Chapter 11 – The Business Case for the approval of DFP

The Business Case

11.1 On 22 March 2012 a Business Case relating to the proposal for an NI RHI scheme was forwarded from DETI to DFP for approval. The covering email[744] from DETI Finance's Accountability and Casework Branch referred to the earlier Strategic Outline Business Case that had been approved in autumn 2011 subject to a number of areas that were to be addressed. It referred the reader to where the Business Case addressed those issues; details and costs in respect of administration, the potential risk of EU infraction fines, risks involved in developing and implementing the proposal and details of how the scheme was to be managed.[745] The covering email also confirmed that the proposal had been approved by DETI Casework Committee and DETI economists.[746]

11.2 DETI was required to complete and submit a short DFP Business Case *pro forma* and to tick an option as to whether the case was "standard"; "novel"; "contentious"; or "setting a precedent".[747] Mr Hutchinson, who completed the *pro forma*; marked it as "standard". He could not recall whether or not there was a discussion with Ms McCutcheon and Ms Hepper about this but agreed it would not have been an issue that was dwelt on.[748] Mike Brennan from DFP, who in 2012 was the head of Central Expenditure Division (CED) within its Public Spending Directorate, said in his oral evidence that at the time he would have ticked the "novel" box and with the benefit of hindsight would have ticked all three "non-standard" boxes.[749]

11.3 A large volume of documentation was supplied to DFP, along with the Business Case, in excess of 700 pages, including the AECOM/Pöyry and CEPA reports, the Ofgem Feasibility Study of December 2011, the EU State Aid notification papers of December 2011 and February 2012, the draft scheme risk register and various relevant calculations. Much of the material contained in the Business Case had been put before the DETI Casework Committee. The Inquiry considers the following incomplete, incorrect or misleading aspects of the Business Case to have been of particular significance.

(i) Funding by HMT was described in paragraph 2.7 of the Business Case as incremental over the budget period 2011-15.[750] No reference was made to the fact this was AME funding, nor that it had been the subject of the suggestion of DEL penalties by HMT in April 2011, nor of the fact DETI Finance had, in May 2011, warned that although it was AME funding it should be treated like DEL. Nor was there any reference to budget controls – see in this regard the Jon Parker, Ms Clydesdale and Ms Brankin emails of April and May 2011 referred to in chapter 3.

(ii) DFP was informed, in sections 7 and 8 of the Business Case that DETI had considered a number of options, the most appropriate of which were seen as either an NI RHI

744 DFE 82632
745 DFE-82657
746 DFE-82632
747 DFE-83337 to DFE-83339
748 TRA-02173 to TRA-02174
749 TRA-01211
750 DFE-82641

scheme or a Challenge Fund.[751] The administrative costs of running a Challenge Fund were described in paragraph 8.5 as prohibitive compared to the potential costs of administering an NI RHI scheme.[752] In section 9, on the monetary costs and benefits, no information or calculation was provided with regard to the projected administration costs or to the lifetime comparative costs of both options which could have illustrated the potential for cost-effective overall savings represented by the Challenge Fund. The actual Net Present Cost (NPC) of the scheme was wrongly quoted as £242 million, which came from the CEPA final report of June 2011, rather than taking account of the addendum in February 2012, which included much higher tariffs and subsidy costs that alone had risen by £111 million since the June 2011 final report.[753]

(iii) In section 10 of the Business Case, dealing with 'Risks', the risk of 'over-subsidising' was clearly recognised but it was pointed out in section 10.4 that:

> "The tariffs have been developed by CEPA and AEA Technologies, subject to a public consultation and then subsequently reviewed by CEPA and AEA. Departmental Economists have also assessed the tariffs and assumptions behind the calculations and have deemed them appropriate."[754]

DETI Economist Mr Connolly was asked about the accuracy of the last sentence of the above quotation by Inquiry Counsel. He replied by stating that it was not an accurate characterisation of what he had done and that he had not assessed any of the technical assumptions. He agreed that it was a potentially misleading statement.[755]

(iv) No consideration appears to have been given to the protection afforded by the 'first come, first served' approach of the Challenge Fund with regard to keeping within an annual budget – once the allocation for any period was used, no further awards would be made.

(v) There appears to have been no guidance provided about whether a Challenge Fund could be introduced more or less expeditiously than the RHI scheme. No new legislation would have been needed for this since the Department could already introduce grant schemes with its existing powers, but arrangements for administration by DETI would have been needed in place of what Ofgem was going to do for the RHI scheme.

(vi) The Business Case, at paragraph 2.31 on internal page 17, again showed a tariff of 5.9p/kWh for biomass boilers between 20kW and 100kW (or the medium biomass tariff)[756] and, two pages previously on internal page 15, stated the cost of biomass to be 4.39p/kWh.[757] At page 17 the same erroneous footnote appeared once more:

> "Tiering is used to ensure the technology is not '*over-used*' just to receive an incentive. It works by dropping the paid tariff after the technology reaches its optimum use for a year; this is deemed at 1314h (15% of annual hours). After this level is reached the tier 2 tariff is paid. Tiering is not included in

751 DFE-82706
752 DFE-82706
753 DFE-82711; DFE-00581
754 DFE-82712
755 TRA-03617 to TRA-03618
756 DFE-82649
757 DFE-82647

the NI scheme because in each instance the subsidy rate is lower than the incremental fuel cost."[758]

(vii) At paragraph 7.53 the business case confirmed that: "There will be scheduled reviews in-built into the Northern Ireland RHI"[759] and, at paragraph 10.4, that it was currently proposed the first review was scheduled to start in January 2014, with any changes or revisions implemented by 1 April 2015.[760] The term "in-built" was not explained, nor does it appear that it was queried by DFP. Comparisons were drawn with the NIRO but the Inquiry notes that reviews were put on a statutory basis in the NIRO regulations, a useful precedent that does not appear to have been highlighted in the documentation or discussions surrounding the RHI Business Case.

(viii) DFP was also informed that an inter-departmental Renewable Heat Strategy Group would monitor the progress of the RHI.[761] Although this could not have been known at the time of the Business Case being submitted (and, therefore, does not represent an omission in the Business Case *per se*), it seems that the work of that group was 'paused' in 2013 because of a lack of resources and not revived thereafter.

DFP consideration of the Business Case

11.4 Based on evidence provided to the Inquiry, there was only limited scrutiny of the Business Case carried out by DFP. The main documented evidence available to the Inquiry stems from work done by Rachel McAfee, an economist within DFP's Economic Appraisal Branch, who, in the limited time available to her, appears to have considered the proposal and highlighted a number of points in her very short summary to colleagues. Two of these points – relating to the need for formal review of the scheme and for its reapproval by DFP in 2015 – were adopted as conditions in the final approval letter of 27 April 2012.[762]

11.5 None of the fundamental errors or omissions in the Business Case (as outlined above) were identified by DFP, which may reflect an inherent lack of challenge in the process, perhaps, as evidenced by Mr Stevenson, the then grade 7 DFP Supply Officer responsible for engagement with DETI, who told the Inquiry:

> "For our system to work at pace, we need to trust the information that would come to us."[763]

The DFP approval

11.6 On 27 April 2012 one of Mr Stevenson's team, Ronnie McAteer, wrote to DETI indicating that DFP were content to approve the proposal on the basis that arrangements were put in place for scheduled reviews by DETI, the first of which was noted to start in 2014, and that any decision to continue the scheme beyond 2015 would require further/separate DFP approval.[764] Despite DFP's own knowledge, which it had from at least 2011, that the NI RHI's capped funding was not standard AME, no condition was imposed requiring any mechanism of budgetary cost control.

758 DFE-82649
759 DFE-82703
760 DFE-82712
761 DFE-82658
762 DOF-03239 to DOF-03240
763 TRA-03096
764 DFE-171221 to DFE-171223

11.7 The DFP approval letter was emailed by Mr McAteer to Iain McFarlane, then head of DETI's Finance's Accountability and Casework Branch.[765] Mr Cooper, who had chaired the Casework Committee, and who at the time was 'acting up' as the grade 3 Senior Finance Director, was unsure in his evidence as to whether he saw the approval letter.[766] Mr Cooper told the Inquiry that conditions were attached to every approval but, given the resources that DETI Finance Division had, it was impossible to check that every condition had been properly managed by the divisions, who had ultimate responsibility for this.[767]

11.8 Despite DFP's clear conditions for the approval – requirement for review of the scheme and for reapproval of spend beyond March 2015 – no formal system of review was established by DETI and no formal record or minute was created to ensure continuity of knowledge of these important conditions, other than placing the DFP approval letter in TRIM. Neither of the above conditions were ultimately fulfilled on time, if at all, during the period for which the scheme was open. The Inquiry was later to hear from Mr Hughes, who took up his post in Energy Division at the end of June 2014, that according to the NICS record-keeping system at the time, the Business Case and the approval letter were not stored together.[768] This was contrary to the principles of project management and a common sense need to have a formal system to ensure continuity of knowledge.

11.9 The non-domestic scheme was not flagged in Energy Division records as requiring reapproval. Mr Mills, who became head of Energy Division in January 2014, later told the Inquiry that he forgot about the need for reapproval, something that he recalled was mentioned to him by Ms McCutcheon and Mr Hutchinson at a meeting in March 2014.[769] He also stated that it was incongruous to seek reapproval in March 2015 for a scheme that to him appeared permanent until 2020 in the implementing regulations.[770] This fallacy may well have led to the need to re-apply for DFP approval in March 2015 being overlooked. This confusion clearly shows the importance of a formal record keeping system rather than a reliance on word-of-mouth communications.

Submission to the Minister on receipt of DFP approval

11.10 The DETI Financial Procedures Manual[771] required both Casework Committee and DFP approval to be obtained before seeking ministerial approval for projects over £1 million. Section 6.5 of the manual provided as follows with regard to seeking ministerial approval after DFP approval has been obtained:

> "All projects over £1 million require Ministerial approval after DFP approval has been obtained. The Casework Committee minutes, casework papers and appraisal documents should be sent to Private Office along with the Ministerial Submission. It is the responsibility of the Operating Division to prepare the Ministerial Submission."[772]

765 DFE-171221 to DFE-171223
766 TRA-15645 to TRA-15646
767 TRA-15648
768 TRA-05846 to TRA-05847
769 TRA-07144
770 TRA-09597
771 DFE-423435 to DFE-423656
772 DFE-423488

No such submission was sent to the Minister. Consequently, the Minister did not receive the Casework Committee minutes or the Business Case, nor did she receive the DFP approval letter in order to see its conditional nature.

Findings

72. Given the novel nature of the scheme, the unpredictability and volatility of demand, the unusual form of funding and the fact that accreditation entitled applicants to 20 years of subsidy, the Inquiry finds that DETI should not have submitted the Business Case to DFP with a *pro forma* claiming it to be a "standard" business case. The Inquiry considers that one of the other available options – such as "novel", "contentious" or "setting a precedent" – would have been more appropriate and should have been chosen.

73. The Inquiry finds that, in the circumstances, the DFP officials concerned should also have recognised that the Business Case that it received from DETI was not "standard" and should have drawn that to the attention of DETI.

74. A large volume of documentation was supplied to DFP with the Business Case. This practice of providing so many lengthy documents may have been seen as a well-intentioned means of informing recipients. The Inquiry has seen that this approach to the quantity of documents did not equate to quality of information or advice, and only very few of those receiving such large packs of documents ever read even a fraction of them. Important information was obscured by the sheer volume of data, and a series of errors went unrecognised and important messages missed.

75. Insufficient challenge was applied by DFP to the information provided and even basic numerical checks were not carried out. Too much reliance was placed on assurances from DETI, which had itself not uncovered the many errors or areas of misunderstanding in the Business Case.

76. DETI did not have proper procedures in place to ensure that the DFP approval conditions were observed. DFP had no procedure in place to monitor compliance with its conditions.

77. The Inquiry finds that, in order to comply with DETI's own financial procedures, the relevant DETI Energy Division officials ought to have sent a submission to the Minister after receiving DFP approval. That submission should have included the Casework Committee minutes, the Business Case sent to DFP, and the DFP approval letter. Had that happened, the Minister would then have been apprised of the structure of the RHI scheme in much greater detail, as well as the fact that approval had been granted subject to conditions.