

## **UKBCSE Response to “Renewable Heat Incentive: Consultation on the proposed RHI financial support scheme”**

### **Introduction**

The UK Business Council for Sustainable Energy (UKBCSE) brings together the major players<sup>1</sup> in the energy sector to secure an effective and rapid transition to a low carbon economy that tackles the challenge of climate change and maintains the UK’s security of supply.

The heat sector has for too long been a neglected area of policy, yet action in this area is vital if the UK is to meet its legally binding carbon reduction targets. The scale of the challenge is huge. The Council therefore welcomes these initial steps by the Government to address this. The Renewable Heat Incentive (RHI) should be the first in a related series of policy actions towards an effective strategy for the heat sector and this submission sets out a number of areas which need to be addressed in order for the Renewable Heating Incentive scheme to be successful. The Council plans to review the wider action that is needed in the heating sector in due course.

The Renewable Heating Incentive (RHI) needs to be sufficiently attractive, and stable, to:

- stimulate consumer interest;
- support the delivery of a range of financing mechanisms; and
- create the confidence needed to promote investment in manufacturing, supply chain development, and the training of significant numbers of qualified installers; and
- become the first stage of the wider development of the heat market.

It will also need to be compatible with, and complement, the wide range of other initiatives including those aimed at tackling climate change as well as those addressing fuel poverty. It is therefore essential that the RHI design is ambitious and cost effective, but without undue costs to consumers.

The Council and its members are committed to working with Government to ensure that the design and implementation of the RHI is able to meet these challenges and provide real benefits to consumers.

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<sup>1</sup> Members of the Council include Centrica, EDF Energy, E.ON UK, National Grid, RWE npower, Scottish and Southern Energy and Scottish Power.

## **Key Recommendations**

The Council welcomes this opportunity to comment on the specific issue of the RHI design at this early stage of the development of this work.

We have summarised our key recommendations below.

### **A strategic approach**

A key objective for the design of the RHI is to ensure that it creates an incentive to install the optimum renewable heat technology to meet a particular heat application, rather than merely the system (or systems) that deliver the best return. This requires a consistency of approach towards the development of tariffs for different technologies within the RHI as well as consistency between the RHI and other schemes.

Companies have raised particular concerns that, whilst there maybe strategic advantages to injecting biogas into the gas grid, the current proposals make it more attractive to generate electricity under the RO/FiTs incentives. If there are clear and agreed benefits to the use of particular fuels in particular ways the RHI should support their delivery.

### **Supportive framework**

An effective framework of measures is needed to support market development, promote uptake, and boost job creation within the sustainable heating sector, which could then lower overall costs. The key elements of such a framework are summarised below;

- an electricity infrastructure development regime capable of adapting to, and supporting, changing patterns of electricity demand to support renewable heat deployment (including network development to support high concentrations of heat pumps, and connection costs if upgraded electricity connection is required) that does not create additional cost barriers to the deployment of renewable heat;
- a market environment that supports the development of an effective supply chain;
- a planning regime that supports the increasing use of renewable heat including a supportive “Permitted Development” regime;
- a clear, coherent, Government led communications strategy that provides potential heat generators with access to impartial information and advice and that increases the profile of renewable heat at senior levels in companies and other organisations should be in place before the RHI goes live. Companies would welcome the opportunity to work with the Government to develop and support this; and

- a supportive fiscal regime that addresses fiscal barriers to the deployment of renewable heat.

### **Cost recovery**

The Council considers that the principles that must underpin the design and development of the funding mechanism (whether interim or enduring) include:

- equitable distribution of costs such that no fuel type, or sector, faces a disproportionate share of the cost;
- sufficient lead time between confirmation of the proposed mechanism and implementation to ensure costs can be shared in the intended way; and
- any interim solution should be simple and low cost to implement and be capable of evolving into the enduring arrangement without incurring significant excess costs.

The Council welcomes the commitment to implementing the RHI in April 2011 and the commitment that work to assess options for funding the RHI scheme will not affect Government's current intention to launch the scheme in April 2011.

Recognising the difficulties associated with designing an appropriate cost recovery mechanism in time for the schemes proposed launch date the companies support the development of a short-term simplified arrangement for 1 April 2011 allowing time for a robust long-term mechanism to be put in place thereafter.

The Council is keen to work with Government and its officials to develop and assess funding options for both the interim and enduring arrangements. A clear process and timetable for moving from the interim to the enduring arrangement is also needed. It is particularly important to ensure that there is early transparency on cost recovery so that companies are able to reflect costs equitably across all customers.

## **Learning from the implementation of the FiT**

Companies' experience of the development and implementation of the FiTs has highlighted the need for a clear timetable for key milestones and a commitment to keeping to this timetable. This is particularly crucial for the secondary legislation that will set out the scheme details. This needs to be completed well in advance of 'go-live' so that companies that wish to participate in the roll out of the scheme to potential heat generators and, crucially, the scheme administrator/payment body can develop robust, cost effective and appropriate arrangements.

## **The payment body and role of Ofgem**

The Council considers it essential that:

- there is robust, customer orientated, payment process that is operated and managed by a body (or bodies) familiar with the design operation and management of large and potentially complex billing systems, provision of high quality customer care, and which can be made subject to the same standards as other parts of the energy sector; and
- clear separation of Ofgem's roles as regulator, scheme administrator, and payment body.

Companies therefore welcome Ofgem's intention to investigate the potential benefits of tendering for an appropriately experienced organisation (or organisations) to design, build and operate the payment system. Companies are also keen to ensure that Ofgem is properly resourced to perform its roles in the RHI.

Early decisions need to be made on the key elements of the design to allow sufficient time to develop a cost effective solution for 1 April 2011. Even an interim solution will need a lead time of many months between specification of the final requirements and go live.

## **Assignment within the scheme**

To support the evolution of a wide range of financing options, it is essential that the owner of a qualifying installation is able to assign payments direct to a third party for a specified time period. Assignment is needed to develop the full range of finance models and ensure full access to the scheme for all sectors including those on low incomes, or poor credit records. However, as with the FiT, it will be essential to ensure that such arrangements are robust and limit the opportunities for fraud.

The Council notes, and welcomes, the Government's intention to consult later in the year on how to ensure that those on low incomes, can access the RHI.

## Heat networks

The Council supports the promotion and use of district heating networks as they can:

- create opportunities for the wider use of heat derived from a variety of renewable and other sources;
- provide a more cost effective solution to delivering heat to a multiplicity of homes and other buildings rather than the separate provision of a large number of individual installations;
- deliver heat to homes and other buildings where it may not be possible to install renewable heating systems in individual properties; and
- offer long term solutions to the challenge of hard to heat properties, whilst lifting vulnerable consumers out of fuel poverty.

A key challenge is the funding of this infrastructure, which, like other network based activity, typically needs long term capital provision that recognises the initial upfront costs involved.

Historically network providers have raised finance for any network from the capital markets (both public and private) and amortised the cost over a long period via the network charges that are part of the gas, electricity, telecoms, and rail or water providers' customer charges. The difference with heat is that other than local authorities (or the specialist heat providing energy services companies that exist in some parts of the UK) there is no national or regional provider of heating networks across which such charges can be accommodated. This means that consumers connected to heating networks often need to bear the full cost of providing and maintain the network.

To overcome this challenge there are a variety of ways forward the Government could consider;

- *Smart regulation*; by extending the infrastructure incentives for existing network providers, be they water, electricity or gas, to give them the opportunity to invest in heating networks as part of a companies Regulated Asset Base (RAB);
- *Smart procurement*; encouraging local authorities and the Government Estate to offer appropriate heat contracts designed to stimulate new investment heating networks – as already done by more progressive Councils;
- *Smart, green, investment*; the planned Green Investment Bank , allied with Green Bonds, could play a critical role in supporting new heating networks.

In addition there is also scope for local authorities to use their normal borrowing powers to raise capital for measures such as district heating, although this would need Treasury approval and should be judged along side the other capital needs of local authorities.

The consultation document raises the prospect of a “network uplift”. Companies do have concerns about the practical and potential cost implications of including such an approach within the RHI, particularly when a range of other options are available which many be more equitable across all classes of consumer. Further consideration is needed on whether the RHI is the right mechanism to fund the cost of heat networks and, indeed, how practical it would be to do so.

### **Delivery of energy efficiency**

It is widely acknowledged that energy efficiency plays a key role in terms of carbon abatement and reducing consumer bills.

We have welcomed the Government’s focus on energy efficiency through existing initiatives such as the Carbon Emission Reduction Target (CERT) and Community Energy Saving Programme (CESP), Pay-As-You-Save (PAYS) as well as proposals for post-2012 delivery under the HEM.

The RHI needs to reinforce the drive for energy efficiency and hence be fully compatible with these existing schemes with consumers actively encouraged to undertake practical energy efficiency measures and as the first step toward improving the energy performance of their properties.

We therefore welcome the proposal to encourage energy efficiency through the tariff structure.

However it is important to ensure that the proposed approach takes proper account of the practical and cost issues raised by particular measures, for instance, solid wall insulation and the package of measure that may be needed to address ‘hard to heat’ properties by taking these characteristics into account when determining the deemed heat load. This assessment must assume that only cost effective, and practicable, measures have been implemented. Indeed in significant cases it would be more effective both in carbon and cost terms to set aside, for instance, solid wall insulation, in favour of decarbonising a community’s energy needs through a combination of lower carbon energy supplies.

Companies have particular concerns about the prospect of ‘heat dumping’ in larger scale installations, where the circumstances are such it is appropriate to meter the heat, but the potential for the tariff rate to exceed the cost of fuel needed to produce the heat, means that there is a risk of creating an incentive to produce heat even when it cannot be used effectively.

Ideally this would be addressed by the scheme becoming a ‘good quality’ CHP scheme when there is then an economic incentive to avoid heat dumping.

In the absence of CHP, companies suggest a two part approach to dealing with the potential heat dumping:

- An absolute prohibition on heat dumping within the RHI regulations, with the scheme administrator having comprehensive rights of auditing and the power to exclude any heat producer from the RHI if they breach the prohibition; and

- Supplementing this by an extension of the arrangements proposed for the proposed tariff for medium biomass whereby the full tariff rate is paid for each kWh of metered heat up to a capped kWh limit (set to reflect a reasonable expectation of heat production) and metered heat above this kWh cap is paid at a lower rate.

This second stage may not be needed if the incentive to over-produce and dump heat is small or if the auditing provisions and expulsion regime is sufficiently robust.

### **Cost to Consumers**

The Council supports the proposal to implement an RHI by 1 April 2011 but recognises that this will come at considerable cost.

Companies consider that it is important that Government ensures that those who are paying for the scheme should understand what these costs are.

It must be recognised that an increasing burden is being placed on consumers of gas and electricity, across all sectors, through government choosing to apply costs of multiple environmental and social initiatives to them, and that this is not the most equitable approach to funding schemes such as the RHI.

### **Conclusion**

The Council looks forward to continued engagement with Government and other stakeholders on the progressive decarbonisation of heat in the UK.