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Dear James

Thank you for your letter of 9 March, setting out views on the Budget package on the Renewable Transport Fuels Obligation (RTFO). Your views and those of other stakeholders, both through written material submitted and through the various meetings and other processes in the run up to Budget, have been invaluable in helping Ministers reach firm views on the announcements made at Budget.

I thought it would be useful if I recapped on the Budget announcements, set out the Government rationale behind these decisions and also touched on next steps over the coming months.

Budget announcements

As you will be aware, key aspects of the Budget package of announcements were:

- The 20 pence per litre (ppl) duty incentive will be extended to 2008-09
- The level of obligation will be 2.5 per cent in 2008-09 and 3.75 per cent in 2009-10, prior to reaching 5% in 2010-11
- The RTFO buy-out price – the price paid by fuel suppliers who fail to meet their obligation – for 2008-09 will be set at 15 ppl. This means the total potential combination of policy support for biofuels in 2008-09 equates to 35 ppl
- A 35 ppl combination of policy support is also guaranteed in 2009-10, but will reduce to 30 ppl in 2010-11. The government expects that the emphasis will move from the duty incentive towards the buy-out price as the principal support mechanism in future years.

In addition, the announcements made clear that the Government intends that in principle, RTFO levels beyond 2010-11 should rise beyond 5 per cent, so long as infrastructural



requirements and fuel and vehicle technical standards allow, and subject to the costs being acceptable to the consumer.

Rationale behind these decisions

As you would expect, there were a range of representations given to Government prior to Budget. In broad terms, biofuels players sought targets at the higher end of the spectrum and a higher combination of duty and buy-out price, while those parties who will be obligated under RTFO advocated targets and a buy-out price at the lower end of the spectrum. Those in the car manufacturing sector stressed the need for fuel quality standards to be maintained.

However, in reaching a view on the right approach to take, we took into account a range of factors. These included recognition of the:

- need to set ambitious targets, both to ensure a sensible path to the 5 per cent Obligation in 2010-11, and also to send the right signals to interested parties
- case for retaining the 20 ppl incentive in 2008-09 to maintain certainty and therefore encourage investment prior to RTFO commencing
- time required to build production capacity and develop the necessary infrastructure to blend and supply the fuels
- need for the cost of the mechanism to be kept within levels acceptable to the consumer and wider economy and consistent with the Feasibility Study published in November 2005
- importance of providing a kick-start to the mechanism in the crucial first two years.

I and the Chancellor took the view that the package of decisions set out in the Budget was the best means of meeting this range of objectives, while ensuring a positive set of announcements to drive RTFO forward.

Next steps over coming months

Further consultations on aspects of the design of the RTFO will be led by the Department for Transport over the next 12 months. A key milestone will be the publication of draft secondary legislation, and the Government envisages consulting on this around the end of the year.

The Low Carbon Vehicle Partnership will also continue work on the issue of carbon and sustainability assurance. This reflects the fundamental importance of ensuring biofuels are delivered in a way which maximises life-cycle carbon savings, while ensuring sustainable sourcing.

Other significant areas of work will include development of a State aids application in respect of recycling any buy-out revenues and the establishment of the Administrator for the scheme.

