of renewable heat in non-domestic sectors (industrial, commercial, public sector and not-for-profit) and producers of biomethane.

4.3 The Renewable Heat Incentive (Amendment) Regulations 2012 (S.I. 2012/1999) ("the 2012 Regulations") amended the RHI Regulations to introduce a mechanism restricting access to the RHI scheme if the forecast for total expenditure in respect of the RHI scheme reached a certain point. This instrument further amends the RHI Regulations in order to substitute a new mechanism for financial control which replaces the mechanism inserted by the 2012 regulations. Further legislation will be required to make any necessary amendments to the cost control mechanism to ensure that it remains fit for purpose after the end of the Spending Review period (31st March 2015).

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain.

5.2 In accordance with section 100(7)(a) of the Act, the Secretary of State has obtained the Scottish Minister's consent to the making of the Renewable Heat Incentive Scheme (Amendment) Regulations 2013.

6. European Convention on Human Rights

6.1 Gregory Barker, Minister of State for the Department of Energy and Climate Change, has made the following statement regarding Human Rights:

In my view the provisions of the Renewable Heat Incentive Scheme (Amendment) Regulations 2013 are compatible with the Convention rights.

7. Policy background

- What is being done and why

7.1 The RHI scheme was introduced primarily to help meet the UK's target under Directive 2009/28/EC (the "Renewables Directive") that 15% of energy consumption is to come from renewable sources by 2020. The UK intends that renewable heat will contribute approximately a third of this overall energy target, and, in order to make that contribution, around 12% of our total heat demand in 2020 will come from renewables, increasing from less than 2% currently. The RHI scheme is in line with the government's longer-term energy and climate change goals (e.g. security of supply and carbon budgets).

7.2 The RHI provides a long-term tariff scheme and opened for applications on 28 November 2011. It currently supports the generation of renewable heat in non-domestic sectors (industrial, commercial, public sector and not-for-profit) and producers of biomethane.

7.3 It is important that government takes measures so that the fixed budgets which have been set for the scheme by Parliament until 2015 are not exceeded. In adopting measures to control spend government is aware that the renewables market is immature and there is a degree of uncertainty about how the market will respond over time, and its budget management controls are designed to provide transparent plans to deal with any future unexpected surges in uptake.

7.4 The 2012 Regulations introduced in July a stand-by (or interim) budget control measure for the non-domestic RHI scheme for the 2012-13 financial year. Under this mechanism access to the scheme will be restricted if estimated spend reaches £67.9 million before the 31st March 2013 - this is not expected to happen however. Government also consulted on a degression-based system to control long-term spending for the non-domestic scheme until the end of March 2015. Government announced on 27 February it will proceed with the introduction of a degression mechanism similar to that consulted on. Degression is a responsive cost-control mechanism which is capable of reducing tariffs at regular intervals to ensure that financial returns are kept at a reasonable rate and the overall scheme budget is kept under control. The principle features of the new degression mechanism are:

- Those who are already in receipt of RHI support will not be affected by any reduction to the tariff levels taking place as a result of degression. Applicants to the RHI scheme will receive existing (i.e. non-degressed) tariffs if the date of accreditation for their installation or date of registration for a biomethane producer is before any new tariffs come into effect.
- A total trigger (set out in £) will exist for the non-domestic RHI scheme to ensure that overall spending levels are protected. This trigger has been set based on the combined estimated deployment of all of the technologies supported by the non-domestic RHI scheme and the estimated cost of meeting the government's 2020 renewables target as set by the Renewables Directive, as at the time that the RHI scheme was launched. The total trigger has been split into quarterly amounts as shown in Schedule 4 of these regulations.
- To prevent one technology from dominating the RHI market, individual technology tariff triggers are also set out for each available tariff in pounds spent. These have also been split into quarterly amounts as shown in Schedule 5 of these regulations.
- Individual technology tariff triggers are either scaled to 150% of their expected levels of deployment, or set at a value which is equal to 5% of the total trigger value, whichever is greater. By scaling to 150% government's intention is to build greater flexibility into the system, and this approach recognises that what happens in practice may differ from projections. Tariff triggers have been set at 5% for those technologies where we are estimating very low levels of deployment, to prevent degression of those tariffs occurring as soon as there is any deployment.
- To avoid over-reduction of tariffs which may undermine the renewable heat market, reductions will be made to individual tariffs at a rate of 5% initially if the individual tariff triggers are hit, with rules to increase subsequent reductions up to 10% or 20% if needed i.e. where degression is not bringing deployment levels back into line with estimates. If the total trigger is also hit, this will result in an additional 5% reduction to that already occurring as a result of individual technologies either exceeding their estimated deployment levels, or hitting their triggers.
- The system includes a rule which means that degression will not be activated - and tariffs will not be reduced - if total expenditure at any quarter is estimated to be lower than 50% of what we expected it to be at that point in time. In this way government intends to avoid reducing tariff levels if only a few technologies are performing well and contributing towards heat targets.

- The Secretary of State will be required to conduct quarterly assessments of whether the triggers have been hit. A one month notice period will apply before reduced tariffs take effect, and monthly updates will be published showing progress towards triggers so that stakeholders can evaluate the risk of any reduction occurring.
- It is the intention that the mechanism set out above will eventually be extended to any additional non-domestic technologies brought into the scheme at a later date.

7.5 The RHI Regulations established the RHI scheme to facilitate and encourage the renewable generation of heat by giving subsidy payments to eligible generators of renewable heat and producers of biomethane. The RHI Regulations provide for the scheme to be administered by the Gas and Electricity Markets Authority: in practice most functions are carried out by its executive arm, the Office of the Gas and Electricity Markets ("Ofgem").

7.6 The new degression mechanism will also apply to applications to add additional plant to an existing accredited RHI installation. The new plant will receive the prevailing tariff at the time it is accredited; which may mean that the existing installation and the additional plant will be eligible for different tariffs. In order to enable this Ofgem will no longer be required to treat additional plant added within 12 months of the existing installation being commissioned as if it was part of the existing installation. As a result, all new plant must be separately accredited by Ofgem. This change does not affect plant added within 12 months to an existing installation which was accredited before this instrument comes into force.

8. Consultation outcome

8.1 The consultation 'Providing certainty, improving performance' was open for 8 weeks from 20 July – 14 September 2012, which was within the recommended timeframes set out by Government in its document on consultation principles, which is available on the Gov.uk website. The document was supplemented by external events hosted between DECC and stakeholders which helped inform the final policy. The consultation set out proposals for a longer-term framework for budget management and also included proposals aimed at simplifying and improving the RHI scheme in particular with respect to biomass sustainability and air quality control, and on changes to metering requirements.

8.2 The consultation was published on the former DECC website alongside impact assessments to explain the economic rationale for the proposals. The consultation received 100 formal responses. Responses were supportive of the policy proposals for the degression-based system of financial control. Respondents raised important points which have influenced the final framework of the scheme. Government announced on 27 February that it will proceed with the introduction of a degression mechanism for the non-domestic RHI scheme.

8.3 On the financial control proposals consulted on:

- There was majority support for the degression proposals with 51 out of 66 respondents agreeing that it was the most appropriate approach to controlling the budget for the non-domestic scheme.
- 41 out of 66 respondents agreed with the proposal to implement quarterly reviews of deployment, with a one month notice period applying before any tariff reduction took effect.
- 32 out of 59 respondents were in favour of the proposal to apply more generous trigger points for more cost-effective technologies (i.e. those which generate more heat per pound spent); whilst 24 respondents either did not support the proposals at all or only supported an aspect of them.
- 33 out of 53 respondents supported the proposal to express any triggers in fiscal terms (i.e. in £ spent). 10 respondents preferred that these should be expressed in units of installed capacity; whilst 8 stated that they should be expressed in both units of measurement.

8.4 Further details on the above responses are contained in the government response to the July consultation, available on the Gov.uk website.

8.5 In addition to the proposals consulted on, respondents said that the scheme should not penalise technologies which deploy well by reducing their tariffs when overall deployment is low. Government has recognised this concern and announced that it will not reduce tariffs (i.e. degression will not be activated) when overall expenditure is less than half of what is expected.

9. Guidance

9.1 Ofgem will provide further guidance for potential participants in the RHI scheme in a variety of formats and place this on their website - www.ofgem.gov.uk.

10. Impact

10.1 The RHI is a voluntary subsidy scheme. The impact on industrial, commercial, public sector and not-for-profit organisations is only applicable if they are owners of eligible renewable heat installations and choose to apply for the RHI. The degression mechanism should provide greater certainty for applicants about what government will do if demand for the scheme rises unexpectedly, such that the overall budget is threatened. In these circumstances, government will gradually reduce the tariffs which are payable to new applicants for support (as prescribed by these regulations). This approach ensures that the scheme continues to deliver value for money, but avoids the need to suspend the scheme. Government has confirmed that there will not be retrospective action, and that there be a notice period before any tariff reductions take effect, which will reassure installers.

10.2 The degression mechanism is considered to be of minimal burden to Ofgem, as providing the deployment information used to forecast expenditure should be relatively routine. Ofgem will need to carry out some additional accreditation checks as a result of the changes being made which affect plant added to an existing accredited RHI installation, although the numbers are expected to be very low.

10.3 An impact assessment is attached to this memorandum and will be published alongside the Explanatory Memorandum on the Gov.uk website.

11. Regulating small business

11.1 The legislation applies to small business who operate in the renewable heat market or use renewable heat, however it does not add regulatory burden to their operations.

12. Monitoring & review

12.1 This instrument will be successful if the RHI scheme remains financially sustainable for the remainder of the current Spending Review and annual budgets are not exceeded, and if the renewable heat supply chain continues to be supported. DECC will conduct periodic reviews of the scheme in 2014 and 2017 and make further amendments to the RHI Regulations 2011 thereafter if necessary. Reviews will involve a broader examination of the design and impact of the scheme overall.

13. Contact

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